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NATIONWIDE RETIREMENT INSTITUTE®

Tax-efficient Retirement Income

A basic tax overview

Important things to keep in mind

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Investing involves risk, including the loss of principal. Share price, principal value and return on investments will vary, and investors may have a gain or loss when selling their investments.

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Nationwide Retirement Institute®

Education and insights

Tools

Consultative support

Advisors tell us their clients' most frequent concerns:

80% worry about maintaining their lifestyle in retirement[1]

78% are concerned about outliving their retirement income[1]

72% are concerned about health care costs in retirement[1]

[1] "Which of the Following Financial Concerns Do Your Clients Most Frequently Express?", Nationwide Retirement Income Planning Survey conducted by Harris Poll (Q4 2017).

Responsibility of retirement funding has shifted to individuals

Only one in four have a pension and retiree health care benefits[1]

Health care and long-term care costs are difficult to determine

The future of Social Security is uncertain

[1] "State of the Insured Retirement Industry: 2016 Review and 2017 Outlook," Insured Retirement Institute (December 2016).

Other risks that can impact retirement income

Longevity

Market volatility

Inflation

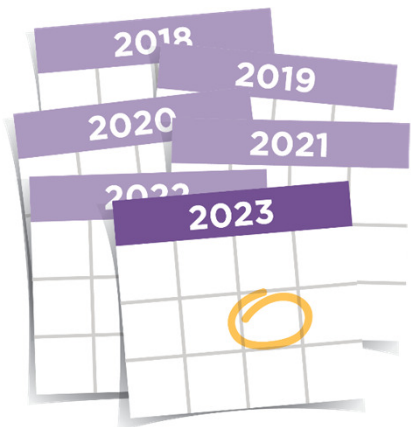
Taxes

Today's retirees typically follow a predictable pattern[1]

1. Take Social Security as early as possible
2. Withdraw from nonqualified accounts
3. Withdraw from qualified accounts, such as IRAs or 401(k)s, when needed/required

[1] "Longevity Risk and Retirement Income Tax Efficiency: A Location Spending Rate Puzzle," Huaxiong and Milevsky (April 20, 2016).

Tax-efficient retirement income strategies can help advisors attract and retain new clients



A tax-efficient income strategy can add tens of thousands of dollars to the estate value and may add up to **6 additional years of portfolio longevity**.[1]

[1] "Tax-Efficient Withdrawal Strategies," Cook, Meyer and Reichenstein, CFA Institute Publication Vol. 71, No. 2 (2015).

Tax basics

Tax basics

How income is characterized

Tax treatment by investment account type (tax deferred, tax free and taxable)

Impact of other income streams, such as Social Security

How income is characterized

Tax treatment varies by income type

Ordinary income

Long-term capital gains

Investment and retirement income characterized as ordinary income

- Distributions from traditional IRAs and qualified retirement plans
- Short-term capital gains (gains from investments held for less than one year)
- Dividends that are not qualified dividends
- Most taxable interest
- Income from money markets and nonqualified distributions from Roth accounts
- Taxable amount of nonqualified annuity distributions
- Taxable amount of life insurance withdrawals
- Social Security payments (depends on total income)

This list is not exhaustive.

2020 ordinary income tax bracket

	Single	Married filing jointly
10%	Not over $9,875	Not over $19,750
12%	Over $9,875 – but not over $40,125	Over $19,750 but not over $80,250
22%	Over $40,125 – but not over $85,525	Over $80,250 but not over $171,050
24%	Over $85,525 – but not over $163,300	Over $171,050 but not over $326,600
32%	Over $163,300– but not over $207,350	Over $326,600 but not over $414,700
35%	Over $207,350 – but not over $518,400	Over $414,700 but not over $622,050
37%	Over $518,400	Over $622,050

IRS Rev. Proc. 2019-44

Capital gain or loss

The difference between the basis (original investment) in a capital asset — such as a home or stocks and bonds held as investments — and the gain or loss realized from its sale.

