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Tax Efficiency

Retirement Savings Worksheet

NATIONWIDE RETIREMENT INSTITUTE®

Are you planning for a tax-efficient retirement?

When we retire, many of us will have put aside a set amount of **retirement savings** that will have to last us the rest of our lives.

Fortunately, most of us will also have **Social Security** benefits as an inflation-adjusted income stream to supplement those savings.

Some of us may also have a **pension**, although that number of workers is shrinking.

Research shows that minimizing one's tax bill can add years to retirement portfolio longevity.[1]

So how do we do that?

We can take steps as we accumulate retirement savings, as well as when we start spending our savings, to reduce the bite of taxes. It all starts with understanding how different sources of retirement income are taxed.

Minimize taxes with tax diversification

A tax diversification strategy can help you in retirement by providing flexibility in how you draw income.

You may reap considerable tax savings by avoiding income sources with higher tax rates.

Income sources fall into three buckets.

Taxable

Taxable accounts are taxed on distributed dividends or interest, which is why you might get a 1099-INT tax form for the interest earned on a savings account: That interest is taxable in the year it is accrued. The other way an account is considered taxable is when a capital gain is realized, such as when you sell a stock at a profit. That gain is also taxable in the year it is realized.

- **Investments (stocks, most bonds, CDs)**
- **Cash accounts (savings and money market)**
- **Taxable portion of Social Security benefits**
- **Profit from selling a primary home**

Tax-deferred

Tax-deferred accounts are funded with pretax deductions from your paycheck. These accounts accumulate over time, often also growing through investment. The money is used for income later in life, usually after wages have stopped. Taxation is deferred to when you withdraw.

- **Pension**
- **Retirement savings**
  - 401(k)
  - 403(b)
  - 457(b)
- **Traditional IRA**
- **Some annuities**

Tax-free

Tax-free accounts are often funded with income that has already been taxed, and so it will not be taxed when you withdraw it. (An exception is a health savings account, or HSA, which is funded with pretax dollars.)

- **Retirement savings**
  - Roth 401(k)
  - Roth 457(b)
  - Roth IRA
- **Cash value life insurance**
- **Certain municipal bonds**
- **Health reimbursement arrangement (HRA)**
- **Health savings account (HSA)**
- **Nontaxable Social Security benefits**

Do you have assets in all three of these buckets?

Having tax diversification in retirement can give you the flexibility to manage your retirement cash flow.

Taxable accounts

When sold, investments may generate short- or long-term capital gains.

Short-term capital gains are gains on the sale of an investment purchased less than 12 months prior to the sale. They are taxed as ordinary income.

Long-term capital gains have their own tax brackets and are based on the profitable sale of an investment held for one year or longer.

What counts as long-term capital gains:

- Gains from the sale of stock or mutual funds
- Qualified dividend income from stocks
- Gains from the sale of a business
- Gains from the sale of real estate
  - *Note that capital gains generated from the sale of your primary residence (up to $250,000 for single filers and $500,000 for a married couple filing jointly) may be exempt from capital gains taxes*

2021 long-term capital gains tax

Filing status	Total taxable income[2]	LTCG tax rate
Single	$0 - $40,400	0%
	$40,401 - $445,850	15%
	Over $445,850	20%
Married filing jointly	$0 - $80,800	0%
	$80,801 - $501,600	15%
	Over $501,600	20%

Generally not taxable

Cost basis:

When you sell an investment, you'll get taxed on your investment gains, but not on the amount you used to purchase the investment (cost basis).

Withdrawals from savings accounts and CDs:

The amount you invested (and any interest on which you have already paid taxes) is not taxable income.

Having a mixture of taxable, tax-deferred and tax-free accounts could offer more tax flexibility in retirement.

Tax-deferred accounts

Distributions from tax-deferred accounts are taxed as ordinary income.

What counts as ordinary income:

- Wages
- Interest income from savings and CDs
- Income payments from taxable bonds
- Short-term capital gains
- Pensions
- Up to 85% of Social Security benefits
- Distributions from tax-deferred retirement accounts

2021 marginal tax brackets on ordinary income

Rate	Single filer taxable income	Married filing jointly taxable income
10%	$0 - $9,950	$0 - $19,900
12%	$9,951 - $40,525	$19,901 - $81,050
22%	$40,526 - $86,375	$81,051 - $172,750
24%	$86,376 - $164,925	$172,751 - $329,850
32%	$164,926 - $209,425	$329,851 - $418,850
35%	$209,426 - $523,600	$418,851 - $628,300
37%	Over $523,600	Over $628,300
	Standard deduction: $12,550 If over 65: $14,250	Standard deduction per couple: $25,100 If both over 65: $27,800

Generally not taxable

Investment in a nonqualified annuity:

The return of your investment in a nonqualified annuity is not taxable income. However, the gains must be taxed before you get to withdraw your investment.

