Tax-Efficient DrawDown™ Strategies

2012 Income Tax Brackets

	Single	Married Filing Jointly	Married Filing Separately	Head of Household
10%	$8,700	$17,400	$8,700	$12,400
15%	$35,350	$70,700	$35,350	$47,350
25%	$85,650	$142,700	$71,350	$122,300
28%	$178,650	$217,450	$108,725	$198,050
33%	$388,350	$388,350	$194,175	$388,350
35%	> $388,350	> $388,350	> $194,175	> $388,350

Three Main Types of Retirement Investment Accounts

1. *<u>Taxable investment accounts</u>* – income generated within the account (i.e. interest, dividends, capital gains, etc.) is taxed each year to the account owner
2. *<u>Tax-deferred investment accounts</u> (e.g. traditional IRAs, traditional qualified retirement plans, non-qualified annuities)* – income generated within the account is **<u>not taxed</u>** until distributions are taken from the account
3. *<u>Tax-free investment accounts (e.g. Roth IRAs, life insurance)</u>* – income generated within the account is **<u>never taxed</u>** when distributions are made (provided certain qualifications are met)

Top Ten Tax-Efficient Retirement Portfolio Strategies

1. Capital loss harvesting
2. Tactical asset sales/specific identification method
3. Tax-exempt interest
4. Tax-deferred annuities
5. Life insurance
6. Oil & gas investments
7. Leveraged real estate investments
8. Net Unrealized Appreciation (NUA)
9. Tax-efficient DrawDown™
10. Roth IRA conversions

Key DrawDown™ Concepts

1. **<u>Tax structure</u>** – Determining the "optimum" mix of taxable investments, tax-deferred investments and tax-free investments (i.e. where should retirement savings be invested?)
2. **<u>Tax-sensitive asset allocation</u>** – Asset allocation done on an after-tax basis
3. **<u>Asset location</u>** – How investors distribute assets across taxable accounts, tax-deferred accounts and tax-exempt accounts to create tax advantages
4. **<u>Tax bracket management</u>** – Short-term timing of income and expenses on a year-by-year basis so as to minimize overall income taxes over the long-term
5. **<u>Tax Alpha</u>™ –** The improvement in portfolio returns produced by efficient income tax management

Tax Structure Overview

Key factors impacting the tax structure

- Age
- Other sources of income (e.g. pension, Social Security, deferred compensation)
- Retirement cash flow needs
- Future tax rates

Tax-Efficient DrawDown™ Decision Matrix

Future income taxed at same or lower tax rate	Future income taxed at higher tax rate
1) Taxable account 2) Tax-deferred account 3) Tax-free account	1) Tax-deferred account 2) Taxable account 3) Tax-free account

Basis Recovery of Retirement Investment Accounts

<u>Accounts which need to be aggregated for basis recovery</u>

- *<u>Roth IRAs</u>* – basis out first
- *<u>Traditional IRAs</u>* – basis pro-rated

<u>Accounts which do not need to be aggregated for basis recovery</u>

- *<u>Life insurance</u>* – basis out first
- *<u>Qualified retirement plans (e.g. 401(k) plan)</u>* – basis pro-rated
- *<u>Non-qualified deferred annuities (annuitized)</u>* – basis pro-rated
- *<u>Non-qualified deferred annuities (not annuitized)</u>* – basis out last

