Five Guidelines for Retirement Withdrawals

UNDERSTANDING THE BASICS

FOR INVESTORS

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Your withdrawal decisions can have a crucial impact on your portfolio's long-term prospects, so there are a number of factors you and your financial advisor will want to consider. In addition to maintaining your overall asset allocation and appropriate levels of diversification, you will want to establish a withdrawal rate that will sustain your savings over the long haul. And, of course, you will want to try to reduce taxes.

Fidelity has developed a set of five guidelines to help you create and maintain a personal withdrawal plan that is tax efficient, based on federal income taxes. Bear in mind that these are only general guidelines, because there is no single sequence appropriate for all investors. In some cases, transfer tax planning or other tax issues and planning considerations may lead you to formulate different withdrawal strategies.

Your ultimate decisions should reflect your personal circumstances and take into account any tax and non-tax tradeoffs that may be necessary, so you should also consult a tax advisor to formulate the withdrawal strategy that is best for you.

Note:

It is always important to maintain your investment strategy. Rebalancing is a potential issue, regardless of the source of your withdrawals, but it's especially important when you target withdrawals from a particular asset class. If your planned withdrawals will skew your asset allocation, work with your financial advisor to try to ensure that you can rebalance your portfolio without generating significant capital gains. You may be able to avoid current taxes when rebalancing by exchanging securities within your tax-advantaged accounts.

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Five Guidelines for Retirement Withdrawals

1 **Take your minimum required distributions (MRDs).** If you are age 70½ or older, make sure you know which of your accounts require such distributions and how large these distributions need to be; then meet the deadlines to avoid penalties.

2 **Liquidate loss positions in taxable accounts.** Some investments in your taxable accounts may be worth less than their tax basis (generally the amount you paid to acquire them). In addition to offsetting (netting) realized losses against realized gains, at the federal level you can usually use up to $3,000 ($1,500 for married couples filing separately) of net losses each year to offset ordinary income such as interest, salary, and wages. Unused losses can usually be carried forward for use in future years.

3 **Sell assets in taxable accounts that will generate neither capital gains nor capital losses.** Such assets might include money market funds or other cash-equivalent investments. If your withdrawals come largely from cash-equivalent investments, be sure to leave sufficient liquid assets intact to cover any short-term financial emergencies, and be especially mindful of potential rebalancing issues (as discussed on the previous page).

4 **Withdraw money from taxable accounts or tax-deferred saving vehicles funded with at least some nondeductible (or after-tax) contributions, such as variable annuities and traditional IRAs.** Fidelity's research has found that the choice depends on the circumstances and, in some cases, it might make more sense to tap the tax-deferred vehicle first. Assuming there is a significant difference in the basis-to-value ratio of the assets to be liquidated in two accounts (in other words, the tax basis of the assets divided by their current value), the best tactic for choosing between these two types of withdrawals often is to liquidate the assets with the higher ratio – that is, the assets that have generated the smallest gain or the largest loss as a percentage of their basis. If the basis-to-value ratio of the assets to be liquidated in each account is relatively low as a percentage of their basis, as in the case of significant investment gains, often it will be preferable to liquidate the assets in the taxable account. Conversely, if the basis-to-value ratio of the assets to be liquidated in each account is relatively high, it may be preferable to liquidate assets in the tax-deferred account. Note that tax-deferred accounts are generally subject to certain aggregation requirements when allocating basis. Consult your tax advisor for additional details.

