Coordination Stats and Facts

Social Security Solutions
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Our research shows the proper coordination of Social Security with the overall retirement plan can add anywhere from two to 10 years of longevity to the portfolio — a material amount.

The following list of terms is a great place to start when understanding the strategy, the returns it can generate and the income it provides.

Coordination

It might sound like a pre-requisite for a varsity sports team, but it actually refers to the inclusion of Social Security in the retirement portfolio and the tax-efficient withdrawal strategies that result. Social Security is *the largest retirement asset* for an increasing number of Americans, and therefore must be accounted for in the overall retirement income plan. To do otherwise is—quite simply—a major fiduciary fail.

Taxable accounts

It might seem obvious, but we include it for the purposes of common understanding. The taxable status of an investment account refers to whether any income earned in the account is taxable at the time of earning. Examples include cash accounts, high-interest savings accounts and mutual funds.[1]

Non-taxable (tax-deferred) accounts

It ain't rocket science. We're talking 401(k)s, IRAs and deferred annuities, to name a few. Assets within the account grow tax-free until they are withdrawn, or in the case of a Roth IRA, grown and withdrawn tax-free.

Annuity

A financial product sold by financial institutions that is designed to accept and grow funds on behalf of an individual and then, upon annuitization, pay out a stream of payments to the individual at a later point in time. Annuities are primarily used as a means of securing a steady cash flow for an individual during their retirement years.[2]

Net present value (NPV)

The present value of an investment's future net cash flows minus the initial investment. If positive, the investment should be made (unless an even better investment exists), otherwise it should not. Ignore the gobbledygook—it simply means that if the return is positive, NPV thinks you should make the investment.

Required minimum distribution (RMD)

The government, like the mob, wants their cut. The required minimum distribution is the minimum amount a person must withdraw from their account each year. They generally have to start taking withdrawals from their IRA or retirement plan account when they reach age 70½. Roth IRAs do not require withdrawals until after the death of the owner.[3]

Sequence of withdrawal

Incredibly important, and not what you think. This one takes a bit more to explain. Conventional wisdom dictates that retirees maximize income and minimize taxes by withdrawing assets from their taxable accounts first, their tax-deferred accounts (e.g., traditional IRA, 401(k)) second and their tax-exempt accounts (such as a Roth IRA) third.

But just because it's conventional doesn't mean it's wise. A large percentage of the taxable account is its basis, or a return of principal, and therefore not taxed. Consider a retiree who has yet to reach age 70½ and therefore has no required minimum distributions. He might be in a 10% or 15% tax bracket with his taxable accounts. But once RMDs begin, he'll jump to 25%.

In early retirement years, he should therefore withdraw funds from tax-deferred accounts to take full advantage of the 15% tax bracket. But it raises the question—why not withdraw from a taxable account since the majority of assets are tax-free anyway? Because he blows the opportunity to take from the tax-deferred account at a 15% (or lower rate). It's better to pay 15% before 70½ than to take these withdrawals after 70½ and pay the higher 25%.

The correct sequence would therefore be to take tax-deferred income first up to the top of the 15% bracket and then taxable income second. After the taxable account is exhausted, he can take tax-deferred income first at the 15% bracket and then withdraw any additional needed funds from his tax-exempt account.

1 Taxable vs Non-Taxable Investment Accounts." abcsofinvesting.net. 2014
2 "Annuity." investopedia.com. 2014
3 "Retirement Plans FAQs regarding Required Minimum Distributions." IRS.gov. Oct. 15, 2014.