

Liquidating Retirement Assets in a Tax-Efficient Manner

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May 2002 Analysis

- Audience – Lay but sophisticated investors
- Pre-15 percent tax rates (LTCG, QDivs)
- Roth IRA new, Pre-Roth 401(k) and 403(b)
- Key Assumptions
 - Retiree has other sources of income
 - Zero basis in retirement assets
 - FMV basis in taxable assets
 - Constant income tax rate
 - Zero transfer taxes and transaction costs
- Not considered – asset selection in portfolios

Contributions of the Work

- Three types of assets
 - Taxable [eg Interest, Dividends, Mutual Funds]
 - Tax-Deferred [eg 401(k), traditional IRA]
 - Partially Tax-Deferred [eg equities held outside qualified plans]
- Decision rule to be used within for asset types
 - Liquidate assets from lowest to highest re the Raabe/Toolson Index:

$$\text{R/T Index} = \text{Tax Liability} / \text{Market Value}$$

Simulation Results – Table 1

Pre-Tax Return (%)	Ordinary Tax Rate (%)	Portfolio Advantage, Distribute Taxable then Tax-Deferred
6	15	1.1 years (6.4%)
6	27	1.1 years (7.2%)
8	15	2.1 years (9.9%)
8	27	2.5 years (13.7%)

Corpus \$300K, 50/50 taxable and deferred. Distribute \$20K per year, 3% increase each year. Re taxable account, gross up for tax rate.

General Conclusions

- Draw from taxable account first
- Draw assets from any account from lowest to highest Raabe-Toolson Index
- If planning for zero bequests, next draw from partial-deferral, then deferred account last
- If planning for significant bequests →

	Draw from Partial-Deferral, then Deferred	Draw from Deferred, then Partial-Deferral
Heirs Inc Tax Rate	Low	High
Retiree's Inc Tax Rate	High	Low
Potential Basis Step-Up	Low	High
Will Plan(s) Payments Last Beyond Retiree's Life?	Yes	No

Extending the Work

- Allow for variable retiree income tax rate
- Allow for variable rates of investment return
- Incorporate Required Minimum Distribution Amount rules

