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Retirement Asset Planning

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Types of Retirement Accounts



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

“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.

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)

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

Employer Plans

- **401(k)**- “normal” employer plans
 - Employee contributions up to \$22,500/ \$30,000
 - Employer matches are common
- **403(b)**- educational and nonprofit organizations
- **457**- government plans (city, county, state)
- **Thrifty Savings Plan (TSP)**- federal employees, including military

Traditional IRAs vs Roth IRAs

Traditional IRA

- ✓ Deduct Upon Contribution
- ✓ Growth is Tax-deferred
- ✓ Taxable as “ordinary income” when withdrawing
- ✓ Non-Deductible contributions- Usually a bad idea

Roth IRA

- ✓ No deduction when contribute
- ✓ Tax free Growth
- ✓ Tax Free Withdrawals

IRA Contribution Limits

- **\$7,000** for under 50 years old
- **\$8,000** for 50 years or older
- **Must have earned W-2 income (W-2 or self employed)**
- **Earnings limits**
 - Traditional
 - ✓ No limit if self/ spouse not covered by a pension plan
 - ✓ If self/ spouse covered by pension, limitations to deduction
 - Roths- no deduction if MAGI > **\$153k** single; **\$228k** married file joint

Use a Traditional or a Roth?

- **Knowing your tax bracket (example: 37% fed + 13.3% CA)**
- **Predicting your future tax bracket (example: 24% fed + 9.6% CA)**
- **Illustration using above assumptions**
 - \$10,000 contribution saves you 50% in taxes (rounded)
 - ✓ Saves \$5,000 in taxes
 - \$10,000 withdrawal costs you 34% in taxes (rounded)
 - ✓ Costs you \$3,400 in taxes
- **Ages 60-69, predicting your future tax bracket**
 - RMDs start
 - Social Security benefits start

IRA Distributions

Before age 59 ½

- ✓ Ordinary income tax
- ✓ 12.5% penalties (10% fed; 2% CA)
- ✓ Some exceptions to penalties

After age 59 ½

- ✓ Ordinary income tax
- ✓ Not required to take distributions until age 72-75

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)

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 31st
- B. Life expectancy for distribution year
- C. Divide: $A/B = \text{RMD}$

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= \$100,000 per taxpayer year
- Must be 70 ½ or older
- Can be part of RMD, all od RMD, and can exceed RMD
- No Charitable deduction is allowed

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 \$8,000 QCD
 - ✓ \$32,000 is taxable
 - ✓ Must tell tax preparer- not shown on 1099-R
 - **Benefits: Lower AGI and good if taking Standard Deduction**

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

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

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

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**

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

Deferring Social Security Benefits

Can start taking Benefits:

- Age 60 for surviving spouse
- Age 62 (early)
- Full retirement Age (FRA)
 - Used to be 65
 - Gradually Moving up to age 67
 - Currently 66 years, 8 months
- Fully deferred (must start at age 70)
- Deferring increases future benefits by 8% per year

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!**

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 banking Social Security benefits.
- Winning Strategy vs. losing strategy- age 82 for “breakeven point”

Retirement Asset Planning

Q & A

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