Asset Location & Timing to Reduce Taxes in Retirement

Read this if you want to preserve more of your nest egg & lower your tax bill.

Location, location, location ... It matters when it comes to real estate, and it also matters when it comes to the way you hold and invest your retirement savings.

You can't control what happens with the tax code, but you can control how your savings are held. As various types of investments are taxed at varying rates, some investments are better held in taxable accounts and others in tax-deferred accounts.

*Funds that trade frequently (such as bond funds and money market funds) are better off in tax-deferred accounts, as much of their yields represent taxable income.
*Traditional IRAs are tax-inefficient (relatively speaking), and by holding a traditional IRA within a tax-deferred account, you can delay paying tax on those IRA assets until you withdraw them in retirement (when you will presumably be in a lower tax bracket than you are now).
*What kinds of investments are usually better off in taxable accounts? Think index funds, growth funds, tax-managed funds and ETFs that tend to generate capital gains (growth funds especially are prone to reinvesting profits). In light of long-term capital gains rates, keeping these types of investments in taxable accounts makes sense.[1,2]

Timing isn't everything, but ... The timing of withdrawals from retirement accounts can have a major impact on your income taxes – and the longevity of your savings.

You don't want to outlive your money, and you want your income taxes to be as minimal as possible once you are retired. To that end, you want to withdraw from your retirement accounts in a tax-efficient way.

By drawing down taxable accounts first, you'll face the capital gains tax rate instead of the ordinary income tax rate. Most retirees will see long-term capital gains taxed at 15%; for others, the long-term capital gains tax rate will be 0%.3 In taking money out of the taxable accounts to start, you are not only giving yourself a *de facto* tax break but also giving the retirement funds in the tax-advantaged accounts more time to grow and compound (and even a year or two of compounding and growth can be significant if you have held a tax-advantaged account for decades). Withdrawals from tax-deferred accounts – such as traditional IRAs and 401(k)s and 403(b)s – can follow, and then lastly withdrawals from Roth accounts.[3]

Following these asset location and distribution approaches may leave you with more retirement income – in fact, Morningstar estimates that in tandem, they can boost a retiree's income by about 8%.[1]

Tax loss harvesting can also help. Selling losers during a given year (i.e., stocks or mutual funds you have held for a year or more that are worth less than what you originally paid for them) will give you capital losses. These can directly lower your taxable income. As much as $3,000 of capital losses in excess of capital gains can be deducted from taxable income, and any remaining capital losses above that can be carried forward to offset capital gains in upcoming years. Additionally, whenever you sell stocks or funds with capital gains, strive to sell shares or units having the highest basis to reduce the gain.[4]

If you receive a lump-sum payout, don't put it in the bank. If you take direct control of that money, you are triggering a taxable event and your income taxes for that year could be staggering. An alternative outcome: make a direct rollover of the lump-sum payout (qualified distribution) into a traditional IRA. That move will exclude that money from your total taxable income for the year, and put you in position to take taxable annual Required Minimum Distributions (RMD), with the taxable RMDs being smaller than the taxable lump sum. (Alternately, you could directly roll the lump sum payout into a Roth IRA, which would leave you paying taxes on the conversion but set you up for tax-free withdrawals in retirement if Roth IRA rules and regulations have been followed).[5,6]

Incidentally, it is often more advantageous to take an in-kind distribution of company stock rather than rolling shares over to an IRA. The question is whether you want to pay ordinary income tax or capital gains tax. If a lump-sum distribution is taken off the shares, the investor pays income tax on the original cost basis of the stock. If the distribution is in-kind (i.e., the payout is in securities, not cash), the net unrealized appreciation (NUA) remains tax-deferred until the securities are sold. At their sale, the NUA is taxed as a long-term capital gain.[5]

Lastly, consider living in a state where taxes bite a little less. Not everyone can afford to move, but in the long run, living in Florida, Nevada, Washington, Texas or other states that are relatively tax-friendly for retirees can help. Even moving to another town within your current state might result in some tax savings.[6,7]

William Otto
Beacon Hill Financial
409 North Broadway Lebanon, OH, 45036
866-289-0759   513-235-6600
billotto@beaconhill-financial.com

This material was prepared by MarketingLibrary.Net Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. This information has been derived from sources believed to be accurate. Please note - investing involves risk, and past performance is

no guarantee of future results. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is neither a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such. All indices are unmanaged and are not illustrative of any particular investment.

Citations.

1 - money.cnn.com/2013/02/11/pf/expert/retirement-tax-plans.moneymag/ [2/11/13]
2 - biz.yahoo.com/edu/mf/vra.html [2/13/14]
3 - tinyurl.com/l6lkrfu [2/12/14]
4 - bankrate.com/finance/money-guides/capital-losses-can-help-cut-your-tax-bill-1.aspx [9/19/13]
5 - raymondjames.com/making_right_distribution.htm [2/13/14]
6 - wife.org/minimizing-tax-burden-in-retirement.htm [2/13/14]
7 - money.msn.com/tax-planning/retired-how-to-cut-your-taxes-mark-koba [2/6/12]