

The Importance of Tax Diversification in Retirement Accounts

RETIREMENT PLANS

When planning for retirement, it is important to create a savings strategy in an effort to optimize asset growth in a tax-efficient manner. Understanding which account types offer tax deferral and tax-free distributions may help you save significant chunks of your wealth for retirement years.

Have you heard of the term “tax diversification?”

Tax diversification is the strategic allocation of assets among multiple investment accounts with varying tax rules. This would include traditional IRAs, Roth IRAs, taxable brokerage, trust accounts, health savings accounts (HSAs), 529 plans, annuities, and employer-sponsored plans like 401(k)s and 403(b)s. Many of these account types offer various benefits like up-front tax deductions, tax-free growth, and/or tax-free distribution to heirs. Rather than putting all of your assets in one type of account, it's important to spread assets across various account types. The primary reasons: flexibility and hedging against future tax rate changes. Let's look at an example:



Adam

Adam Anderson (age 70) contributed:

- **\$1,200,000 to a pre-tax 401(k) over his career**



Suzie

Suzie Smith (age 70) contributed:

- **\$400,000 to a pre-tax 401(k)**
- **\$400,000 to a Roth IRA**
- **\$400,000 to a brokerage account over her career**

While Adam would have reduced his taxable income over the last 50 years by making only pre-tax 401(k) contributions and Suzie would have had to earn more income to match the \$1,200,000 savings goal, each person could be impacted differently later in life when withdrawals begin. For instance, let's say both Adam and Suzie need \$120,000 for living expenses in 2025 and each receives \$45,000 in Social Security benefits per year.

Adam:

\$45,000 taxable Social Security benefits

\$75,000 taxable 401(k) distribution

24% federal tax rate with income between \$103,351 and \$197,300 as a single filer.

Suzie:

\$45,000 taxable Social Security benefits

Has the option to take:

- \$75,000 from the Roth IRA tax-free
- \$75,000 from the brokerage account and potentially be subject to capital gains tax
- \$75,000 from the pre-tax 401(k) and be subject to ordinary income taxes
- Any combination from the three accounts to obtain \$75,000

SINGLE			
Taxable Income		Tax Rate	Ordinary Tax Calculation
Minimum	Maximum		
–	\$11,925	10%	10% of taxable income
\$11,926	\$48,475	12%	\$1,192.50 + 12% of the amount over \$11,925
\$48,476	\$103,350	22%	\$5,578.50 + 22% of the amount over \$48,475
\$103,351	\$197,300	24%	\$17,651 + 24% of the amount over \$103,350
\$197,301	\$250,525	32%	\$40,199 + 32% of the amount over \$197,300
\$250,526	\$626,350	35%	\$57,231 + 35% of the amount over \$250,525
\$626,351	–	37%	\$188,769.75 + 37% of the amount over \$626,350

Suzie has the flexibility to take \$75,000 from the Roth IRA *tax-free* and keep herself in the **12% federal tax rate with income between \$11,926 and \$48,475 as a single filer**. Even if future legislation increases or decreases tax rates, she still has multiple account options to withdraw from to keep herself in a favorable tax situation.

In addition, assuming each individual's modified adjusted gross income (MAGI) in 2025 was similar to what it was over the past few years, Adam will pay \$74.00 more per month in Medicare Part B premiums and \$13.70 more per month in Medicare Part D premiums than Suzie.

2025 Income-Related Monthly Adjustment Amounts			
Modified Adjusted Gross Income (MAGI)		Part B Premium	Part D Premium
Single or Married Filing Jointly			
Single	\$106,000 or less	\$0.00	Plan Premium
Married*	\$212,000 or less		
Single	\$106,001 – \$133,000	\$74.00	\$13.70 + Plan Premium
Married*	\$212,001 – \$266,000		
Single	\$133,001 – \$167,000	\$185.00	\$35.30 + Plan Premium
Married*	\$266,001 – \$334,000		
Single	\$167,001 – \$200,000	\$295.90	\$57.00 + Plan Premium
Married*	\$334,001 – \$400,000		
Single	\$200,001 – \$499,999	\$406.90	\$78.60 + Plan Premium
Married*	\$400,001 – \$749,999		
Single	\$500,000 and above	\$443.90	\$85.80 + Plan Premium
Married*	\$750,000 and above		

* Married filing jointly

Considerations when choosing which account type to fund:

1. Your current tax rate versus future tax rate
2. Your financial goals
3. Your time horizon until retirement or need for asset liquidity
4. Ways to minimize Social Security taxation, Medicare premium costs, and taxation for beneficiaries
5. Current balances in taxable versus tax-deferred versus tax-free accounts

While this hypothetical example seemed to benefit Suzie later in life, there may have been reasons why Adam solely made pre-tax 401(k) contributions. For example, if Adam was in a high tax bracket while working and wanted to minimize income, pre-tax 401(k) contributions would have accomplished that. For this reason, it's important to talk to your tax preparer or CPA each year to help you project your current year income and applicable tax rate.

The decision of which account to open and fund should be made with financial goals and tax objectives in mind. It's also imperative to actively monitor your retirement account contributions to make sure you are contributing in a tax-effective manner as you pursue your retirement goals. It's impossible to predict future tax rates, but having tax diversified accounts provides options.

Stifel does not provide legal or tax advice. You should consult with your legal and tax advisors regarding your particular situation.

One Financial Plaza | 501 North Broadway | St. Louis, Missouri 63102
Stifel, Nicolaus & Company, Incorporated | Member SIPC & NYSE | www.stifel.com

1124.7376944.1