

# Retirement Asset Planning

Mark L Prendergast MS CPA CFP® CDFA®

Aidan J Green, Financial Planning Resident

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# Types of Retirement Accounts



- Defined Benefits Plan
- 401(k) plans
- 403(b) Plans
- 457 Plans
- **Individual Retirement Accounts (IRAs)**

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# “Qualified” Accounts- Encourage Savings

- **IRA-** a deduction (except for ROTHs)
- **401(k) plans, 403(b) Plans, 457 Plans-** exclusion from income
  - Reduces your W-2 taxable income.
- **Saving Taxes Encourages Savings For Retirement**
  - Reduce future dependence on government/ Social Security Income.

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# Qualified Plans (contrast to IRAs)

## Sponsored by Company, Government, or Nonprofit

- Defined benefit plans (e.g., Boeing retiree receiving monthly pension).  
No planning once distributions start.
- 401(k) plans. Employee contributes and makes investment decisions and bears investment risk. Employer may contribute/ match employee contributions.
- 403(b)- for nonprofits and education
- 457 plans- governmental plans (fire, police, municipals)

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# 401(k), 403(b), 457 Plans

## Employer Plans

- **401(k)**- “normal” employer plans
  - Employee contributions up to \$23,000/ \$30,500
  - Employer matches are common
- **403(b)**- educational and nonprofit organizations
- **457**- government plans (city, county, state)
- **Thrifty Savings Plan (TSP)**- federal employees, including military

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# Traditional IRAs vs Roth IRAs

## Traditional IRA

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- ✓ Deduct upon contribution
- ✓ Growth is tax-deferred
- ✓ Taxable as “ordinary income” when withdrawing
- ✓ Non-Deductible contributions- Usually a bad idea

## Roth IRA

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- ✓ No deduction when contribute
- ✓ Tax free growth
- ✓ Tax free withdrawals

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## IRA Contribution Limits

- **\$7,000 for under 50 years old**
- **\$8,000 for 50 years or older**
- **Must have earned income (W-2 or self-employed)**
- **Earnings limits – No IRA deduction allowed if high earner**
- **Roth Contributions – Not allowed if MAGI > \$161k single; \$240k married file joint**

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## Use a Traditional or a Roth?

- **Knowing your tax bracket (example: 37% fed + 13.3% CA)**
  - \$10,000 IRA contribution saves you 50% in taxes (rounded)
    - ✓ Saves \$5,000 in taxes
- **Predicting your future tax bracket (example: 24% fed + 9.3% CA)**
  - \$10,000 IRA withdrawal costs you 33% in taxes (rounded)
    - ✓ Costs you \$3,300 in taxes



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# IRA Distributions

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## Before age 59 ½

- ✓ Ordinary income tax
- ✓ 12.5% penalties (10% fed; 2.5% CA)
- ✓ Some exceptions to penalties

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## After age 59 ½

- ✓ Ordinary income tax
- ✓ Not required to take distributions until age 73-75

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# Required- Minimum- Distribution (RMD)

## Contract Made with IRS

- Deduct when I contribute \$\$\$
- Tax-deferred growth
- *SOMETIME*- I will pay taxes on the amount deducted and the growth

**Once achieved a certain age, distributions required to be taken, based on:**

- Your age in a particular year
- Balance of the deferred income (account balance)

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# RMD- When and How to Calculate

**Minimum that must be distributed starting at age 73 or 75**

- Born between 1951 and 1959, age 73 start date
- Born between 1960 or later, age 75 start date

## **Calculation of RMD**

- A. Balance of IRA on the prior December 31<sup>st</sup>
- B. Life expectancy for distribution year
- C. Divide:  $A/B = \text{RMD}$

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# RMD for IRAs and 401(k)'s

## More than one IRA Account (RMD age)

- Must calculate RMD for each IRA
- Total RMD can be taken from only one IRA account

## IRA and 401(k) accounts (RMD age)

- Cannot aggregate RMDs
- IRA RMDs taken from IRA(s); 401(k) RMD from each 401(k)

# QCD: Qualified Charitable Distribution



- Limit= \$105,000 per taxpayer year
- Must be 70 ½ or older
- Can be part of RMD, all of RMD, and can exceed RMD
- No Charitable deduction is allowed

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# QCD- Qualified Charitable Distribution

- **Direct distribution to charity**
- **Must be a qualified charity**
  - Cannot be your Donor Advised Fund
- **Excluded from income**
  - Example: \$40,000 total distributions including \$10,000 QCD
    - ✓ \$30,000 is taxable
    - ✓ Must tell tax preparer- not shown on 1099-R
  - **Benefits: Decreases AGI and good if taking Standard Deduction**

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# Roth Conversion- What is it?

