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Get a Tax-Smart Plan for In-Retirement Withdrawals

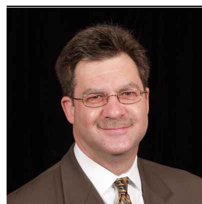
The following sequence may make sense for retirees to preserve the tax-saving benefits of tax-sheltered investments for as long as possible.

1) For retirees over age 70 1/2, the first stop for withdrawals are those accounts that carry required minimum distributions, or RMDs, such as Traditional IRAs and company retirement plans such as 401(k)s (to avoid paying penalties).

2) For retirees who are not required to take RMDs or have taken their RMDs and still need cash, turning to taxable assets may be an option. A good start may be selling assets with the highest cost basis first and then moving on to those assets where cost basis is lower (and the tax hit higher). Relative to tax-deferred or tax-free assets, these assets have the highest costs associated with them. However, taxable assets could also be valuable to tap in later retirement years because retirees will pay taxes on withdrawals at their capital gains rate, which is generally lower than the ordinary income tax rate.

3) Finally, after taking RMDs or tapping taxable assets, retirees still in need of cash may want to further tap company retirement-plan accounts and IRAs (Roth IRA assets last.)

401(k) and IRA plans are long-term retirement-savings vehicles. Withdrawal of pretax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Direct contributions to a Roth IRA are not tax-deductible but may be withdrawn free of tax at any time. Earnings may be withdrawn tax and penalty free after a 5 year holding period if the age of 59 1/2 (or other qualifying condition) is met. Otherwise, a 10% federal tax penalty may apply. Please consult with a financial or tax professional for advice specific to your situation.



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More about COMPASS Wealth Management, LLC

COMPASS Wealth Management, LLC is a client-focused wealth management firm dedicated to providing superior advice to individuals, families, and corporate retirement plans.

Our wealth management services include investment management, retirement and gift planning, education funding, and other advisory services.

We take pride in offering you expert financial advice along with personalized service. Assisting you in reaching your financial goals is our business and we take that responsibility very seriously.

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Retirement Contribution Limits Increase for 2015

By Louis E. Conrad II, CFA

- Contribution limits will be increasing for employer-based retirement accounts, though they will be unchanged for Traditional and Roth IRAs in 2015.

The IRS announced recently that the contribution limits to employer-based retirement accounts, such as 401(k) accounts, will increase in the New Year, but remain unchanged for Traditional and Roth IRAs. Annual contribution limits are adjusted when the annual increase in the consumer price index meets statutory thresholds. Given the current low inflationary environment, the thresholds were not met to allow for increases in 2015 contribution limits for Traditional and Roth IRA accounts.

Employer-Sponsored Accounts

As indicated above, the amount that you may contribute to an employer-sponsored retirement account will increase for 2015. For 401(k), 403(b), and 457 plans, offered by corporate, non-profit, and government employers, respectively, the maximum you may contribute via payroll deduction to such plans will increase from $17,500 to $18,000 annually.

If you will be 50 years of age or older by December 31, 2015, you may contribute an additional $6,000 in 2015 (also known as the “catch-up” provision), an increase of $500 from 2014. Consequently, if you will be at least 50 years of age during 2015, you may contribute a total of $24,000 to an employer-sponsored retirement account versus $23,000 in 2014. Contributions to your employer-sponsored retirement account, when made on a pre-tax basis, have the benefit of lowering your taxable income (and thus your taxes), as well as assisting in saving for your retirement.

For those with SIMPLE IRAs, the maximum annual contribution has also increased for 2015 to $12,500 from $12,000. The “catch-up” provision has grown to $3,000 from $2,500 for those individuals over 50.

IRA Accounts

For Traditional and Roth IRAs, you will be able to contribute up to $5,500 as your 2015 tax year contribution (unchanged from this year) until April 15, 2016. If you will be at least 50 years old at any time during 2015, you may contribute an additional $1,000, an amount which is unchanged from 2014. To qualify to make an IRA contribution, your taxable compensation must be equal to or greater than the contribution you wish to make.

In addition, to contribute to a Roth IRA, you must be income eligible. To make the full contribution to which you are otherwise entitled, your modified adjusted gross income (MAGI) during 2015 must be $116,000 or less as a single filer and $183,000 or less as a married individual, filing jointly. If your MAGI is between $116,000 and $131,000 as a single filer, or between $183,000 and $193,000 as a married individual, filing jointly, you are entitled to make a prorata contribution to a Roth and a Traditional IRA as long as your total contribution does not exceed the applicable limit.

If your MAGI exceeds the upper end of the applicable MAGI range, then you may contribute up to the allowed maximum to a Traditional IRA. You must be less than 70½ years old to contribute to a Traditional IRA.

