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TAX DIVERSIFICATION

REDUCING YOUR TAX BILL IN RETIREMENT

Tax diversification is the practice of diversifying assets across different account types with varying tax characteristics. Simply put, it is spreading out your nest egg into multiple baskets to maximize tax efficiency.

ADVANTAGES OF TAX DIVERSIFICATION

The strategy of tax diversification is generally viewed as a way to mitigate tax risk, so you don't share too much of your retirement nest egg with Uncle Sam. Since tax policies are always changing, tax diversification provides the flexibility to withdraw assets from optimal sources at preferred times to help preserve your retirement assets. This strategy can help protect against higher tax rates in the future and improve the longevity of your retirement assets.

TYPES OF ACCOUNTS

Working with your financial professional, you can use different types of accounts to help diversify your retirement assets.

- **Traditional 401(k), 403(b), or IRA:** May offer a tax deduction when you contribute, but you'll have to pay taxes when you withdraw the money in retirement. These accounts require minimum distributions when you reach a certain age.
- **Roth 401(k), 403(b), or IRA:** No tax deduction when you contribute but funds grow tax deferred, and qualified withdrawals are tax free. On Roth IRAs, income limits apply on who can contribute and there are no required minimum distributions during the original owner's life.
- **Taxable savings or brokerage account:** Tax is paid annually on any dividends and interest or capital gains when sold.

COMPARISON OF ACCOUNT TYPES		
CURRENTLY TAXABLE	**TAX DEFERRED**	**TAX FREE**
Created with after-tax proceeds, taxable in the current year or upon sale.	May be funded with both pre and after-tax proceeds. Tax deferred while invested, taxable upon withdrawal.	Created with after-tax proceeds, tax free when withdrawn
• Stocks • Mutual Funds • Bonds • Real Estate • CDs and Money Market	• Qualified Retirement Plans • Annuities • IRAs (traditional, SEP, SIMPLE) • Life Insurance Cash Values (withdrawal)	• Municipal Bonds* • Roth IRAs and 401(k) • 529 Plans • Life Insurance (loans and death benefits)
Pros • Liquidity • No contribution limits • Unlimited investment options • Potential capital gains treatment • Step-up in basis at death (for capital gains)	**Pros** • May provide a tax deduction • More control over taxation through timing withdrawals • Ability to switch investments without tax • Tax deferred growth	**Pros** • Proceeds are generally income tax free • Amounts paid to heirs are income tax free • Growth is tax free
Cons • No tax deduction • Varying tax treatments depending on asset and holding period	**Cons** • Distributions are generally taxed as ordinary income instead of capital gains • Limited liquidity prior to age 59 ½ • Investments may be limited by platform	**Cons** • Contribution limits and rules apply • No tax deduction

* Only bonds from the taxpayer's home state are exempt from federal and state taxes.

TAX DIVERSIFICATION ACTION STEPS

To help you create the retirement of your dreams, a tax diversification strategy is best started years — or decades— before you retire. But even if you're near or already retired, a financial professional can still help manage your tax bill.

- **Assess** — Your financial professional will ask you to locate all types of retirement accounts you may have and determine their current value. Your funds will be divided into three categories: currently taxable, tax deferred, and tax free.
- **Develop a strategy** — Working together, you and your financial professional will create a strategy that helps to determine how much you need to be contributing, provides flexibility in accessing retirement assets, and balance out your tax exposure now and down the road.
- **Monitor and rebalance** — Because markets and needs change, you will meet periodically to rebalance investments and ensure your retirement picture will help you retire on your terms. Your financial professional can help you determine which accounts to tap first during changing tax environments.

HIERARCHY OF SAVINGS AND SPENDING

Taxable Accounts
- Capital gains, then fully taxable

Additional Retirement - IRAs, Roth IRAs, Annuities
- Additional tax advantages up to amount allowed then annuities

Eliminate Low Interest Debt - Car, Student Loans
- Lower interest debt - payment above minimums

Maximize Employer Plan - Retirement Plans
- Contribute the most allowed under the contribution limits
- Take full advantage of amount allowed under the law

Eliminate High Interest Debt - Credit Cards
- Any high interest debt - payment above minimums

Take Advantage of Matching - Retirement Plans
- Employer-sponsored retirement plans up to the match
- Make contributions at least up to the matching amount

Employer Benefits (if applicable)
- Health savings account
- Tax-advantaged growth, potential employer contributions, tax free for health expenses, can be used for retirement at 65

Immediate Need - Emergency Savings
- Liquid account

PAYING YOUR FAIR SHARE

When it comes to taxes, Uncle Sam will always get his portion. By using tax diversification strategies, you and your financial professional can help ensure he only gets what is necessary and your retirement assets last a lifetime. Contact your financial professional and start planning today.

When it comes to preparing for your future, there's no time like the present.

Let's get started today.

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