When liquidating gain positions in taxable accounts, it usually makes sense to sell assets with long-term capital gains first, because they should be taxed at lower rates than short-term gains are. In addition, consider liquidating assets that are likely to generate smaller taxable gains when expressed in dollar terms. If you are thinking of leaving assets to beneficiaries, this fourth guideline may not serve you well. **See the note on estate planning on the next page.**

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Withdraw money from tax-deferred accounts funded with deductible (or pretax) contributions such as 401(k)s and traditional IRAs or tax-exempt accounts such as Roth IRAs. Fidelity's research suggests that, contrary to popular wisdom, it may not make much difference which account you tap first within this category assuming (1) all withdrawals from any tax-deferred accounts funded with fully deductible (or pretax) contributions are taxed at the same rate throughout your retirement and (2) when you withdraw money from the tax-deferred account funded with fully deductible (or pretax) contributions, you'll have to take out enough to cover taxes. As a result, you'll have less money continuing to grow on your behalf than if you had taken a qualified tax-exempt distribution of a smaller sum from a tax-exempt account.

If you believe that withdrawals you make may be subject to different tax rates over the course of your retirement (for example, based on changes to tax laws or to your level of income), you may be better off liquidating one type of account described in this fifth guideline before another. For example, it may make more sense to leave your Roth account intact if you think your ordinary income tax rate is likely to rise in later years, increasing the value of the Roth's tax exemption. Estate planning considerations may also significantly impact this guideline as detailed below.

A note on estate planning

If your primary concern is leaving assets to beneficiaries, then with respect to the fourth guideline, you may want to avoid selling assets in taxable accounts that have risen significantly in value. Under current federal tax law, beneficiaries of securities held in taxable accounts will usually receive a stepped-up cost basis (the adjusted purchase price of an asset assumed for calculating gains or losses) that usually equals the assets' market value when you die. This means that they shouldn't have to pay taxes on gains that accrued during your lifetime, so selling such assets now might expose you, your estate, and/or your heirs to unnecessary tax liabilities.

With respect to the fifth guideline, you may want to consider withdrawing from tax-deferred accounts funded with fully deductible (or pretax) contributions before withdrawing from tax-exempt accounts. After income taxes are taken into account, the same net withdrawal amount may result in a larger withdrawal from the pretax account than from the tax-exempt account, thus potentially reducing estate taxes (which are based on total assets). In addition, unlike tax-deferred monies, your beneficiaries should not have to pay income taxes on withdrawals from most tax-exempt accounts, provided certain requirements are met. You should consult a tax advisor and/or an estate planning professional regarding taxes and other issues related to estate planning.

The elements of your withdrawal plan

Here are the different types of accounts that might play a role in your withdrawal plan:

Taxable accounts	Taxable accounts are funded with after-tax dollars. Any earnings should be taxed in the year they are realized. Different types of earnings (interest, capital gains, etc.) may be subject to different tax rates. Examples include conventional brokerage or mutual fund accounts, CDs, and savings and checking accounts.
Tax-deferred accounts funded with nondeductible (or after-tax) contributions	Any earnings in the account grow tax deferred, and should be subject to income taxes at ordinary income tax rates when they are withdrawn. Examples include traditional IRAs and tax-deferred annuities.
Tax-deferred accounts funded with deductible (or pretax) contributions	Any earnings in the account grow tax-deferred. Contributions and earnings should be taxed at ordinary income tax rates only when they are withdrawn from the account. Examples include 401(k) and 403(b) plans, traditional IRAs, SEP-IRAs, and SIMPLE IRAs.
Tax-exempt accounts	These accounts are usually funded with after-tax dollars. Withdrawals should be tax free at the federal level, provided certain conditions are met. Tax rules related to withdrawals vary at the state level. Examples include Roth IRAs and Roth 401(k)s.

Conclusion

Fidelity's retirement withdrawal guidelines won't always lead to the perfect withdrawal sequence for your retirement assets. However, the important thing is to be aware of the issues that arise when you make withdrawals. Maximizing the after-tax proceeds from all your accounts does not necessarily mean trying to achieve the smallest immediate tax bill. Be careful to avoid withdrawal decisions that are based only on short-term considerations. Keep your long-term asset allocation in mind. You should consider consulting with your financial advisor and a tax advisor as needed to formulate your withdrawal strategy.

Contact your financial advisor for more information on retirement income planning and withdrawal strategies.

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