Have you Considered the **Impact of Taxes and Volatility** on Your Retirement Savings?

The financial reality we face today brought about by the global pandemic, human rights violations and what's sure to be a flashpoint Presidential election— can negatively affect the economy and potentially, retirement savings.

There are two major factors that could impact many people's retirement income as a result of our current environment. Although both are out of anyone's control, when you understand these two risks, you may choose to use a different strategy that could help mitigate them.

One of the Biggest Expenses in Retirement

There are three commonly discussed expenses in retirement: health care, housing, and taxes.[1]

That being said, taxes is one expense that doesn't seem to get mentioned as often, however, it should be considering the largest source of retirement income—Social Security—is taxable in most cases up to 85% of the benefit[2] (unless it's your only income source). On top of that, your tax bill will be coming due on any tax-deferred retirement income sources such as Traditional IRAs, 401(k)s and pension plans when you take distributions from them in retirement.

You probably know approximately the amount you pay in taxes today, but do you know if taxes will go up or down in the future—when you're ready to retire?

Of course not, no one can predict what will happen in the future, but looking back over time, tax rates have increased. Historically, they've gone up following a large increase in government spending or a decrease in government revenue (e.g., war, economic downturn, bailouts, etc.).[3] Which means, you could fairly assume that taxes will go up in the future.

Here's why:

It's no secret that more government money has been spent and will be spent in 2020 than ever before. Between mass layoffs, unemployment rates skyrocketing, small businesses in trouble and an overloaded healthcare system, trillions of dollars are being spent by the government in aid. This could push total government debt to over $25 trillion.[4]

To further understand the implications of this, we have to look at the impact of a government's financial health on taxpayers. A measurement of a government's financial health used by the World Bank is the debt to Gross Domestic Product (GDP) ratio. A study by the World Bank found governments that hold a higher than 77% debt to GDP ratio for an extended period of time see slowed economic growth and investors become concerned about possible default.[4] The US debt to GDP ratio is projected to be 120% by the end of 2020 and has been over 100% since 2013.[5,6]

“The increase in government spending means growing federal debt and a bigger deficit. The federal deficits over the last 50 years have averaged just 3% of GDP. Even during the Great Recession, the largest deficit recorded (in Fiscal Year 2009) was just 9.8% of GDP. In contrast, the Congressional Budget Office projected in April 2020 that the deficit for Fiscal Year 2020 will be at least $3.7 trillion, or 17.9% of projected GDP, and it could be even larger if Congress approves more spending increases or tax cuts in light of the pandemic.”[7]

To illustrate the impact, we can look at a hypothetical example where an individual saves for 5 years and then takes income for 5 years, assuming a static 6% return on their qualified account. **Scenario 1** assumes tax rates remain the same in retirement. Many people would plan for that and expect to receive $9,368 per year. However, if taxes were to go up by just 5% to 35%, as in **Scenario 2**, the distribution amount in retirement would be 7.1% less, or $8,698.

Taxes

		Scenario 1			Scenario 2		
Year	**Pre-Tax Contribution**	**Tax Rate**	**Pre-Tax**	**Post-Tax**	**Tax Rate**	**Pre-Tax**	**Post-Tax Distribution**
1	10,000	30%	0	0	30%	0	0
2	10,000	30%	0	0	30%	0	0
3	10,000	30%	0	0	30%	0	0
4	10,000	30%	0	0	30%	0	0
5	10,000	30%	0	0	30%	0	0
6	0	30%	13,382	9,368	35%	13,382	8,698
7	0	30%	13,382	9,368	35%	13,382	8,698
8	0	30%	13,382	9,368	35%	13,382	8,698
9	0	30%	13,382	9,368	35%	13,382	8,698
10	0	30%	13,382	9,368	35%	13,382	8,698

Difference in Distribution -7.1%

Not actual results. This hypothetical example is not intended to project the performance of any specific investment or index. It is not possible to invest directly in an index. Keep in mind, if this were an actual product, the returns may be reduced by certain fees and charges. We cannot guarantee the accuracy of this data and it does not apply to any one individual. To see the impact specific to your situation, consult with your professional for an illustration.

