Retirement Asset Planning

"It's Your Estate"
Financial and Estate Literacy, Inc.
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Presenters:
Mark L Prendergast MS CPA CFP® CDFA®
Claire M Thornton EA CFP®
Inspired Financial / Huntington Beach

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Types of Retirement Accounts

- Defined Benefit Plans
- 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), 403(b), 457 plans – exclusion from income
- Reduces your W-2 taxable income

Saving taxes encourages saving for retirement
- Reduce future dependence on gov't / Soc Sec 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 decision and bears investment risk. Employer may contribute/match employee contributions.
- 403(b) – for nonprofits and education
- 457 plans – governmental plans (fire, police, muncipals)

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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)
- Thrift Savings Plan (TSP) – federal employees, including military

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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

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IRA Contribution limits

- $6,500 for under 50
- $7,500 for 50 or older
- Must have earned 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

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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 60-79, predicting your future tax bracket
  - ➢RMDs start
  - ➢Social Security benefits start

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IRA distributions

Before age 59 ½

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

After age 59 1/2

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

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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 1960 or later, age 75 start date

Calculation of RMD

A. Balance of IRA on the prior Dec 31
B. Life expectancy for distribution year
C. Divide: A / B = 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)

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QCD = Qualified Charitable Distribution-1

- ❖Limit = $100,000 per taxpayer per year
- ❖Must be 70 ½ or older
- ❖Can be a part of RMD, all of RMD, and can exceed RMD
- ❖No charitable deduction is allowed

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QCD = Qualified Charitable Distribution-2

- 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: lowers AGI and good if taking Std Ded

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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% fed + 9% California
- You are now paying taxes on $13,000 ($10 + $3) in order to convert $10,000 in Roth.
- Don't do: inefficient

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Roth Conversions for those 60+ (1)

Higher tax brackets loom in the future due to:

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

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Roth Conversions for those 60+ (2)

Financial Planning Perspective

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

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Roth Conversions for those 60+ (3)

Planning example

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

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Testamentary Charitable Giving

Giving to charity at death?

- Give from 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 – 1

Can start taking benefit:

- Age 60 for surviving spouse
- Age 62 (early)
- Full retirement age (FRA)
  - Used to be age 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

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Deferring Social Security benefits – 2

Example:

- Age 67 is your Full Retirement Age
- Social Security benefit =$1,000/mo
- 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 – 3

- Do you have other assets to draw from?
  - Consider taking IRA withdrawals during the Soc Sec deferral period.
  - Feels 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"

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Thanks to the *Financial & Estate Literacy, Inc.*

Q&A

Presented by:

INSPIRED FINANCIAL

Mark L Prendergast MS CPA CFP® CDFA®
Claire M Thornton EA CFP®
Inspired Financial / Huntington Beach
www.InspiredFinancial.biz
Tele: 714-971-0663

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