

## SHOULD YOU ALWAYS WITHDRAW FROM IRAs LAST?

*Conventional wisdom says yes, but there are exceptions.*

Presented by IWM Partners

**Shouldn't you delay IRA distributions for as long as you can?** According to conventional retirement planning wisdom, you should structure your retirement withdrawals so that money comes out of your taxable accounts first, then your tax-deferred accounts, and then finally your tax-free accounts. Roughly speaking, that means withdrawing income from investment funds, CDs, money market accounts and bank accounts before taking a dime from your IRAs.

The wisdom behind this is easy to discern. By postponing withdrawals from a traditional IRA and/or Roth IRA for as long as possible, you give the assets in those tax-advantaged accounts even more time to grow. You have to take required minimum distributions from a traditional IRA after age 70½, of course; if you have a Roth IRA, RMD rules are inapplicable while you are alive.<sup>1</sup>

**Or should you disregard that approach?** Under certain circumstances, it may be a good idea to tap your IRA(s) in the early stages of retirement. While it may seem unconventional, making IRA withdrawals in your 60s might potentially help you enhance your wealth in the long term.

How, exactly? If you start drawing down the assets in your traditional IRA before age 70½, your RMDs could eventually be smaller than they would be otherwise. Smaller RMDs mean less taxable income. Not only that, a smaller RMD might keep you in a lower income tax bracket; welcome relief if you have a large traditional IRA.

**Can exemptions & deductions shelter the income?** A study from Rider University in New Jersey sees merit in this unconventional strategy. In the big picture, the researchers at Rider feel it may help seniors to level out annoying fluctuations in adjusted gross income and taxable income over the long run.<sup>2</sup>

The key: sheltering some or all of the early IRA withdrawals with IRS standard deductions and personal exemptions. As an example, take a married couple in which both spouses are at least age 65. The spouses have done their homework and determined that their IRS deductions and exemptions will add up to (at least) \$21,800 for 2012. If their taxable income before any IRA withdrawal would fall below \$21,800, they could use “withdrawals from tax-deferred IRAs to create tax-free income,” according to Alan Sumutka, one of the researchers behind the Rider study.<sup>2</sup>

The Rider study compared 15 model scenarios. Each one used a hypothetical married couple (both 65-year-olds) retiring in 2013 with \$2 million in investable assets, \$80,000 in current living expenses and \$30,000 arriving from Social Security. Within the mock \$2 million portfolio, 70% of the assets were held in traditional IRAs, 20% in taxable accounts and the rest in Roth IRAs. The portfolio returned a steady 6% annually (again, these were model scenarios).<sup>2</sup>

What was the most tax-efficient model scenario in the bunch? It played out as follows: from age 65 to age 70, the couple drew down their traditional IRAs right to the limit of their combined deductions and exemptions. Then, they reached into their taxable accounts for the balance of the money needed to meet that \$80,000 in expenses, incurring taxes of up to 15% on long-term gains. They didn't tap their Roth IRAs.<sup>2</sup>

After age 70½, they altered their approach: they took required distributions from their traditional IRAs, withdrew money from taxable accounts until those were exhausted, and then they turned to Roth accounts with the remaining balances on the traditional IRAs representing the last of their retirement savings.<sup>2</sup>

After all that, the hypothetical couple still had \$1.61 million in their portfolio at age 95. The conventional withdrawal strategy (taxable accounts first, then tax-deferred accounts, then tax-free accounts) left them with just \$1.17 million at that age, and it also led to them spending 23 years in the 25% tax bracket.<sup>2</sup>

The Rider study found that this approach was ill-suited to very large portfolios (ones with assets above \$8 million) and portfolios with roughly 50% in taxable assets. It was also a bad fit for couples with sizable taxable pensions.<sup>2</sup>

**It is worthwhile to review your retirement assumptions.** As the American vision of retirement has changed in the last generation, so have retirement planning precepts. The recession and the financial pressures facing the baby boomers have upended some of the conventional thinking. A talk with a retirement planner may lead you toward some new financial options and some good ideas worth exploring.

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#### **Citations.**

- 1 – [www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Required-Minimum-Distributions#3](http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Required-Minimum-Distributions#3) [8/2/12]
- 2 - [money.msn.com/retirement-plan/when-should-you-tap-your-iras](http://money.msn.com/retirement-plan/when-should-you-tap-your-iras) [11/16/12]