Taking all or part of your Traditional IRA and transferring it to a Roth IRA

- Used to be pre-tax dollars
- Pay taxes on the amount “converted”
- Roth IRA assets will grow tax free forever
  - Are not subject to RMDs: leave and let grow
  - Future distributions are tax free
  - Heirs inherit and take distributions tax-free
    - ✓ Can wait until year 10 after your death to distribute

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# Roth Conversion- Basics

*To pay the tax, you need cash on hand*

- **Inefficient to convert (e.g., \$10,000) and take another \$3,300 from your IRA to pay the taxes.**
  - Assumes 24% Federal + 9% California
  - You are now paying taxes on \$13,300 (\$10,000+\$3,300) to convert \$10,000 in Roth.
  - Don't Do: inefficient



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# Roth Conversions for those 60+

Higher tax brackets loom in the future due to:

- **RMDs starting at ages 73-75**
- **Social Security benefits starting at age 70**
- **Heirs may be in higher tax brackets**
  - Surviving spouse has compressed tax brackets and lower standard deduction
  - Kids may be in peak earning years
- **Heirs may have to withdraw Traditional IRA faster than you**
  - Nonspouse (kids, nieces, nephews) have 10 years to distribute in full

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# Roth Conversions for those 60+

## Financial Planning Perspective

- **Left unchecked, what will RMDs look like in your 70s?**
  - Taxable Income? Highest (marginal) tax bracket?
- **Can you reduce income now (in 60s) by living off after- tax savings?**
- **Roth conversions to lift income each year to top of “tolerable” tax bracket**

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# Roth Conversions for those 60+

## Planning Example

- **Left unchecked, RMDs may be \$100,000 in your 70s?**
  - Add social security benefits and other sources of income, you will likely be in a 32% tax bracket
- **Without IRA and Social Security income, you are *currently* in a 12% bracket**
- **Make Roth conversions to lift income each year to top of 24% tax bracket**
- **Wealthy People: 100's of thousands of \$\$**
- **Regular People: \$5,000 or \$10,000 or ??? Each year.**
  - **Work it!**

# Testamentary Charitable Giving

## Giving to a charity at death?

- Give from an IRA account (or 401(k))
  - Charity pays no taxes on gift
  - Children, other heirs, pay taxes on gift
- Children, other heirs: give non-IRA dollars
  - Heirs pay no taxes on this type of inheritance
  - Some exceptions

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# Deferring Social Security Benefits

## Can start taking Benefits:

- Age 60 for surviving spouse
- Age 62 (early)
- Full retirement Age (FRA)
  - Used to be age 65
  - Age 67 for those born in 1960 or later
- Fully deferred (must start at age 70)
- Deferring increases future benefits by 8% per year

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# Deferring Social Security Benefits

## *Example:*

- Age 67 is your Full Retirement Age
- Social Security benefits= \$1,000/ month
- Defer to:
  - Age 68: \$1,080
  - Age 69: \$1,166
  - Age 70: \$1,260
- Over 25% increase, from \$1,000 to \$1,260
  - **For the rest of your life!**

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# Deferring Social Security Benefits

- Do you have other assets to draw from ?
  - Consider taking IRA withdrawals during Social Security deferral period
    - Feel like you are consuming assets
    - Spending IRA Assets; your liquid net worth decreases
  - Reality: by spending your IRA assets, you are:
    - Increasing lifetime Social Security benefits
    - Decreasing future RMD's
- Winning Strategy vs. losing strategy - age 80 for “breakeven point”

# Retirement Asset Planning

Q & A



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