



RetirementWorks®

## Retirement Income — Sources

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The RetirementWorks® Retirement Income Sources calculator analyzes which assets should be spent down or liquidated first in order to supplement household income during retirement.

It achieves this by reviewing the investment, tax, risk, and liquidity characteristics of the client's assets to identify those that are most expendable. It also takes into account the client's own financial priorities. If there are two retirees in the household, the system will look at assets belonging to each of them, if desired.

This kind of analysis requires the input of a fair amount of detail. Because the investment environment can be volatile, the results provided by this module are intended to be applied only to the current situation. If used in this way, results should generally be satisfactory. Frequent periodic updates (at least annually) are therefore highly recommended.

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### When to Use This Calculator

The Retirement Income Sources calculator is intended to be used shortly before retirement, while planning for retirement, and periodically thereafter.

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### How to Use This Calculator

1. Start with the main Retirement Income Sources input screen. If there is more than one retiree, indicate this right away, and enter the date of birth (it will effect Step 2). If you wish, you may at the same time also fill out the tax-related information in the lower part of the screen.
2. Click the Investment Detail button and enter all the pertinent information about any assets that you wish to consider for spending down. This may include illiquid assets such as a primary residence or collectibles, or you may exclude these, if you prefer.
3. Click the Weighting Factors button to review the relative weights given to various financial goals. Changing these factors can have a major effect on the outcome.
4. To preview results, click the Calculate button at the lower left. For more detail, preview or print a report using the Print menu.



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## How This Calculator Works

The system will evaluate each asset on four criteria (or five, if there is a second retiree): expected lifetime after-tax rate of return, expected post-death after-tax rate of return, risk, liquidity, and balance of ownership between the two retirees.

The first two items are the most difficult. They involve a projection of future earnings on each asset up through normal life expectancy. The earnings take into account the expected year-by-year taxation, as well as the taxation that would occur if the asset was either sold just before death, or was passed first to the heirs and then sold just after death. Distinctions are made between ordinary income and capital gains; asset types normally eligible for a step-up in basis are assumed to receive it at death. Current tax brackets are based on current federal tax rates, and future tax brackets take into account any future adjustments already passed by Congress, along with normal inflation thereafter. State and local taxes are also taken into account, at least in an approximate way. State taxes are assumed to be deductible at the federal level.

Once each asset is evaluated on each criterion, weighting factors are applied. These factors can be adjusted by the system user, and they can significantly affect the outcome. A total score is calculated internally, and all the listed assets are ranked according to that score, with the assets most eligible for liquidation listed first. The report does not display the final scores (they are, after all, numbers with no external reference), but it does *graphically* display the relative score for each asset, so that you can see whether two assets listed in sequence are virtually tied in score or are instead widely separated.

As the printed reports state, the theoretical rationality of this process can easily be trumped by other factors, and we do not recommend that the order of liquidation provided by the system be followed slavishly. However, it does offer an objective place to start the discussion.



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Name:  Date of birth (mm/dd/yyyy):

2nd Retiree Date of birth (mm/dd/yyyy):

**Investment Detail (required)**

**Weighting Factors (optional)**

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*Income Tax Information*

Tax Filing Status:

Estimated taxable income (EXCLUDING capital gains from this distribution): \$

Annual rate of increase in taxable income (excluding distributions from this plan):  % Next year's estimated taxable income, to be used as a base for future inflation (optional) \$

State + local tax rate on pension income:  %

State + local tax rate on ordinary income:  %

State + local tax rate on capital gains:  %

General inflation rate (applied to tax tables):  %

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## Detailed Input Instructions

### Name

Enter the client's name as it should appear on the printed report.

### Date of Birth

Date of birth must be entered in m/d/yyyy format. **The client's date of birth is always required.**



## **2<sup>nd</sup> Retiree**

If there is a second retiree in the household whose assets should be taken into consideration, click the "2<sup>nd</sup> Retiree" checkbox on, and enter the other person's date of birth in the field to the right (m/d/yyyy format only).

*You may proceed directly to Investment Detail and Weighting Factors now, if you like. When you are done with them, you will be returned to the main input screen. Or you may proceed first with the tax-related items at the lower part of the main screen. These tax items are described next, followed by the Investment Detail and the Retirement Asset Priorities screens.*

## **Tax Filing Status**

Please select the correct filing status that the client is expected to use on his or her federal income tax return. This matters, because the system will be performing tax calculations using actual (or projected) income tax rates, which differ depending upon filing status.

## **Estimated Taxable Income for This Year**

In this field, please enter the amount of ordinary taxable income (i.e., after deductions and exemptions) that the client expects to have during the current tax year. Include all ordinary income except any that might be generated by liquidating assets. Also exclude long-term capital gains or other income subject to special taxes.

It is important to make a reasonable guess at this value, though it is not necessary to know it precisely. Leaving it at zero will warp the calculations unless the correct number is, in fact, zero.

## **Annual Rate of Increase in Taxable Income**

Indicate the rate at which the taxpayer's taxable income is assumed to grow in the future (excluding any income from liquidating assets). For example, if one-third of the person's other taxable income will derive from Social Security, which is inflation-adjusted, and two-thirds from a corporate pension that is not inflation-adjusted, the overall rate of increase in taxable income may be quite low (say, 1.0%, or less). This value should be input as a percent, not a ratio.