When a nonqualified annuity is annuitized[3] and turned into a stream of income, each payment is considered partially a return of investment and partially gains.

Tax-free accounts

Distributions from tax-free accounts are generally not taxable. This includes:

Qualified distributions from Roth accounts:

To be qualified, the withdrawal must be taken after you have attained age 59½, and you must have held the account for at least five years.

Loans and withdrawals from a cash value life insurance policy:

Loan amounts are not taxable. Withdrawals made from your investment in the contract (cost basis) are not taxable. But if you exhaust the basis and withdraw gains on the policy, that may be considered ordinary income.

Note that if your life insurance policy is considered a Modified Endowment Contract (MEC), gains will have to be taxed before you receive your cost basis.

Diverse retirement income sources may help you pay less tax

In 2021, two couples decide to take their grandkids to the Grand Canyon.

For each couple, the trip will cost

$10,000

But before they go, both couples need to pay contractors for home renovations. To cover this one-time expense, each couple needs another

$10,000

So each couple needs

$20,000

on top of their usual retirement income.

Let's assume each couple normally draws $100,000 of retirement income per year, so they'll need a total of

$120,000

(Continued on next page)

As a reminder, each couple needs a total of

$120,000

Couple 1 decides to take the extra $20,000 out of the same account as the $100,000 for their retirement income — that is, their tax-deferred 401(k).

After their standard deduction of $27,800, ***this means $92,200 will be taxed.***

Taxable bracket	Tax rate	Amount taxed	Tax due
$0 – $19,900	10%	$19,900	$1,990
$19,901 – $81,050	12%	$61,150	$7,338
$81,051 – $172,750	22%	**$11,150**	**$2,453**
			Total: $11,781

$92,200 - $81,050 = $11,150 x 22% = $2,453

Couple 2 has some account diversity, including a savings account and a Roth IRA. They withdraw $10,000 tax free from the Roth and another $10,000 from savings for the renovations.

They withdraw only $100,000 from their tax-deferred account, ***of which $72,200 will be taxed.***

Taxable bracket	Tax rate	Amount taxed	Tax due
$0 – $19,900	10%	$19,900	$1,990
$19,901 – $81,050	12%	**$52,300**	**$6,276**
			Total: $8,266

$72,200 - $19,900 = $52,300 x 12% = $6,276

Couple 1 owes $11,781 in tax, whereas Couple 2 owes $8,266.

Couple 2 will pay $3,515 less in tax for 2021.

So for expenses like these, it was helpful that they had the option of making tax-free withdrawals.

Retirement Savings Worksheet

Use this worksheet to list your retirement savings and investments.

It may reveal where there are opportunities to diversify your asset location.

Taxable accounts

Savings/Money Market	$ 0.00
Certificates of Deposit	$ 0.00
Traditional brokerage	$ 0.00
TOTAL:	**$ 0.00**

Taxable accounts percentage of total retirement savings: **0%**

Tax-deferred accounts

Traditional 401(k)/403(b)/457(b)	$ 0.00
Traditional IRA	$ 0.00
Pensions	$ 0.00
Nonqualified Deferred Comp	$ 0.00
Nonqualified Annuities[4]	$ 0.00
TOTAL:	**$ 0.00**

Tax-deferred accounts percentage of total retirement savings: **0%**

Tax-free accounts

Roth 401(k)/403(b)/457(b)	$ 0.00
Roth IRA	$ 0.00
Health Savings Accounts	$ 0.00
Life Insurance Cash Value[5]	$ 0.00
TOTAL:	**$ 0.00**

Tax-free accounts percentage of total retirement savings: **0%**

TOTAL RETIREMENT SAVINGS: $ 0.00

Share this sheet with your financial professional,
who can help you take any needed steps to adjust your balance of retirement income sources.

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[1] "Tax-Efficient Withdrawal Strategies," T. Rowe Price Insights On Retirement (2020).

[2] Your tax rate on long-term capital gains may be based on both your investment gain(s) as well as your ordinary income. Please consult a tax advisor for details.

[3] Annuitization is the process of converting your annuity contract into a guaranteed stream of income. This allows you to start receiving money from your annuity through recurring income payments over a specified period of time or for the rest of your life. Please note that all guarantees are subject to the claims-paying ability of the issuing insurance company.

[4] Note that nonqualified annuities are funded with after-tax dollars. See Page 4 of this brochure for more details.

[5] Investment growth in life insurance contracts is taxable after the return of investment. See Page 4 of this brochure for more details.

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