



ABOUT THE EXPERT

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Putting IRAs into a Bucket Plan

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A Google search for "Retirement Bucket Plan" generates over 2 million results. With so much information out there, it's likely that advisors are familiar with this concept and may use such an approach for retired clients.

That said, bucket planning doesn't always drill down to the use of employer-sponsored accounts and IRAs in coordination with regular taxable accounts. In addition, as Roth IRAs mark their 20th year in 2018, it has become increasingly important to consider the role of Roth accounts as well.

A well thought out bucket plan may serve many valuable purposes. By broadening their tactics to properly place IRAs and employer accounts in the mix, astute advisors strive to help clients enjoy comfortable retirements with reduced stress.

Please keep in mind that there is no certainty that any investment strategy will be profitable or successful in achieving an investor's goals.

The Bucket List

The many reasons for implementing a bucket plan include:

- **Simplifying portfolio drawdown:** Clients easily understand the idea, which may help their retirement funds deliver essential cash flow needs over many years.
- **Complying with required minimum distributions (RMDs):** Bucket plans are typically designed to meet RMD rules, avoiding a 50% penalty while holding down tax bills.
- **Addressing sequence (or sequence of returns) risk:** Even a sound investment strategy can be endangered if clients retire when market results are near a bottom. Bucket plans can build in the flexibility to avoid selling low, which leaves fewer assets to ride the next high tide. Without planning for sequence risk prior to retirement, poor timing could mean a lower standard of living for retirees and for loved ones who inherit depleted assets.

The Pail Procession

Bucket plans will vary widely, from advisor to advisor and even from client to client. The key component of any such approach, though, is to have a cash bucket from which funds can be drawn for immediate income needs, planned expenses, and an emergency reserve. The cash bucket, which I might call the Now bucket, focuses on asset preservation.

It typically holds one to three years' worth of projected spending needs in cash equivalents as well as other stable and liquid investments, which can regularly drip into the client's checking account. Markets may rise and fall, yet money will keep flowing in, so retirees can maintain their lifestyle.

Once the cash bucket is in place and funded, other buckets can hold other assets. I use an income-oriented Soon bucket, which will hold up to ten years' worth of projected spending needs, and a growth-oriented Later bucket, for other portfolio holdings.

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The Later bucket usually will be more heavily invested in equities. Although future performance can't be guaranteed, stocks and similar investments generally have produced attractive long term results, so an extended holding period might offer clients potential for outstanding wealth building, even as they draw down from their portfolios in retirement.

As the Now bucket is depleted for living expenses in retirement, it will be replenished from the Soon bucket, and the Soon bucket will be replenished from the Later bucket. Details will vary, depending on client need, advisor philosophy and economic circumstances.

Nevertheless, a foundational belief to a bucket plan is that holding sufficient amounts in the Now bucket permits such replenishment to be deferred during market downturns, which may reduce sequence of returns

risk by avoiding ill-timed asset sales.

Streaming Options

If that's the basic skeleton of a bucket plan, how can advisors help their clients benefit from smart asset location? Should IRA money splash around in the Now bucket or flow in Soon, or Later? One way to help make such decisions is to put clients into one of two categories.

A hypothetical Carl Davis might retire at 65 and immediately need to replace his paychecks with income from his life's savings. In the other category, 65-year-old Eve Ford might retire and live comfortably on a government pension. She won't need to tap her IRA until age 70½, when RMDs begin.

It's likely that Carl, in need of cash, will start Social Security right away. The income will impact the amount he needs in his cash bucket.

Meanwhile, Eve could defer Social Security until age 70, delivering more monthly income, with at least 15% exempt from income tax. Eve will need to take RMDs from her cash bucket after age 70½, but she may have substantial after tax cash flow for family gifts, charitable planning, and "wish list" outlays.

Cashing in

Suppose that Carl will need \$2,500 a month from his portfolio, in addition to Social Security and other income he expects in retirement. He would like to be comfortably insulated from market moves for up to two years.

Carl also plans \$10,000 worth of home improvements and would like another \$10,000 for emergencies. Altogether, he would

like \$80,000 in his cash bucket: \$60,000 (24 months times \$2,500) plus \$10,000 plus \$10,000.

That \$80,000 could come from Carl's bank accounts and money market funds and similar holdings, which Carl can tap without owing tax. Assuming that total is below \$80,000, the shortfall might be made up by taking funds from his taxable account without triggering much tax: taking losses, taking gains to offset those losses, taking small long-term gains, etc.

Suppose Carl has a total of \$800,000 in financial assets. With two years' worth of cash flow in his Now bucket, plus the \$20,000 for planned and unplanned costs, Carl's advisor might suggest eight years' worth of cash flow in his Soon bucket: \$240,000.