While it's true you have no choice but to pay taxes... here's the good news:

You DO have a choice as to WHEN you'll pay them. If you could save even a little on taxes in retirement-- that could have a huge effect on what's available to you in income.

Assuming an average 30% tax bracket, 24% Federal tax and 6% State tax with the taxable equivalent yield of a non-tax increase of 1% being 1.4%, not having to pay the 30% tax bill in retirement at all, would equate to a 42% return on your taxable investment. The taxable equivalent yield (also called equivalent taxable interest rate) is the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment.

If you believe taxes could go up in the future, you may want to consider options that allow you to pay taxes up front and as a result, help reduce this tax hit to your retirement savings.

Another Factor Impacting Your Retirement

Although volatility of the market isn't commonly talked about as an "expense" in retirement, there is a potential for loss. If you've been invested in the market, then you've likely felt the ups and downs over the years. Due to the nature of risk and reward, this is to be expected. Early on in your saving years, it can be less of a concern because there is still time to bounce back. But when you're nearing and in retirement, it's a different story. The losses are felt much more significantly.

Consider what would happen if the market dropped 50%. What would need to happen to get your retirement savings back to where you started?

The market would need to increase 100% to make up that kind of loss (50% to get back to 0 and 50% to get to where you were previously). If you're nearing or in retirement, you may not have time to wait while your retirement savings recoups a loss like this.

The truth is: even if the market recovered somewhat from dramatic drops we saw in March 2020-- it doesn't necessarily mean your retirement savings will get back to where you want it to be when you're ready to start taking income.

If your retirement savings is subject to market volatility, it's important to work with a qualified financial professional to understand how the timing of your distributions can affect the amount you'll receive in retirement.

Timing is Everything

Sequence-of-returns risk, or order of returns risk, is the risk associated with the timing of distributions from investment accounts used for retirement income. Negative market returns early in retirement can adversely impact how long retirement savings will last.

To see how great an impact sequence of returns can have, refer to the hypothetical example below.

Let's consider the same individual as earlier who saves for 5 years and takes income for 5 years. Assume a 30% tax rate in all years. In **Scenario 1**, we'll assume a 6% return in all years. In **Scenario 2**, the returns are variable but still average 6% over the same timeframe.

Sequence of Returns

Year	Pre-Tax Contribution	Scenario 1 Growth	Scenario 1 Pre-Tax	Scenario 1 Post-Tax	Scenario 2 Growth	Scenario 2 Pre-Tax	Scenario 2 Post-Tax Distribution
1	10,000	6%	0	0	18%	0	0
2	10,000	6%	0	0	6%	0	0
3	10,000	6%	0	0	-6%	0	0
4	10,000	6%	0	0	18%	0	0
5	10,000	6%	0	0	-6%	0	0
6	0	6%	13,382	9,368	-6%	11,653	8,157
7	0	6%	13,382	9,368	18%	11,653	8,157
8	0	6%	13,382	9,368	6%	11,653	8,157
9	0	6%	13,382	9,368	-6%	11,653	8,157
10	0	6%	13,382	9,368	18%	11,653	8,157
Average		6%			6%		

Difference in Distribution -12.9%

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In the chart above, the average rate of return was exactly the same, but the sequence of returns caused the income in retirement to be 12.9% less than expected.

When your retirement savings is invested directly in the market and you know the impact of taking distributions during a down market, you may realize you won't be able retire when you initially expected.

Next, we'll look at what a hypothetical example of the impact of increased taxes and sequence of returns on retirement income:

Taxes and Sequence of Returns

		Scenario 1				Scenario 2			
Year	**Pre-Tax Contribution**	**Tax Rate**	**Growth**	**Pre-Tax**	**Post-Tax**	**Tax Rate**	**Growth**	**Pre-Tax**	**Post-Tax**
1	10,000	30%	6%	0	0	30%	18%	0	0
2	10,000	30%	6%	0	0	30%	6%	0	0
3	10,000	30%	6%	0	0	30%	-6%	0	0
4	10,000	30%	6%	0	0	30%	18%	0	0
5	10,000	30%	6%	0	0	30%	-6%	0	0
6	0	30%	6%	13,382	9,368	35%	-6%	11,653	7,575
7	0	30%	6%	13,382	9,368	35%	18%	11,653	7,575
8	0	30%	6%	13,382	9,368	35%	6%	11,653	7,575
9	0	30%	6%	13,382	9,368	35%	-6%	11,653	7,575
10	0	30%	6%	13,382	9,368	35%	18%	11,653	7,575
Average			6%				6%		

Difference in Distribution -19.1%

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However, if delaying retirement is not an option you want to consider, having at least a portion of your savings outside of the market can be beneficial.

