M Financial Wealth Management

M WEALTH PERSPECTIVE

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M Wealth provides Member Firms with exceptional fee-based wealth management solutions for their clients.

To help Member Firms grow their wealth management businesses, M Wealth offers everything from component solutions and value-added wealth services to turnkey asset management and investment consulting.

Retirement Withdrawals—Which Account First?

Many investors spend valuable time weighing important decisions such as what investment philosophy to employ, which manager to use, and which fund to choose. Determining which accounts to draw retirement funds from first, and why, is an equally important consideration. Many affluent investors have both taxable and tax-deferred accounts, which can be comprised of similar holdings. This raises the question: how can clients most effectively draw from their assets at retirement? There are a number of factors to consider when making this decision, and this article will shed light on different strategies to assist clients in making their retirement income more efficient.

Taking into consideration the fact that not every investor is the same and this approach may not work in every situation, the general rule is to withdraw retirement income in the following manner:

1) If 70½ or older take Required Minimum Distribution (RMD)
2) Taxable Account (with losses)
3) Taxable Account (with little to no gains, held one year or longer)
4) Taxable Account (with large gains, held one year or longer)
5) Taxable Account (with short-term gains)
6) Tax-Deferred Account
7) Roth Accounts

Due to the 20% gap that currently exists between the highest tax bracket (35%) and the current long-term capital gains rate (15%), the conventional wisdom is to draw from taxable accounts first. This enables the client to preserve and shelter holdings in tax-deferred accounts as long as possible, where assets grow uninhibited by annual taxation.

However, IRS regulations require individuals to withdraw a percentage of their tax-deferred accounts (their RMD) the year they turn 70½. Because affluent investors may have sizeable tax-deferred accounts, waiting to withdraw funds until they reach age 70½ may result in RMDs large enough to place them in a higher tax bracket. In this scenario, an investor might benefit from taking small withdrawals from his or her account beginning at age 59½ (the age at which individuals can begin withdrawing funds without suffering early withdrawal penalties) in order to reduce the amount of their future annual RMDs.

Another option to consider: sell the holdings with the lowest expected return first, regardless of which account they are in. This would grant extra time for holdings with the greatest expected return to grow, which in turn would prolong the life of the client's portfolio. This option may expose a client's portfolio to greater risk than he or she may wish to tolerate, and so should be considered carefully.

Another factor to consider is the tax treatment of a client's account assets at death. For example, given the choice between withdrawing funds from a taxable account with

large unrealized gains and a tax-deferred account, it may be preferable for a client, and his or her non-spousal heirs, to withdraw funds from the tax-deferred account. This is due to the fact that beneficiaries receive a step-up in cost basis on the amount passed on at death (a rule by which only gains earned above the inherited value are taxable when sold). This scenario is not without its tax implications: if the beneficiary is a spouse over the age of 70 ½, the mandated withdrawal schedule still applies.

In light of the flexibility that comes at age 59½, investors may consider further positioning their assets based upon the tax implications of those assets. For example, tax-inefficient assets such as taxable bonds can be held in tax-deferred accounts where their regular distributions are not immediately taxed. Whereas equities can be held in taxable accounts where the primary taxation occurs only once assets are sold, and this capital gains tax rate can be reduced by holding the assets longer than one year. Additionally, if equity positions held in a taxable account suffer capital losses, a client can realize those losses for a current tax benefit – an option unavailable in a tax-deferred account.

There are numerous options at retirement, and no one strategy can fulfill the needs of every investor. Advisors should mindfully assess the needs, goals, and situation of each client in order to efficiently manage investment accounts at retirement.

2009 is Special—RMD Suspension

Investors age 70½ or older will not have to take their required minimum distribution (RMD) from tax-deferred retirement accounts in 2009, thanks to a new federal law intended to help retirees conserve their resources following last year's sharp stock market downturn.

On December 23, 2008, The Worker, Retiree and Employer Recovery Act of 2008 was signed into law. This Act temporarily waives the RMD rules for 2009, subject to certain qualifications. The provision allows a retirement plan participant or beneficiary to suspend (or skip) their RMD for calendar year 2009 without triggering the 50% excise tax penalty that would normally apply for RMDs that are not distributed.

Lawmakers who voted for the measure suspending RMDs in 2009 said it was unfair to require retirees to withdraw money from retirement accounts already reduced in value by the stock market selloff. This would presumably leave more money in investors' retirement accounts, where it would have the opportunity to continue growing tax-free until withdrawal.

The 2009 RMD suspension applies to IRAs, 401(k)s, 403(b)s, and other defined contribution plans. The suspension also applies to investors under age 70½ with inherited IRAs or inherited retirement plan accounts that would otherwise be subject to RMDs.

If you have any questions regarding this article or other wealth management related matters, please contact any member of the M Wealth team at 800.508.1820.

This material is for informational purposes only and should not be construed as legal or tax advice. It is not intended to replace the advice of a qualified attorney or tax advisor.

For More Information

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