This \$240,000 might be held in investments such as short- and intermediate-term bonds or funds, conservative managed accounts or laddered fixed annuities, for example. If such funds are held in the taxable account (perhaps muni bonds or funds), they could be assigned to the Soon bucket.

Of course, Carl might not have \$240,000 in such type of funds. If not, money could be moved within his traditional IRA to appropriate investments, without incurring current tax.

Going forward, money might go from the investments in the Soon bucket to the Now bucket, maintaining Carl's desired \$80,000 balance. As an example, \$30,000 might be moved towards the end of each calendar year, when it's possible to calculate the most tax-effective mix of withdrawals from Carl's taxable account and traditional IRA. Filling up his current tax bracket may be the desired outcome.

The remaining \$480,000 of Carl's portfolio could be held in equities, including growth funds or less conservative managed accounts, and perhaps alternative investments, all of which might reward patient investors. They would comprise Carl's Later bucket, from which gains could also be harvested when available and redeployed into different holdings in the Soon bucket.

Note that Later-to-Soon replenishment doesn't have to take place each year. If markets are down, there's no need to sell low, as a multi-year amount in the Soon bucket provides time to wait for a possible rebound. The plan described here might change when Carl reaches age 70½. From then on, he must be sure that he withdraws at least enough from his traditional IRA to meet his RMD each year.

Advisors should keep in mind that planning for future bucket withdrawals may require funding adjustments to meet a client's real "net" taxable income needs as well as inflation; this is especially true when using an IRA or another tax-deferred account as an asset source. I have not done so in these examples in order to simplify the main points.

Meeting the Minimum

Whereas Carl's bucket plan started at retirement, that's not true for Eve, who has other income from non-portfolio sources to meet her needs. Before age 70½, even though she does not need the cash today, Eve might take enough money from her traditional IRA to fill up a modest tax bracket, pay the resulting tax, and use the withdrawn funds for a Roth IRA conversion, say, or life insurance to

benefit a loved one.

Nevertheless, at age 70½, Eve must start taking annual RMDs. It will be in Eve's interest to have a Now bucket within her traditional IRA, holding one to three years' worth of anticipated expenses in safer, stable, and liquid investments. The Now bucket would be the source of her RMDs, allowing other assets to potentially grow, tax-deferred.

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Eve's Now bucket might be replenished with interest and dividends within the traditional IRA, with bonds maturing, bond fund withdrawals, or perhaps from interest credited on fixed interest or fixed indexed annuities. For Eve as well as Carl, Roth accounts could go in the Later bucket, with equities held for potential long-term appreciation or bequests.

Any equities not held in a Roth account could remain in the taxable account, for a possible basis step-up at death. Eve's traditional IRA could hold the fixed or dividend income to flow into cash for RMDs.

A Bucket is Not a Box

The above suggestions might apply to many clients but they are not cast in stone. Advisors should be alert for other possibilities that can work in specific situations.

Here are some hypothetical ideas derived from actual experiences:

A client might retire with two 401(k) plans, one from a major

corporation containing a sizeable amount of highly appreciated employer stock and the other from a former employer's 401(k) plan holding mostly mutual funds. I would suggest he speak to his CPA about distributing the most highly appreciated employer shares in-kind, while rolling the majority of the remaining 401(k) balance to an IRA, tax-deferred.

On the in-kind distribution, only the low basis of the employer shares is taxed as ordinary income while the remaining value (the net unrealized appreciation or NUA) will be favorably taxed at long-term capital gains rates, upon sale.

I may then designate the NUA shares for the client's Later bucket (along with other more diversified tax-efficient growth investments).

In future years, consider a plan to harvest gains by selling NUA shares if the market price is attractive, then use the cash to replenish the Soon or Now bucket, depending on the client's needs at the time. Perhaps the qualified dividends from those NUA shares can help pay for a \$1 million second-to-die life insurance policy with a death benefit for a special needs child.

I'd also consider using the age 55 rule to leave money behind in a 401(k) account that has a stable value fund paying about 2%, which can fund some of the client's Now bucket for the remaining part of the calendar year. If someone is 55 or older in the year of leaving the company, withdrawals from the company plan are not subject to the 10% early distribution penalty.

Meanwhile, the remaining non-NUA portion of one 401(k) can fund the Soon bucket using a conservative balanced dividend strategy and the other, an even

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A Word of Thanks

Readers may recognize the "Now, Soon, and Later" buckets as terms popularized by Jason L. Smith, my friend and mentor. Jason has kindly provided permission for me to use the concepts found in his valuable book, *The Bucket Plan*. Advisors seeking more details on this approach will find much to learn in his book and the courses that he teaches.

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