3 withdrawal strategies to maximize your retirement plan in 2021

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There are many changes in store for retirees in 2021. Under the Biden administration, we might see an increase in individual tax rates and other key tax policy changes that could have a direct impact on your retirement portfolio in years to come. We are also expecting to see increased stimulus measures as we continue to combat the COVID-19 pandemic.

With these changes on the horizon, now is a good time to revisit your retirement withdrawal strategy — or put one in place if you haven't already — and ensure you are taking advantage of today's low-tax environment.

While there are many withdrawal strategies that can be deployed to help meet your financial goals and needs, below are three options that could help you achieve greater tax efficiency and preservation of wealth.

- **Converting to a Roth IRA**

Under the Setting Every Community Up for Retirement Enhancement (SECURE) Act that went into effect last year, the age to start taking required minimum distributions (RMDs) from tax-deferred retirement vehicles such as a 401(k) or IRA was raised from age 70 ½ to 72. This alone could enable you to leave a little more money to your heirs by giving you an extra year-and-a-half to let that money grow untouched in your retirement portfolio.

If you are currently required to take withdrawals from your IRA, it may make sense to convert all or some of that money into a Roth IRA depending on your tax situation. When you place money into a Roth IRA, the money will grow tax-free until you are ready to eventually make withdrawals, which can be passed along to your beneficiaries tax-free as well. With tax rates at historic lows today and with the potential of tax increases on the horizon under President Biden, a Roth conversion might be a great strategy to help maximize the tax impact of your withdrawals and serve as a legacy planning tool.

Conversely, if you take withdrawals from your IRA and put them into a traditional brokerage account or other non-qualified account, you will have to pay capital gains taxes. You would also want to avoid holding high-dividend-paying stocks or other high-yielding securities in a traditional brokerage account, as you could incur additional taxes on the interest earned from those investments. Whereas with a Roth IRA, you could own those higher-yielding strategies that may be necessary to support your future income needs, as they would grow tax-free.

Of note, IRS laws currently do not allow for “high-income earners” to contribute directly to a Roth IRA. For 2021, your adjusted gross income must be under $140,000 for single filers and under $208,000 for those married filing jointly to contribute. And for those who qualify, the maximum you can contribute to a Roth IRA for 2021 is $6,000 if you’re under age 50, or $7,000 if you’re age 50 or older (data from IRS.gov). These income and contribution limits do not apply when you are converting from a traditional IRA to a Roth IRA, however, making this a particularly attractive option for high-net-worth (HNW) individuals.

If you are considering a Roth conversion, be sure to work closely with your financial advisor and tax advisor to build out an annual tax budget and ensure this move will not bump you into a higher tax bracket.

- **Delaying Social Security**

As people approach retirement, many believe that they need to start taking Social Security as soon as possible because they see it as “free money” from the government. However, for every year you delay taking Social Security after you reach full retirement age (currently age 66 and 10 months in the U.S. for workers who become eligible for retirement benefits in 2021), you will receive an extra 8% in benefits up to age 70. In other words, if you delay claiming Social Security for one year, you will be entitled to 108% of your benefit, and so on until you reach up to 132% of your benefit at age 70. So, if you would normally receive $1,000 per month from Social Security, delaying your benefits to age 70 would increase your monthly check to $1,320.

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When compounded, this can add up to significant additional income over time. The more you delay, the more you will ultimately receive from Social Security and the less you will have to dip into other sources of income to fund your retirement. In that regard, delaying Social Security can help not only boost your short-term income, but also preserve your wealth longer so you can afford any unexpected expenses in retirement or pass it along to your heirs when you are gone.

When you consider Social Security as part of your long-term investment strategy, delaying as long as possible may be the best path forward if your financial situation allows.

- **Funding legacy vehicles**.

For those who have sufficient income to fund their immediate needs in retirement (i.e., those who don’t need to rely on an IRA or other qualified retirement account beyond satisfying their RMD each year), it may be a good idea to utilize legacy planning vehicles.

For example, you can take your RMD from an IRA and either gift it to your children or grandchildren directly or make contributions on their behalf to a 529 college savings plan. If you

are gifting directly, you can contribute up to $15,000 per person in 2021 without being subject to the federal gift tax. So, if you are a grandparent, you can gift up to $15,000 per year to each of your grandchildren ($30,000 if you are married) without having to file a federal gift tax return.

Alternatively, you can take the path of opening a 529 plan, a tax-advantaged savings vehicle designed to help pay for education expenses. 529 plans grow tax-deferred, and withdrawals are tax-free so long as they're used for qualified education expenses. Additionally, depending on the state you live in, they may be tax deductible for the person funding the account.

Unlike a 401(k) or an IRA, there are no annual contribution limits for 529 plans. However, contributions made to these accounts are considered gifts for tax purposes and are therefore subject to the same gift-tax exclusion requirements noted above.

No matter which option you choose, gifting through one of these legacy vehicles could be a great option for HNW clients to put some of their supplemental income to work.

As we make our way through the first half of 2021, you may want to consider incorporating the above withdrawal strategies into your retirement plan. It's important to remember that there is no one-size-fits-all strategy to building the perfect retirement plan. Some people live and die by the 4% rule, for example, which states you should withdraw 4% from your portfolio each year in retirement to live comfortably. But the truth is that this rule is outdated and does not account for an individual's unique needs. If you are older and have other sources of income, the 4% rule could very well work for you. However, if you are just entering retirement, withdrawing 4% per year from your portfolio could quickly deplete your savings and put you at risk of outliving your money.

Every retirement plan should be customized and representative of your full financial picture (Social Security, pensions, savings, inheritances, etc.). Setting annual check-ins with your adviser to review your retirement strategy may help ensure you stay on track to reach your unique goals and needs.

By Brian Walsh Jr.