Keep in mind that the tax code offers exclusions for certain types of capital gain or restrictions on losses — for example, the sale of a primary home.

For more information, visit www.irs.gov/taxtopics/tc409

Investment income characterized as long-term capital gains

- Gains from investments sold that were held for more than 12 months
- Qualified dividends, such as common stock dividends
- Investments held within a qualified plan are taxed as ordinary income

2020 long-term capital gains tax rates

Long-term capital gains rate[1]	Single filer	Married filing jointly
0%	Up to $40,000	Up to $80,000
15%	$40,000 – 441,450	$80,000 – $496,600
20%	Over $441,450	Over $496,600

IRS Rev. Proc. 2019-44

Tax treatment varies by investment account type:

Tax-deferred investment accounts
Traditional IRAs, qualified retirement plans and nonqualified annuities; tax not paid until withdrawn

Tax-free investment accounts
Roth IRAs, life insurance and health savings accounts (HSAs), provided certain qualifications are met

Taxable investment accounts
Stocks, bonds, etc., held within a brokerage account; tax paid as it occurs in the account

Tax-deferred investment accounts

Contributions

- Pretax (deductible)
- After-tax (nondeductible)
- Not permitted after age 70½

Growth

- Tax deferred

Withdrawals

- Generally taxable as ordinary income
- Permitted without penalty after age 59½
- Required after age 70½
- Basis (if any) pro-rated

Individual retirement account (IRA)

Individuals can contribute to a traditional IRA each year. All, a portion or none of the contributions may be tax deductible, depending on whether the client or their spouse is covered by an employer retirement plan — e.g., 401(k) or 403(b) — and their income.

Filing status	Contribution limit	Deductible limit if covered by employer's retirement plan — phase-out limits	
		From	To
Single/head of household	$6,000*	$65,000	$75,000
Qualifying widow(er)	$6,000*	$104,000	$124,000
Married, filing jointly and only you are in employer plan	$6,000*	$104,000	$124,000
Married, filing jointly and only your spouse is in employer plan	$6,000*	$196,000	$206,000

* Plus $1,000 if age 50 or older. Note that the annual contribution to all traditional and Roth IRAs cannot exceed the contribution limit shown above. For more information, visit www.irs.gov/retirement-plans/individual-retirement-arrangements-iras.

Employer-sponsored retirement plans

- Employer-sponsored IRAs
  - SEP (simplified employee pension) / SEP IRA
  - SIMPLE IRA
- Qualified plans under IRS Code section 401(a)
  - Profit-sharing plan with or without cash
  - Deferred arrangement (401(k) deferrals), matching or nonelective contributions by the employer
  - Money purchase pension plan (mandatory fixed annual contribution)
  - Cash balance (hybrid — the employer bears the market risk; agrees to make annual contributions and credit a certain rate of interest thereon)
  - Traditional defined benefit

Employer-sponsored retirement plans

- 403(b) plans
  - Similar to a 401(k) plan in that employees can defer their own compensation
  - There may be nonelective contributions by the employer
  - Can be sponsored only by public education organizations and 501(c)(3) organizations
- Eligible deferred compensation plan – 457(b)
  - Can be sponsored only by a governmental unit for all employees
  - Tax-exempt entities may also offer this type of plan but only for a select group of management or highly compensated employees (top hat plan)
  - Similar to a 401(k) and 403(b) plan with some minor variations

For more information, visit www.irs.gov/retirement-plans/irc-457b-deferred-compensation-plans

Qualified pretax accounts

Required minimum distributions (RMDs)

- Apply to:
  - Traditional IRAs
  - Qualified plans under 401(k) and 403(b)
  - Governmental deferred compensation plans under 457(b)
- A prudent retirement income plan will account for both the timing and amount of RMDs

RMD aggregation rules for account owners only

IRAs

Can be aggregated only with other IRAs*

403(b)s

Can be aggregated only with other 403(b)s

Other qualified plans

Cannot be aggregated with other qualified plans or IRAs or 403(b)s

Therefore, an RMD must be taken from each qualified plan.

