Tax-Smart Withdrawal Guide

DALE PURUCZKY

Tax-Smart Withdrawal Guide

Withdrawing money in retirement isn't as simple as taking what you need when you need it. The order in which you withdraw from taxable, tax-deferred, and tax-free accounts can significantly impact your tax bill, Social Security benefits, and even Medicare premiums. Without a plan, you could end up paying more in taxes than necessary, reducing the money available for your retirement.

For retirees, tax-efficient withdrawals help savings last longer and prevent unexpected tax burdens. For pre-retirees, planning ahead allows you to minimize taxes over time and avoid costly mistakes. The goal isn't just to withdraw money—it's to withdraw it wisely.

This guide will break down the best withdrawal strategies, how to manage required minimum distributions (RMDs), and how to optimize your retirement income for tax efficiency. A little planning today can keep more of your money in your pocket for the years ahead.

1. The Traditional Withdrawal Sequence

A commonly recommended approach is to withdraw funds in the following order:

1. Taxable Accounts: Utilize assets from these accounts first, as they have already been taxed, and withdrawals typically incur minimal additional taxes.
2. Tax-Deferred Accounts: Next, tap into accounts like traditional IRAs and 401(k)s, where withdrawals are taxed as ordinary income.
3. Tax-Free Accounts: Lastly, consider Roth IRAs, which allow for tax-free withdrawals, potentially providing tax-free growth for a more extended period.

This sequence aims to allow tax-advantaged accounts to continue growing while minimizing immediate tax liabilities.

2. Blending Withdrawals for Tax Efficiency

An alternative strategy involves withdrawing from a combination of account types each year to maintain a lower overall tax bracket. By carefully managing the sources of your income, you can potentially reduce the total taxes paid over the course of your retirement.

3. Implementing Roth Conversions

Converting portions of your traditional IRA or 401(k) into a Roth IRA can be a strategic move, especially during years when your taxable income is lower. While you'll pay taxes on the converted amount now, future withdrawals from the Roth IRA will be tax-free, which can be advantageous if you anticipate higher tax rates later in retirement.

4. Managing Required Minimum Distributions (RMDs)

After reaching a certain age, typically 73, you're required to take minimum distributions from tax-deferred accounts. Planning for these RMDs is essential to avoid substantial penalties and to manage your taxable income effectively.

5. Considering State Tax Implications

Be aware that state taxes on retirement income vary. Some states do not tax certain retirement income, such as Social Security benefits, 401(k) withdrawals, IRA distributions, or pensions. Understanding your state's tax policies can influence your withdrawal strategy and overall tax burden.

Developing a tax-smart withdrawal strategy is one of the most important steps in preserving your retirement savings and maximizing your income. Without proper planning, you could unknowingly increase your tax burden, reduce your Social Security benefits, and even push yourself into a higher Medicare premium bracket.

By carefully structuring your withdrawals—whether through the traditional sequence, blended withdrawals, or Roth conversions—you can minimize taxes and stretch your savings over a longer period. Managing RMDs and considering state tax implications are also key factors in ensuring your money works for you in the most efficient way possible.

The best approach depends on your financial situation, goals, and expected income needs. Whether you're already retired or preparing for retirement, taking control of your withdrawal strategy today can make a significant difference in how much money you keep in your pocket for the years ahead.

Securities offered through LPL Financial, member FINRA/SIPC. Investment advice offered through Stratos Wealth Partners, Ltd., a registered Investment Advisor and a separate entity from LPL Financial.
Trading instructions sent via email, fax or voicemail will not be honored. There is no assurance that these messages can be retrieved on a timely basis, nor is there any sure method of confirming the customers identity. The information contained in this email message is being transmitted to and is intended for the use of only the individual(s) to whom it is addressed. If the reader of this message is not the intended recipient, you are hereby advised that any dissemination, distribution or copying of this message is strictly prohibited. If you have received this message in error, please immediately delete.

On Sept. 13, 2024, Stratos Wealth Partners, Ltd. placed 29th on the list for the year 2023. Stratos Wealth Partners, Ltd. applied for the award by submitting responses to a detailed questionnaire for the award committee's consideration. Stratos Wealth Partners, Ltd. did not pay any compensation to be considered for the award. The award is not representative of any one client's experience and is not indicative of our firm's future performance. The award was independently granted, as Stratos Wealth Partners, Ltd. has no affiliation with Barron's. Please note that the award is not a referral to, endorsement or recommendation of, or testimonial for the advisor with respect to its investment advisory or other services. Barron's weighs dozens of qualitative and quantitative components, including assets managed, the size and experience of teams, regulatory record of the advisors and firms, succession planning, technology spending, and staff diversity based on responses supplied by the advisor to a detailed survey. *Barron's "Top 100 RIA Firms" ranking is based upon quantitative and qualitative criteria including: regulatory records, client retention reports, assets managed, revenue generated, technology spending, number of clients, size and diversity of staff, placement of a succession plan, and more. Investor experience and returns are not considered. Neither THE FIRM nor its financial advisors pay a fee to Barron's in exchange for the ranking.