## Next Year's Estimated Taxable Income

This is the basic post-retirement amount of taxable income to which the Annual Rate of Increase will apply. We ask for taxable income in the second year because, if the analysis is being performed during the year of retirement, for many people there are too many unusual transactions occurring that year, and many of them result in taxable income. Using the next year as a base gives a more accurate rendering of what future income is likely to be. Again, do not include any income expected directly or indirectly from liquidating assets. If you do not have an accurate estimate of the next year's taxable income, a ballpark figure will do (say, 50% of pre-retirement income). **If there is no big difference between the first and second year, you may leave this field blank, and the amount entered as Estimated Taxable Income for This Year will automatically be used as a base for future years.**

## State and Local Tax Rates

Three State & Local Tax Rates can be entered in the lower portion of the Retirement Income Sources input screen. Enter all three values as percentages (e.g., 3.5). If you do not wish state and local taxes to be taken into account, leave all three values at zero.

- **State & Local Tax Rate on Pension Income** is the combined state and local tax, if any, on pension income. Many jurisdictions have a lower tax rate for pension income than for ordinary income. But, where appropriate, this percentage can be the same as for the State & Local Tax Rate on Ordinary Income (below).
- **State & Local Tax Rate on Ordinary Income** is the combined state and local tax, if any, on ordinary income. If the jurisdiction in question has a different rate for investment income than for income earned from salary or wages, use the investment income rate.
- **State & Local Tax Rate on Capital Gains** is the combined state and local tax, if any, on investment capital gains. Again, many states have different rates for capital gains than for ordinary investment income.

## General Inflation Rate

Enter the percentage by which the tax brackets from the most recently available federal tax tables should be assumed to increase annually.



## Invested Assets Detail (Required!)

Invested Assets				
Asset Class or Item	Current Asset Balance	CASH Annual Return %	TOTAL Annual Return %	Owned by 2nd Retiree?
+ IRA, 401(k), 403(b), 457 & other non-Roth balances	\$	%	%	% Surr. fee <input type="checkbox"/>
+ Bank accounts, cert's of deposit, money mkt. funds	\$	%	%	% Penalty <input type="checkbox"/>
+ Taxable mutual funds	\$	%	%	% Cap.gain <input type="checkbox"/>
+ Individual common and preferred stocks	\$	%	%	% Cap.gain <input type="checkbox"/>
-	\$	%	%	% Cap.gain <input type="checkbox"/>
-	\$	%	%	% Cap.gain <input type="checkbox"/>
+ Individual taxable bonds	\$	%	%	<input type="checkbox"/>
+ Non-taxable bonds or bond funds	\$	%	%	% State tax <input type="checkbox"/>
+ Cash value life insurance	\$	%	%	% Gain <input type="checkbox"/>
+ Annuity account balances (excl. qualified plans)	\$	%	%	% Surr. fee <input type="checkbox"/>
+ Other income-producing assets, taxable at sale	\$	%	%	% Cap.gain <input type="checkbox"/>
+ Other income-producing assets, non-taxable at sale	\$	%	%	<input type="checkbox"/>
+ Other non-income-producing assets	\$	%	%	% Cap.gain <input type="checkbox"/>

Close      Click " + " to add a detail item in any category. Click " - " to delete any detail item.

This screen appears when you click the Investment Detail button on the Retirement Income Sources main screen. This screen enables you to itemize assets, and/or to enter them by category, with details about each item.

Eleven fixed categories of investment are provided. You may change the names of the fixed categories, if you want, but not the nature of how each category is treated, so make any such changes with caution.

You can add space to enter specific assets in one or more categories by clicking the "+" sign next to the appropriate category. You will get one new blank row each time you click "+" (such as the two blank lines under "Individual Common and Preferred Stocks" in the illustration). If you later wish to delete a detail row, click the minus sign next to that row. You cannot delete the fixed category rows, only the detail rows. If you use detail rows, the inputs for the affected



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categories are disabled; but subtotals and overall rates of return will be calculated automatically and displayed for these categories, based on the detailed information provided underneath them.

In the first three columns enter the current asset balance (normally, this should be net of any associated liability such as a mortgage or other loan), the average annual cash rate of return, and the average annual total rate of return (including any capital gains, realized or not). Enter actual rates of return, not inflation-adjusted rates. If there is a Second Retiree, it is also preferable to indicate which person owns the asset, using the check box at the far right.