* Your clients may not aggregate their own IRA with an inherited IRA.

Qualified pretax accounts

RMD rules

Traditional IRAs (including SEP and SIMPLE plans)

Frequency	Beginning	Notes
Annual	No later than April 1 of the year after attaining age 72	If clients wait until after December 31 of the year after they turn 72, two RMDs will need to be taken for that calendar year

Prior to 2020 the required beginning date was April 1 of the year after attaining age 70 ½. SECURE Act changed it to age 72.

For more information, visit www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions.

Qualified pretax accounts

RMD rules (cont'd)

401(a), 403(b) and governmental 457 plans

Frequency	Beginning	Notes
Annual	No later than April 1 of the year after attaining age 72 **OR** No later than April 1 of the year after the employee retires from working for the plan sponsor	"Still working" exception does **not** apply to: • Individuals with more than 5% ownership • IRAs • Qualified plans of previous employers

Prior to 2020 the required beginning date was April 1 of the year after attaining age 70 ½. SECURE Act changed it to age 72.

For more information, visit www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions.

Tax-deferred nonqualified annuity

High-income taxpayers

- Tax-deferred growth
- No contribution limits
- Ordinary income
- No RMDs

All protections and guarantees are subject to the claims-paying ability of the issuing insurance company.

Tax-free investment accounts

- Qualified Roth IRA distributions
- Interest from tax-exempt bonds
- Certain withdrawals from life insurance
- Qualified HSA withdrawals

However, tax-free income could impact the taxation of Social Security income.

2020 Roth IRA overview

Contributions	Growth	Withdrawals

After tax	Tax deferred	• No RMD for Roth IRA
		• RMD for Roth 401(k) at 70½
		• Tax free under certain conditions:
		  - Owner is over 59½
		  - Owner has had at least one Roth continually for at least five years immediately prior

Roth IRA

- ☑ $6,000 contribution amount
- ☑ $1,000 catch-up
- ☑ Income limits vary by filing status
- ☑ Both Roth account types offer tax-free distributions

Other Roth account types

- ☑ $19,500 salary deferral
- ☑ $6,500 over age 50 catch-up

Roth IRA

Taxation of withdrawals

- First-in, first-out principle:
  1. Contributions
  2. Converted amounts
  3. Earnings
- Conditions for a tax-free withdrawal of earnings:
  - The owner is over age 59½
  - The owner has had the Roth IRA for over five years
- Roth 401(k) distributions are done pro-rata

Taxable investment accounts

- Funded with after-tax money
- Cost basis is not taxable
- Earnings may be treated as ordinary income, capital gains or tax-free income depending on the investment product used

Taxation on investments by product type

	Short-term capital gain or loss (held <1 year)	Ordinary or nonqualified dividends	Taxable interest	Federal interest	Long-term capital gain or loss (held ≥1 year)	Qualified dividends	Tax-exempt interest
Type of income/event	Ordinary income				Long-term capital gains		Nontaxable income
Stock sale	✓				✓		
Stock dividend		✓			✓		
Corporate bond interest			✓				
Corporate bond sale	✓				✓		
Federal gov't securities interest				✓			
Federal gov't securities sale	✓				✓		

Taxation on investments by product type (cont'd)

	Short-term capital gain or loss (held <1 year)	Ordinary or nonqualified dividends	Taxable interest	Federal interest	Long-term capital gain or loss (held ≥1 year)	Qualified dividends	Tax-exempt interest
Type of income/event	Ordinary income				Long-term capital gains		Nontaxable
Tax-exempt bond interest							✓
Tax-exempt bond sale	✓				✓		
CD interest			✓				
Mutual fund sale	✓	✓			✓	✓	
ETF sale	✓	✓			✓	✓	
Deferred annuity distributions		✓					
Immediate annuity distributions		✓					

