

## **Annual Tax Withholding for Regularly-Scheduled IRA Withdrawals Keeps Your Money Working Longer**

If you take regular monthly (or semi-monthly or bi-monthly) withdrawals from your IRA account, you may be paying the tax on these withdrawals earlier than you need to. By switching from a monthly to an annual tax withholding strategy, you can effectively give yourself six extra months of investment growth for those dollars used to pay your annual IRA taxes.

Let's look at two hypothetical retirees, Mr. Smith and Mr. Jones. Both retirees have a \$500,000 IRA account, from which they take regular monthly withdrawals to provide after-tax "income" of \$3,750. They are both taxed on these withdrawals at a rate of 25%. Because both retirees use their IRA dollars to pay the taxes on these withdrawals, they must take out an additional \$1,250 for the taxes (25% of \$5,000 is \$1,250 for taxes, leaving the required \$3,750 for living expenses).

Mr. Smith follows a monthly withholding strategy, paying his taxes as he takes his money. He withdraws \$5,000 from his IRA each month -- he receives a check for \$3,750, and \$1,250 is sent directly to the federal government on his behalf. By December 31st, he has withheld \$15,000, enough money to cover his annual tax bill (or at least the portion resulting from his IRA withdrawals).

Mr. Jones follows an annual withholding strategy, delaying the payment of his taxes until the end of the year. He withdraws only \$3,750 from his IRA account each month. Then, in December, he takes his regular withdrawal of \$3,750, plus a one-time withdrawal of \$15,000, of which 100% is withheld for taxes.

Both Mr. Smith and Mr. Jones paid their taxes in a timely manner according to IRS regulations, but Mr. Jones kept his \$15,000 of tax money growing in his IRA account for an average of 6 months longer. If his investments had a modest annual growth rate of 10%, then he earned an extra \$750 (\$15,000 annual tax bill times six-month growth of 5%) by delaying his withholding until the end of the year.

Of course, as with any tax strategy, annual withholding for IRA withdrawals is not appropriate for everyone, especially those who pay quarterly estimated taxes in addition to IRA withholding. And there are some risks involved, most notably that your investments will drop significantly in value at the end of the year, wiping out any investment growth benefits and forcing you to make a significant withdrawal when the market is down. Be sure to talk with your tax advisor about your unique situation before changing your tax withholding strategy.