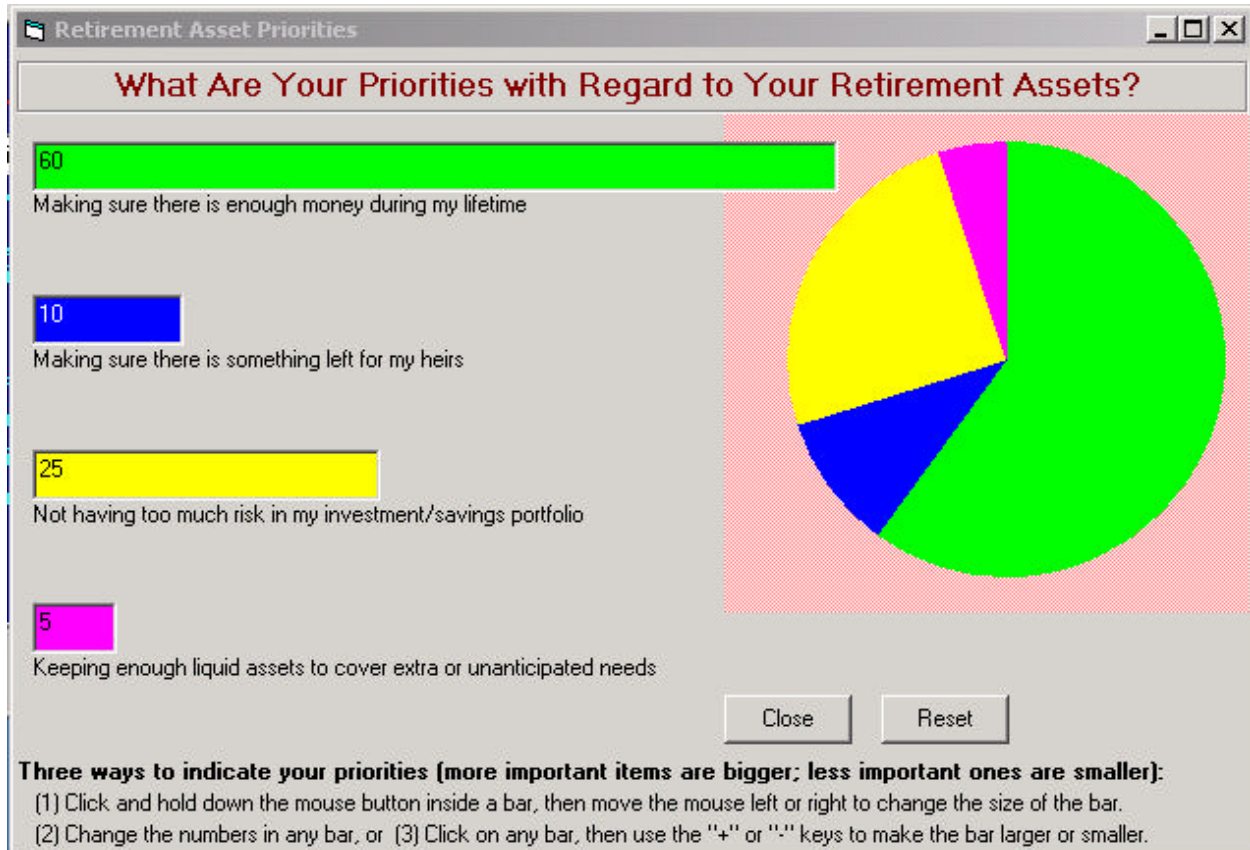
Details concerning fees or gains are important when doing the Retirement Income Sources analysis.

- **Surrender fee %:** the percentage by which an annuity account will be penalized if it is surrendered immediately.
- **Penalty %:** the percentage by which a term bank account will be reduced if it is cashed in immediately.
- **Capital gain %:** the percentage of the current value that represents an unrealized gain in the asset (i.e., market value minus cost basis).
- **State tax %:** the state tax, if any, that is payable on municipal bonds (in general, in-state bonds have zero state tax, while out-of-state bonds are taxed by most states).
- **Insurance gain %:** the percentage of an insurance policy cash value that represents a gain in the policy (in general: cash surrender value minus tax basis, where tax basis is the sum of premiums paid minus any dividends or partial surrenders already received).

When you have entered all the data and clicked the Close button, you will return to the main input screen.



## Retirement Asset Priorities screen



This screen appears when you click the Weighting Factors button on the Retirement Income Sources main screen. Its purpose is to enable the system to reflect the client's financial priorities in evaluating retaining vs. spending down current assets.

Do these priorities affect the results? Yes, sometimes dramatically. The suggested order of spending down assets can often be nearly reversed by putting high emphasis on risk avoidance instead of financial returns.

The screen lists four concerns, or five if there is a second retiree. The relative importance of these items is illustrated in three ways: (1) numerically, with a value inside a colored bar for each item; (2) graphically, by the relative length of each bar; and (3) as a pie chart.

There are also three ways to adjust the relative priorities. As described on the screen itself: (1) by clicking and holding the main mouse button inside any bar, then dragging to the left or right to decrease or increase the length of the bar; (2) by changing the numbers inside the bars; or





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(3) by clicking on any bar then using the "+" or "-" keys to increase or decrease the value of that bar. The pie chart will change dynamically to illustrate any of these changes.

At any time you can return the priorities to the way they were when the screen opened, just by clicking the Reset button.

To save changes and close the screen, click the Close button.

### Retirement Income Sources Results

You can see the complete results by previewing or printing a report using the Print menu. For a quick preview of results, use the Calculate button in the lower left corner of the screen. This button will pop up the Retirement Income Sources Results screen. Here is a sample:

