



Registered Investment Advisor Firm

©ISSUE XII, VOL. V -

DECEMBER - 2016

TAX-EFFICIENT DRAW DOWN

For most retirees, the tax-efficient liquidation of a retirement portfolio requires coordinating between both taxable and pre-tax (IRA and 401(k)) retirement accounts.

The classic approach is to liquidate taxable accounts first, and the pre-tax accounts last. This allows the retiree to spend down the least tax-efficient portion first – because of annual taxable interest and dividends and potential capital gains- while preserving the tax deferral and benefits of tax-deferred compounding growth as long as possible.

If the pre-tax accounts are liquidated first, it requires a lot more of the account each year because of the tax consequence of distributions as income. This is less tax-efficient than the classical approach because the IRA loses its compounding and tax deferral sooner.

Given that full distributions from the pre-tax account up front can drive the retiree into a higher tax bracket, and full Required Minimum Distributions

(RMDs) from the IRA in later years will do the same, the solution is: Take distributions from each account along the way.

Taking a blended-distribution approach helps the portfolio last significantly longer. This is driven by both the fact that most of the pre-tax accounts still enjoy tax-deferred growth and compounding and more importantly because the annual IRA distributions are modest enough to avoid hitting a higher tax bracket.

A strategy to assist the tax-efficient compounding is to do partial ROTH conversions. This allows the retiree to maintain the tax-deferred growth and also to leave a legacy (inheritance). ROTHs do not have RMDs after age 70 - 1/2 like IRAs and 401(k) s.

The combination of taking advantage of the lower tax brackets and avoiding higher tax brackets, plus the tax favored compounding in the traditional and ROTH IRA accounts ultimately means the partial ROTH conversion strategy produces greater after-tax wealth.

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Another benefit of the blended-distribution and utilizing partial ROTH conversions is reducing the impact of RMDs in the traditional account in future years. Doing partial ROTH conversions ensures the distributions occur at more favorable tax rates in the early years and can whittle down the IRA to the point that by the time RMDs kick in, the IRA has been reduced to the point that the RMDs aren't very large, allowing the retiree to remain in the lower tax brackets.

Another strategy to help take IRA distribution and lower your taxes is to take qualified charitable distributions (QCDs) from the individual retirement accounts. The law was made permanent in 2016 for those 70-1/2 and older. The retiree does not have to claim the RMD as income as long as the RMD is distributed directly to a qualified charity. The QCD may be made from any IRA or individual retirement annuity, but not from a Simplified Employee Pension (SEP) or an inherited IRA.

The fundamental goal to spend from the portfolio in a more tax-efficient manner is to find constructive ways to whittle down a pre-tax account and stop it from growing too large, either by taking distributions outright at an earlier phase, or by taking partial ROTH conversions. Of course, if too much is withdrawn or converted in the early years, retirees may drive up their tax rates now, which works against the strategy. The end goal is to find the balance between the two.

As usual, when dealing with tax issues, you should consult your tax advisor. If

you need more info on this subject, contact me at the numbers below.

FED Watch

The FED left interest rates unchanged while again saying risks to the US economy have subsided and the labor market is getting tighter, suggesting conditions are getting more favorable for an increase in rates.

Market observers give a 94% chance of a quarter point rise in the Fed Funds at the December meeting.

The next meeting is December 14th.

Davis Investment Group

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If you have questions or would like further information on this month's topics or any other financial or investment related subjects, including Social Security claiming strategies, please contact me by phone or through my email address at:

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