Lesser-Known Alternatives for a Portion of Retirement Savings

The problem is NOT that most people aren't using the common retirement savings strategies… the problem is that they ARE using the common retirement savings strategies—ones that put off paying unknown tax rates on both principal and gain until sometime in the future and ones that are subject to the ups and downs of the market as well as sequence of returns risk.

But consider this—Is it fair that you spend years of your life saving as much as possible, not knowing how much you'll be on the hook for in taxes down the road? Is it fair that your retirement lifestyle may be reduced by an unknown amount as a result? Especially when there are other options available that allow you to know what your tax bill is and pay it upfront and be protected from market volatility—potentially putting you much further ahead when you enter retirement.

Those options are Indexed Universal Life insurance and a Roth IRA in a fixed indexed annuity.

Keep in mind, there are underwriting requirements and fees associated with life insurance, including but not limited to cost of insurance and administration fees. A Roth IRA or other qualified plan, like a 401(k), which can hold various types of investments and interest-bearing accounts, may have fees as well.

Here's how these two insurance solutions can specifically address two major factors impacting your retirement income:

Mitigate Taxes

An IUL and a Roth IRA have a variety of benefits and uses and you must be able to qualify for both. An Indexed Universal Life Insurance policy, as with any life insurance, should only be purchased if there is a need for a death benefit. If that's the case, the insured must also pass medical and in some cases, financial underwriting to qualify for the policy. Roth IRA contributions are limited by income level.[9] Consult IRS.gov for current and specific requirements.

They do have one thing common that makes these strategies useful in helping reduce overall taxes in retirement. And it's that the contributions or premium paid into them are after-tax dollars. This means you would be taxed on those contributions or premiums to fund the policy or set up the Roth IRA at your current income tax rate rather than sometime in the future (when you take distributions) at a potentially higher tax rate.

However, it's important to keep in mind that any contributions to a Roth IRA or premiums paid to an IUL, cannot be deducted from your taxable income as contributions from a qualified plan, such as 401(k), would be.

Reduce Exposure to Market Volatility

To help protect your retirement savings from volatility, it makes sense for at least a portion of your retirement savings to be in a vehicle that is not directly invested in the market. This could mean putting retirement savings in an indexed product, such as Indexed Universal Life Insurance or a Roth IRA in a fixed indexed annuity. Being an individual retirement account, a Roth IRA is a type of retirement account than can hold after-tax contributions in several types of investments, both those invested in the market and those not invested in the market.

In an indexed life insurance or annuity product you would not be directly invested in the market, but you can earn interest based on the performance of an underlying index and you are protected from market losses because your credited amount would not be less than 0. In exchange for that protection, there are also limits to the potential growth of the premiums contributed.

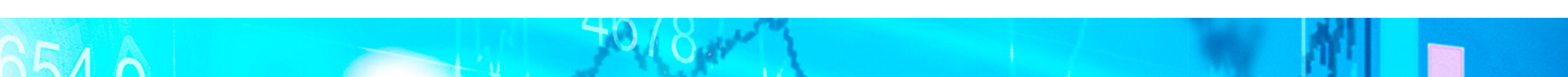
As with any strategy, what's most suitable will depend on your specific situation.

Your Next Step

Interested in learning more about how properly structured strategies such as an Indexed Universal Life Insurance policy or Roth IRA in a fixed indexed annuity could help you potentially save on taxes and minimize the effects of volatility in retirement?

Talk to a qualified financial professional about the options available to you.

Your Name
Company Name
Phone Number
Website
Email Address



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