Under current law, if you do not qualify to contribute directly to a Roth IRA because your MAGI exceeds the allowed limits, you may contribute to a Traditional IRA and then convert the contribution (and other retirement assets, if you desire) to a Roth IRA, subject to limitations and possible taxes, which are beyond the scope of this article.

One other difference between Roth and Traditional IRAs is worth noting. Contributions to a Roth IRA cannot be used as a deduction to reduce the income taxes you pay, while contributions to a Traditional IRA may or may not be used as a deduction. Whether or not a Traditional IRA contribution can be deducted is dependent on your income level and whether you or your spouse participates in an employer-sponsored retirement plan.

Monthly Market Commentary

Recent U.S. economic reports, while not always meeting expectations, suggested more of the slow and unsatisfying growth rates of the past four years. Businesses are looking and feeling more optimistic at a time that both U.S. and international consumers are sitting on their hands.

GDP: GDP numbers have been volatile lately, with wild quarter-to-quarter swings driven by inventory and export data. The overall growth rate for the third quarter came in at 3.5%, surpassing expectations of 3.1% growth and down modestly from the 4.6% rate of the second quarter. However, both those quarters represent a bounceback from a 2.1% decline in the first quarter. In other words, the recent strength is probably more of a catch-up than the start of a new, higher, sustained growth rate of 3% or more. Looking at the less volatile year-over-year data growth instead of annualizing one quarter of change suggests the economy is growing at 2.3%, just about in the middle of 2.0%–2.5% intermediate- and long-term growth potential of the U.S. economy.

Employment: The October employment report was below expectations but still consistent with trend-line employment growth of just under 2%. Nonfarm employment growth for October came in at 214,000 jobs added, below the consensus of 243,000 but roughly in line with the 12-month average of 222,000. This follows sharp growth of 256,000 jobs added in September, which was revised higher by 8,000 jobs. Government job growth, on the other hand, has been truly awful: The government has lost almost 1.1 million jobs since May 2010.

More interestingly, a lot of analysts are characterizing the current low-level job growth as unprecedented, a kind of new normal (which is another way of saying a new awful). But job growth, looked at year over year, hasn't been all that much higher, at least for long, stretching all the way back to the 1980s. And some of those earlier periods had the benefit of substantial population growth to help push things along. The average job growth since 1980 has been 1.3%; currently it is running at 1.9%.

Hourly Wage Rates: Besides the raw employment numbers, it's also important to look at the average hourly wage and the number of hours worked. Combining these can provide insight into consumer wage growth, the fuel for future spending. On a year-over-year, 3-month average basis, wage growth looks consistent at just about 2%.

Consumption and Income: Headline consumption data dropped by 0.2% in September following an unsustainable 0.5% growth rate in August. However, single-month growth rates are volatile and influenced by a variety of variables such as shifting seasonal patterns, weather, changes in tax holidays, and retailer big-event dates. Year-over-year data shows reliable consumption growth of about 2.4% on an inflation-adjusted basis.

Trade: Analysts had expected the trade deficit to widen from $40.0 billion to $41.5 billion. Instead, it widened all the way to $43 billion. Although averaging and inflation-adjusting the data paints a much less bleak pattern, it is still going to mean a downward revision in the third-quarter GDP estimate. Combining the new trade deficit report with a poor construction report probably means that GDP for the third quarter will be revised down from a great 3.5% to a more believable 3.0% rate. However, with inventory data and retail sales revisions yet to come, that GDP downgrade isn't a sure thing just yet.

Also, falling energy prices in general and gasoline prices in particular should be a huge aid to consumers in the fourth quarter. Going into the last holiday season (2013), saving rates had moved up and gasoline prices had collapsed over the summer and early fall, similar to the set-up we are seeing in 2014.

Retirement Distribution Pitfalls: Not Accounting for Market Fluctuations

Accumulation is a key facet of reaching your retirement goals. However, we tend to see far less about portfolio drawdown, or decumulation—the logistics of managing a portfolio from which you're simultaneously extracting living expenses during retirement. This can be even more complicated than accumulating assets.

Pitfall: One of the big mistakes of retirement distribution can be not adjusting withdrawals to account for market fluctuations. So-called sequencing risk—the chance that retirees may encounter a harsh bear market early in the life of their withdrawal program—can have a big effect on a portfolio's longevity. Taking fixed distributions from a shrinking pool means that a retirement portfolio could suffer losses from which it would be impossible to recover.

Workaround: Maintaining a well-diversified asset mix may be a retiree's best weapon for protecting his or her portfolio from a bear market. For example, holding assets in high-quality bonds and cash may allow a retiree to meet desired living expenses without having to withdraw from equity holdings during periods of market weakness. That said, the smartest retirement-distribution plans also make adjustments during times of market duress, possibly reducing withdrawals or, at a minimum, forgoing upward inflation adjustments.

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