Impact of other income streams, such as Social Security

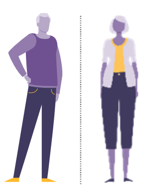
Social Security benefits are taxed based on "provisional income"

Gross income not including Social Security + Tax-exempt interest income (e.g., interest on municipal bonds) + Excluded foreign income + 50% of Social Security benefits = **Provisional income[1]**

[1] 2015 Internal Revenue Service Publication 915 — Worksheet A (2017)

Taxation of Social Security benefit





Filing status	Base amount	Provisional income[1] ranges	Percentage of Social Security benefit that is taxable
Individual [single, head of house hold, qualifying widow(er) or married filing separately and lived apart from spouse for entire calendar year]	$25,000	Up to $25,000 $25,000 – $34,000 Above $34,000	0% 50% 85%
Married filing jointly	$32,000	Up to $32,000 $32,000 – $44,000 Above $44,000	0% 50% 85%
Married filing separately (but lived together at any point during the year)	N/A	N/A	85%

[1] SocialSecurity.gov

Taxation of Social Security benefit — Example 1

Gross income not including Social Security + Tax-exempt interest income (e.g., interest on municipal bonds) + Excluded foreign income + 50% of Social Security benefits = **Provisional income[1]**

$47,000 + **$30,000 x 50% = $15,000** = **$62,000**

Filing status	Base amount	Provisional income[1] ranges	Example: $62,000 provisional income	Percentage of Social Security benefit that is taxable	Dollar amount of taxable Social Security income	Total of Social Security income that is subject to ordinary income tax[2]
Married filing jointly	$32,000	Up to $32,000	$32,000	0%	$0	
		$32,000 – $44,000	$12,000	50%	$6,000	
		$44,000 – $62,000	$18,000	85%	$15,300 →	**$21,300**

[1] SocialSecurity.gov

[2] "The Taxation of Social Security Benefits as a Marginal Tax Rate Increase?", Michael Kitces (March 2013).

Taxation of Social Security benefit — Example 2

Gross income not including Social Security + Tax-exempt interest income (e.g., interest on municipal bonds) + Excluded foreign income + 50% of Social Security benefits = **Provisional income[1]**

$52,000 (gross income + tax-exempt interest + excluded foreign income)

$20,000 x 50% = $10,000 (50% of Social Security benefits)

$62,000 (provisional income)

Filing status	Base amount	Provisional income[1] ranges	Example: $62,000 provisional income	Percentage of Social Security benefit that is taxable	Amount of taxable Social Security income	Total of Social Security income that is subject to ordinary income tax[2]
Married filing jointly	$32,000	Up to $32,000	$32,000	0%	$0	
		$32,000 – $44,000	$12,000	50%	$6,000	
		$44,000 – $62,000	$18,000	85%	$15,300	~~$21,300~~

[1] SocialSecurity.gov

[2] "The Taxation of Social Security Benefits as a Marginal Tax Rate Increase?", Michael Kitces (March 2013).

Taxation of Social Security benefit — Example 2, cont'd

Filing status	Base amount	Provisional income[1] ranges	Percentage of Social Security benefit that is taxable
Married filing jointly	$32,000	Up to $32,000 $32,000 – $44,000 $44,000+	0% 50% **85%**

$20,000 x 85% = $17,000

[1] SocialSecurity.gov

[2] "The Taxation of Social Security Benefits as a Marginal Tax Rate Increase?", Michael Kitces (March 2013).

Summary

Tax diversification gives clients options.

Another 1-hour CE course:

• planning opportunities

* sequencing strategies

Get in touch

Contact the Nationwide Retirement Income Planning Team for help with leveraging your existing analytical tools to identify a tax-efficient distribution strategy for your clients.

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