First Quarter 2023

Rethinking Retirement Accounts

Tax-deferred retirement accounts offer the benefits of tax-deductible contributions, lowering your taxable income, as well as tax-deferred growth of assets. But there are disadvantages to ending up with excessive balances in taxable retirement accounts.

The higher your annual Required Minimum Distribution, the higher your “means-tested” Medicare premiums and the lower your after-tax Social Security payments. Your distributions might be subject to the upper brackets of Federal income tax rates. Any balances left in your retirement accounts when you die will be included in the calculation of your estate value for tax purposes, but there will be no markup in the basis of those assets. Your beneficiaries will pay personal income taxes on every penny, with the exception of Roth IRAs.

There was a time when leaving excess retirement accounts to the next generation was a way of assuring your heirs would have funds to help them in retirement. The 2019 SECURE Act eliminated the ability for retirement account beneficiaries to stretch withdrawals from inherited IRAs over their projected life expectancy. Now inherited tax-deferred and Roth accounts must be depleted within 10 years, with limited exceptions. That can mean higher income tax rates for beneficiaries as well as a considerable distribution of funds at a time when they may not have much experience managing money.

While it is always better to have income and pay taxes than it is to not have income, a retirement asset strategy can potentially lower taxes in retirement, leave you with more money to spend, and assets that can be passed on to heirs with a step-up in basis, giving your heirs the ability to plan when gains on an inheritance become taxable.

Roth IRAs, where taxes as paid up-front and there are no taxes on gains, can be used to eliminate federal taxation of future disbursements. In addition to increasing after-tax income during the account holder’s retirement, the Roth structure allows an inherited Roth IRA to transfer to beneficiaries without personal income tax liability.

Assets with interest earnings such as bonds or income-producing stocks that would be taxed at your personal income bracket may be best placed in tax-deferred retirement accounts where they can grow tax-free until withdrawn. That provides additional leverage for growth compared with paying taxes as interest and income occurs.

Assets purchased for long-term appreciation can be more efficient in taxable accounts where capital gains taxes take a smaller bite out of the final proceeds than personal income taxes during your life.

If you are already retired, it may make sense to start drawing down tax-deferred retirement accounts before you tap into taxable accounts. That’s where a withdrawal strategy or plan comes in very handy. Any time you can save taxes on your income, you have more money to spend and less need to liquidate additional assets.

It’s never to early to rethink your investment strategy to blend asset location and tax impacts into an approach that makes the most sense for your financial situation and your future goals. Let’s start the New Year off with a plan!

Your Conservative Advisory Firm Since 1990
301 Forest Avenue
Laguna Beach, California 92651-2115 USA Telephone: 1-949-464-1900
www.gobcafunds.com
brian@gobcafunds.com