RETIREMENT **Navigator**
Guidance and advice to get you there.
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Which Retirement Income Sources Should I Draw From First?

If you are looking to maximize the amount you can safely withdraw from your investment accounts in retirement, choosing the right withdraw order is a vital component. Your tax bracket, sources of income and account balances are all important factors in choosing the right strategy. Most people still utilize a traditional withdraw strategy (taxable accounts first, followed by tax-deferred accounts). Yet, growing research suggests it is worth considering a reverse order strategy (tax-deferred first, then taxable). Ultimately, the right strategy is one that considers your current and future tax consequences, and likely combines the two strategies into a custom-fit approach for you.

Traditional withdrawal strategy:

This strategy remains the overwhelming favorite amongst retirees. At face value, this strategy makes sense because it most closely resembles the traditional savings approach we are taught: maximizing tax deferral.

Also, a more traditional retirement includes pension income. If your retirement income strategy is heavily dependent upon taxable income sources, such as a pension or rental income, this approach is probably a good fit for you.

Your Social Security claiming should also be considered. It is likely that all or some of your Social Security income will be considered taxable income. So, if your strategy is to take Social Security as soon as possible, you may want to couple that approach with the traditional withdrawal strategy.

Reverse withdrawal strategy:

Throughout the years, pensions have been replaced by the individual retirement account (IRA). Thus, significant wealth has been accumulated in deferred retirement vehicles, such as traditional IRAs and 401(k)s. A large deferred account balance is good, but most fail to realize that there is also a significant tax ramification looming in the form of forced withdrawals due to required minimum distributions (RMDs).

Often, people see a drop in their taxable income after retirement – only to see their taxable income rise again in later years as a result of RMDs. There are planning opportunities to cope with this scenario. If you have a significant amount of your wealth in deferred retirement accounts, a prudent strategy for you may be to begin withdrawals from your deferred accounts between the years of retirement and the time that RMDs begin, when you are in those gap years of lower income tax obligations. It is better to withdraw the funds from your deferred accounts now in the 10-15% tax bracket, versus in the future, in the 25% bracket.

This strategy lends itself well to those who are delaying Social Security until full retirement or later. The longer you delay, the larger your benefit; doing so delays any tax consequence of claiming early benefits.

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Putting it all together:

A custom-fit approach may be one that combines the two withdrawal strategies and is part of an overall retirement income plan. When working with clients, I encourage them to consider withdrawing from deferred accounts up to the 15% tax-bracket, then using non tax-deferred assets to satisfy any remaining income need.

Combining a custom-fit withdrawal strategy with a personalized Social Security claiming strategy can have a significant impact on your portfolio's longevity risk exposure and your tax efficiency in retirement.

In addition, Roth IRAs need to be part of the consideration. If you have accumulated wealth in a Roth IRA, you will want to earmark those dollars as last on the spending waterfall. This is because those assets grow tax-free and are eligible for tax-free withdrawals. However, if accessing other income sources will push you into a higher tax-bracket, you should consider accessing your Roth account to maintain your lower tax bracket.

You may be fortunate enough to have saved substantial funds in tax-deferred and non-retirement accounts, therefore a Roth conversion strategy would be appropriate for you. Using a best-fit approach, you withdraw assets from your deferred accounts at a lower tax-bracket while funding your lifestyle and tax obligation with non-retirement accounts. With a conversion, you now have assets that will continue to grow tax-free. This strategy can have significant long-term tax efficiency and portfolio longevity benefits.

Conclusion:

While there is not a one-size-fits-all approach to retirement income planning, there are a few generalizations that serve as a good starting point.

Consider the traditional withdrawal strategy if:

- You have significant pension income
- You do NOT have a large part of your net worth in tax-deferred accounts
- You are compelled to draw Social Security early

Consider the reverse withdrawal strategy if:

- You have significant tax-deferred savings
- You have a decrease in taxable income between retirement and RMDs
- You understand the advantages that accompany delaying Social Security benefits

As explained, a best-fit strategy is likely one that incorporates both strategies, considers Roth assets and includes Social Security claiming as part of a comprehensive retirement plan. A qualified retirement income planning specialist is able to help you consider your unique circumstances to satisfy your retirement income objectives.

To review your retirement income strategy, please contact **Jeff Mahoney**, CFP®, RICP® at jeffmahoney@hjsims.com or (952) 683-7503.