Tax and Estate Planning Throughout Retirement

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October 2015

There are many life changing events that occur in a lifetime with retirement normally being in the top five. In addition to being assured that you have accumulated enough assets for a comfortable retirement, there are also estate and income tax, portfolio allocation, and logistical planning decisions that, at times, may become overwhelming.

Portfolio allocation and logistical planning is typically a routine task for a seasoned financial planning team. While we don't mean to trivialize their importance, our main focus for this article consists of tax and estate planning throughout your retirement.

Additional tax and estate planning are typically needed when someone has accumulated assets far in excess of what they will need in retirement and have a desire to pass their remaining assets onto their heirs. The tax planning becomes most important when your heirs have also achieved a level of success that places them into the upper range of federal taxation.

There are typically three investment pools that are useful in achieving the above goal: Taxable Assets (TA) (non-retirement accounts), Tax-Deferred Assets (TDA) (annuities, qualified retirement plans and IRAs), and Tax-Free Assets (TFA) (Roth 401(k)/Roth IRA).

The Roth assets are typically the best asset for an heir to inherit since they are tax-free upon distribution. The two remaining asset pools require some planning in the retirement process in order to minimize income taxes to both the owner and the intended heir. The planning process can begin at any time after age 59½. Attention to the Effective Tax Rate (ETR) is the key in deciding when to distribute assets from TDAs. Traditionally, we have always been told to delay distributions from TDAs for as long as possible. However, if the owner will move to a significantly lower tax-bracket upon retirement and the intended heir will remain in a high tax-bracket, then it may make sense to distribute assets from the TDA as early as age 59½, especially if the TDA accounts are larger than the TA accounts.

Distributions from TDAs and TAs are treated differently under the federal tax code. TDA distributions are taxed as ordinary income while TAs have a mixture of ordinary income and capital gains tax treatment. Upon death, the TDA will still maintain its ordinary tax rate while TAs will receive a stepped-up basis. This can certainly work in favor of the

intended heir since moderately or highly appreciated assets will reset the capital gains and treat the asset as 100% principal based on the date-of-death (DOD). Only future gains from the DOD will be subject to capital gain taxes.

While it may seem against traditional wisdom, paying attention to the ETR during retirement can result in essentially the same asset growth of the combined asset pools. This technique does require annual analysis since Social Security Benefits can rapidly increase the ETR if they are received at a later time period once retirement begins. In addition, annual changes to the tax code should be closely monitored to ensure the ETR remains attractive during the distribution process.

While the caveat "do not attempt this at home" does not apply, why not consult your financial advisor to discuss these and other options, so you can devote your attention to enjoying retirement?

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