KANAWHA
CAPITAL MANAGEMENT
First Quarter 2016

This Quarter's Highlights

- Retirement Spending Rates
- Constant Inflation-Adjusted Retirement Spending
- Constant Percentage Retirement Spending
- Retirement Spending Decision Rules
- The Qualified Charitable Distribution Becomes Permanent
- 2016 Important Financial Data

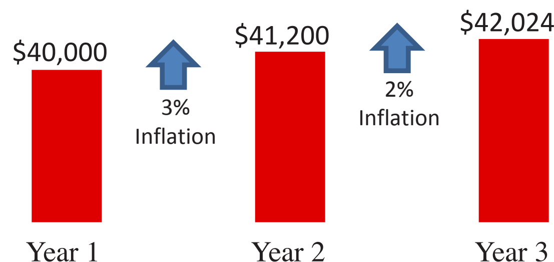
Kanawha Currents

Retirement Spending Policies and Decision Rules

The recent pullback in stock prices has caused many retirees to revisit their retirement spending policies. Negative returns coupled with rising living expenses can strain retirement *Spending Rates* – annual withdrawals relative to portfolio values. As the rate of withdrawal increases, the risk of outliving one's resources also goes up. Retirees should periodically monitor their annual withdrawal rates and determine if any adjustments to spending are warranted.

There has been no shortage of research devoted to better understanding how much money retirees can reasonably take from their savings and still expect their portfolios to survive them. The general rule of thumb is that a 4% initial withdrawal rate is sustainable. Many of the studies endorsing this rule assume that a retiree withdraws 4% of savings in year one of retirement and then increases their withdrawal dollar amount in subsequent years by an inflation factor. For example, a person retiring this year with $1 million in savings takes 4%, or $40,000, from her portfolio to help meet retirement expenses. In year two, she increase her withdrawal amount by the preceding year's Consumer Price Inflation factor of 3%. This approach gives retirees a stable withdrawal amount they can rely on from year to year. It also helps them combat the erosion of purchasing power that occurs over time as the prices of goods and services increase.

Figure1: Constant Inflation-Adjusted Retirement Spending



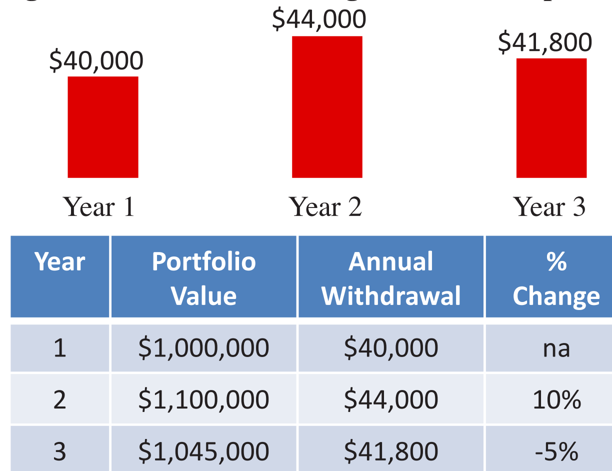
Increase annual withdrawal amount by preceding year's inflation factor.

Others advocate using a different approach in which a retiree takes a constant percentage each year. Under this approach, one takes the same percentage (e.g. 4%) annually from the preceding year-end account value. While this ensures the current spending rate does not increase to unsustainable levels, there are some drawbacks to this strategy. The retiree will not have

7201 Glen Forest Drive, Suite 200, Richmond, VA 23226 (804) 359-3900

a consistent withdrawal amount that they can plan for each year in order to meet expenses. Also, during years when investment returns are above average and portfolio values have increased, the retiree is withdrawing more than he or she may need and this may negatively impact the long-term sustainability of the portfolio. Of course, during difficult market environments when account values are depressed, the lower withdrawal amounts may not be sufficient to meet expenses.

Figure 2: Constant Percentage Retirement Spending



Year	Portfolio Value	Annual Withdrawal	% Change
1	$1,000,000	$40,000	na
2	$1,100,000	$44,000	10%
3	$1,045,000	$41,800	-5%

Withdraw the same percentage (4% above) of the portfolio value each year.

So what can investors and retirees do if they notice a potentially unsustainable rate of withdrawal from their portfolios? As with most complex issues, there are no easy answers. The most effective way to avoid or resolve an imbalance is through a set of contingency plans or Decision Rules. For those retirees who are not using a constant percentage approach to retirement spending and who recognize their current withdrawal rates are elevated, there are several ways to take action.

A common rule for retirees who experience a decline in portfolio value during the previous year is to avoid increasing their current withdrawal amount by inflation. In other words, the withdrawal dollar amount holds steady. This helps to alleviate the spending pressure on accounts following years with negative returns.

Another rule may state that if the current year's withdrawal rate is more than 20 or 30% greater than the initial withdrawal rate, then the withdrawal amount is actually reduced by some percentage, say 10%. This lower amount will then serve as the basis for future withdrawals. For example, if one's current withdrawal rate had increased to 5% from 4% (a 25% increase), then he or she should lower the target dollar withdrawal amount by 10%.

Lastly, during periods of higher inflation, one might apply a decision rule which caps the annual inflation factor by some amount (e.g. 4%). In recent years, generalized price increases have been relatively benign; however, *inflation capping* can be another prudent tool to improve the odds that your retirement portfolio survives you.

