To Your Wealth®

FINANCIAL SERVICE GROUP INC.

October 2013

When paying no income taxes is a bad idea

As published in the Racine Journal Times | October 3, 2013 | by Justus Morgan, CFP®

I recently met with someone who was very proud that she had accumulated enough in her bank savings account that she wouldn't have to draw from her retirement accounts until several years into retirement. She was a bit confused when I told her she could actually run out of money sooner if she pursued this strategy because she only paid taxes on the interest from her savings account, yet all of her withdrawals from retirement accounts would be taxable. How could this happen?

Since we have progressive income tax brackets, not every dollar earned is taxed the same. The more income you have, the higher the percentage you pay. While the idea of not paying any income taxes may sound appealing, it could actually lead to paying more taxes in the future if most of your retirement savings are in accounts like 401(k)s or traditional IRAs. This issue can become more pronounced once you reach age 70.5 and must begin to take mandatory withdrawals from your IRAs.

A better strategy is to recognize that eventually you will pay income taxes on retirement accounts, so why not pay the tax at the lowest rate possible? For example, a single person could have income up to $46,250 (assuming they're younger than 65 and take the standard deduction) and still be in the 15 percent tax bracket. The next higher tax bracket is 25 percent, which is significantly higher.

One caveat to following this strategy is to recognize that someone collecting Social Security retirement benefits has a more complicated situation because the rules for how much Social Security benefits are taxable is based on how much other income is being reported. Also known as the "tax torpedo," a person's effective tax rate could be significantly higher based on the calculation for taxing Social Security, so caution is warranted.

The idea of tax-efficient withdrawals has been supported for a number of years by academic research. Most recently, Dr. William Reichenstein from Baylor University published an article in the Journal of Wealth Management demonstrating that tax-efficient withdrawals could result in a portfolio lasting 20 percent longer than a less optimal approach. Reichenstein looked at several scenarios with different types of accounts. He found that drawing income from accounts such as 401(k)s and IRAs to use lower tax brackets had a significant impact on the longevity of an investment portfolio.

Based on this research, a better approach for the woman I spoke with would be to use her savings account in conjunction with her retirement accounts to use the lower tax brackets every year, ultimately allowing her money to last longer.

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FSG is hosting a flu clinic on November 8

Lakeview Pharmacy will be at our offices on Friday, November 8 from 9 a.m. to 10 a.m. to administer influenza vaccinations to anyone choosing to receive one.

The cost is $36 per person and Lakeview Pharmacy will give each person a $5 Lakeview Pharmacy gift card. A receipt for the flu shot will be provided for you to submit to your insurance company.

Please call our office and let us know by October 30 if you will be stopping by for your vaccine, so we can make sure Lakeview Pharmacy has an adequate supply available.

November Workshop: Social Security & You

Join FSG's Justus Morgan and Justin Moilanen to learn the basics of Social Security including how benefits are determined for workers, spouses, and surviving spouses as well as the interaction between claiming now versus delayed benefits and how different claiming strategies can significantly impact your retirement income sustainability.

This interactive presentation to be held at our office on Wednesday, November 20 from 6:30 p.m. to 8 p.m is for individuals and couples getting close to the age when they may start collecting Social Security retirement benefits.

To reserve your seat, please call Lori at 262-554-4500 ext. 105 by November 13. Seating is limited.

We've got something new coming soon….

FSG will be launching our newly revised website in the next couple of weeks. While you may still prefer to read our news in our monthly print version of *To Your Wealth Update*, our new site will provide a fresh look and the ability for more frequent updates and timely posts via our *To Your Wealth Blog.* Consider taking a peek at our new site after November 1 at www.ToYourWealth.com