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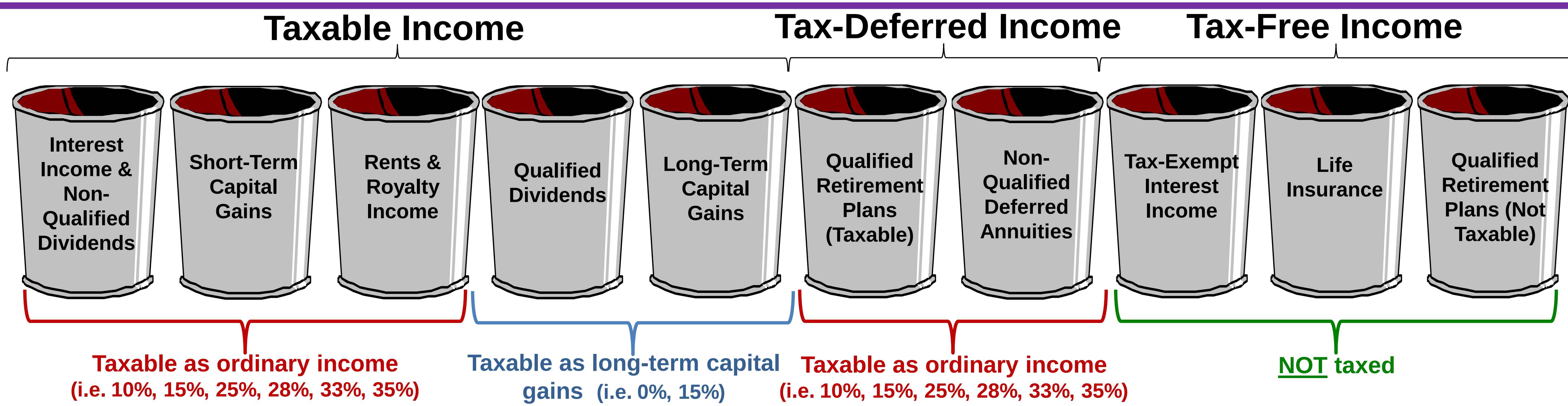
Tax Asset Classes℠



	Interest Income & Non-Qualified Dividends	Short-Term Capital Gains	Rents & Royalty Income	Qualified Dividends	Long-Term Capital Gains	Qualified Retirement Plans (Taxable)	Non-Qualified Deferred Annuities	Tax-Exempt Interest Income	Life Insurance	Qualified Retirement Plans (Not Taxable)
Examples	• Bank interest • Money market interest • Corporate bond interest • Corporate dividends which do not meet specific qualifications	• Gains from investment assets which are held 1 year or less at the time of sale	• Rental real estate income • Limited partnership income • Royalties from patents, copyrights, etc. • Oil & gas income	• Corporate (both domestic and foreign) which meet specific qualifications	• Gains from investment assets which are held more than 1 year from the time of sale	• Traditional 401(k) plans • 403(b) annuities • 457 plans • Defined benefit plans • Traditional IRAs	• Annuities which do not meet specific requirements	• Interest from state and local government bonds • Interest from U.S. territory bonds (e.g. Puerto Rico, Guam, USVI)	• Whole life insurance • Universal life insurance • Term life insurance	• Designated Roth accounts within a qualified retirement plan • Roth IRAs
Losses offset other ordinary income	No	Yes, but only up to $3,000 losses (in excess of capital gains)	Yes, but losses may be limited under the passive activity rules	No	Yes, but only up to $3,000 losses (in excess of capital gains)	Yes, but losses are miscellaneous itemized deductions subject to the 2% AGI floor	Yes, but losses are miscellaneous itemized deductions subject to the 2% AGI floor	No	No	Yes, but losses are miscellaneous itemized deductions subject to the 2% AGI floor
Deferral of income taxation?	No	Yes, until the asset is sold	No	No	Yes, until the asset is sold	Yes, until distributions are made	Yes, until distributions are made	No	Yes	Yes
Other considerations	• May include income imputed under IRC §7872 or the Original Issue Discount (OID) rules	• Reduced by short-term capital losses • Excess long-term capital losses may offset short-term capital gains	• Depreciation • Depletion • Amortization • Intangible drilling costs (IDCs) • IRC §1031 exchanges	• Special long-term capital gains tax treatment is set to expire for tax years after 12/31/2012	• Special tax rates apply to depreciation recapture, collectibles gains and qualified small business stock	• Required minimum distributions (RMDs) at age 70½ • 10% early withdrawal penalty on pre-59½ distributions	• If annuity is not annuitized, then taxable income comes out first before non-taxable basis	• Need to compare rate of return against after-tax rate of return on taxable bonds	• Gross income does not include proceeds paid • Taxable income could occur if there is a "transfer for value"	• No required minimum distributions (RMDs) – Roth IRAs only • Need to meet certain criteria to be tax-free