Capital Analysts of New England, Inc.

Retirement Income: Order of Withdrawals

In the past, many retirees had a relatively easy time planning their retirement income. They would claim social security benefits and turn on their pension income. The income streams would continue for life. Today's retirees have multiple accounts to draw from for retirement income. The typical retiree will have personal investments funded with after tax dollars, IRA's or 401k investments funded with pretax dollars and Roth accounts that allow tax free distributions. Since retirees are living longer, it's important to have a well thought out withdrawal strategy. The following is a rule of thumb to follow as it relates to the order of withdrawals:

1) **Social Security/Pension Income** – determine the best age to take the income based on your personal situation. Compare pension income versus a rollover to an IRA. (1)
2) **Personal investments** – Consider taking all of the dividends, interest and any capital gain distributions in cash as opposed to reinvesting. These distributions are taxed whether you take the funds or reinvest.
3) **IRA/401K** - Take the required minimum distribution (RMD) at age 73. These distributions are fully taxable at your income tax rate.
4) **Personal Investments** – go back to your personal investments and think about taking tax managed withdrawals. Take any tax losses first and be aware of the capital gain on each distribution.
5) **IRA/401k** – Planning to take distributions above the RMD amount may be an effective strategy.
6) **Roth IRA** – since the Roth IRA is a tax-free account, letting this account accumulate as long as possible could be an option to consider.

As I mentioned, this is only a rule of thumb. Some retirees may want to tap into the Roth account sooner to receive tax-free income and lower their taxes. In general, this rule of thumb can be effective since the personal investments are funded with after tax dollars and upon withdrawal you are only taxed on the capital gain. Capital gain rates also tend to be lower than ordinary income tax rates. The IRA/401k is not tax efficient – in the distribution stage - as every dollar you withdraw is 100% taxable at the higher ordinary income tax rates. This is why it may be best to only take the RMD until you need additional funds. The Roth IRA is usually the last account considered so the retiree can grow this tax-protected account as long as possible. Partial conversions from your IRA to your Roth IRA can also make sense…especially if you are in a low tax bracket in the early retirement years. The Roth IRA may be a tax-free account you could leave to your family (estate taxes may still apply).
One of the best ways to plan your order of distributions in retirement is to work with a financial advisor who understands your overall financial situation and your tax advisor on a regular basis.

(1) Note: Prior to rolling over assets from an employer-sponsored retirement plan into an IRA, it's important that you understand your options and do a full comparison on the differences in the guarantees and protections offered by each respective type of account as well as the differences in liquidity/loans, types of investments, fees and any potential penalties.

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