Figure 3: Potential Decision Rules

Decision Rule #1 ➡	Do not increase current year's withdrawal by inflation factor following a year with a negative total return.
Decision Rule #2 ➡	Reduce current year's withdrawal amount by 10% if most recent spending rate exceeded initial withdrawal rate by 25%.
Decision Rule #3 ➡	Increase current year's withdrawal by prior year's CPI, capped at 4%.

Individuals relying on their investment portfolios to help meet expenses during retirement can be well served by defining spending policies along with a set of decision rules for contingency planning. While there is no such thing as a "one size fits all" policy, certain rules of thumb may offer good beginning points for discussion. Further defining how adjustments should be made given rising withdrawal rates due to negative investment returns or higher inflation is paramount to improve the long-term sustainability of one's financial resources. Employing these decision rules can potentially relieve the pressure created from increased spending against the backdrop of declining portfolio values.

The *Qualified Charitable Distribution* Becomes Permanent

The Protecting Americans from Tax Hikes (PATH) Act, signed into law on December 18, 2015, made the Qualified Charitable Distribution permanent. Also known as the IRA Charitable Rollover, the law permits IRA owners who are age 70 ½ and older to make gifts up to $100,000 directly from their IRA to qualified charities. Under the law, the donation is not claimed as a charitable deduction but the IRA distribution amount does not count as taxable income as it would have otherwise been treated. This ensures 100% of the charitable contribution is made pre-tax. The gift may also satisfy the IRA owner's Required Minimum Distribution.

This is intended to be for informational purposes only and should not be interpreted as advice. Consult your tax professional for advice regarding the Qualified Charitable Distribution and your specific circumstances.

2016 Important Financial Data

2016 Tax Rate Schedule	
Taxable Income	Marginal Rate
Single	
$0 to $9,275	10%
$9,276 to $37,650	15%
$37,651 to $91,150	25%
$91,151 to $190,150	28%
$190,151 to $413,350	33%
$413,351 to $415,050	35%
$415,051 +	39.6%
Married Filing Jointly & Surviving Spouse	
$0 to $18,550	10%
$18,551 to $75,300	15%
$75,301 to $151,900	25%
$151,901 to $231,450	28%
$231,451 to $413,350	33%
$413,351 to $466,950	35%
$466,951 +	39.6%
Head of Household	
$0 to $13,250	10%
$13,251 to $50,400	15%
$50,401 to $130,150	25%
$130,151 to $210,800	28%
$210,801 to $413,350	33%
$413,351 + $441,000	35%
$441,001 +	39.6%
Married Filing Separately	
$0 to $9,275	10%
$9,276 to $37,650	15%
$37,651 to $75,950	25%
$75,951 to $115,725	28%
$115,726 to $206,675	33%
$206,676 to $233,475	35%
$233,476 +	39.6%
Estates and Trusts	
$0 to $2,550	15%
$2,551 to $5,950	25%
$5,951 to $9,050	28%
$9,051 to $12,400	33%
$12,401 +	39.6%

Capital Gains Tax Rates	
Short-term (held 1 year or less)	Same as ordinary income
Long-term (held > 1 year):	
If income falls in 10% or 15% brackets	0%
If income falls in 25%,28%,33%, or 35% brackets	15%
If income falls in 39.6% bracket	20%
Unrecaptured gains on Section 1250 property	25%
Collectibles	28%
Qualified Dividend Income Tax Rates	
If income falls in 10% and 15% brackets	0%
If income falls in 25%,28%,33%, and 35% brackets	15%
If income falls in 39.6% bracket	20%
Income Tax Deductions and Exemptions	
Standard Deduction	
Single	$6,300
Married filing jointly	$12,600
Head of household	$9,300
Over age 65 or blind additional standard deduction	
Married or surviving spouse	$1,250
Single or not a surviving spouse	$1,550
Itemized deduction may be reduced by 3% of every dollar that exceeds certain AGI thresholds	
Personal exemption	$4,050
Personal exemption may be reduced by 2% for every $2,500 that exceeds certain AGI thresholds	
Retirement Plan Contribution Limits	
401(k), 403(b), 457 plans elective deferrals	$18,000
Catch-up contributions for 50 and older	$6,000
Defined contribution plans	$53,000
Defined benefit plans	$210,000
SIMPLE plans elective deferrals	$12,500
Catch-up contributions for 50 and older	$3,000
Traditional and Roth IRA	$5,500
Catch-up contributions for 50 and older	$1,000
Traditional IRA deductibility for active participants	Phaseout Limits:
Single	$61,000 to $71,000
Joint	$98,000 to $118,000
Spousal IRA if one spouse is covered by a plan	$184,000 to $194,000
Married filing separately	$0 to $10,000
Roth IRA income phaseout	
Single	$117,000 to $132,000
Joint	$184,000 to $194,000
Married filing separately	$0 to $10,000

Estate and Gift Tax	
Annual gift tax exclusion	$14,000
Estate and gift tax exclusion	$5,450,000
Maximum estate tax rate	40%

New Medicare Surtaxes
0.9% on wages that exceed $200,000 (single filers) or $250,000 (joint filers)
3.8% on net investment income that falls above MAGI of $200,000 (single filers) or $250,000 (joint filers)

Medicare	
Part A Hospitalization	
First 60 days inpatient deductible	$1,288 for each benefit period
Days 61 - 90	$322 per day, for each benefit period
Days 91 +	$644 per day, up to 60 days over lifetime, then full amount per day

Part B Premium: Many people will continue to pay the monthly premium of $104.90. Others who enroll for the first time in 2016, whose MAGI from 2014 exceeded certain thresholds, or who don't get Social Security benefits will be subject to these premiums.

MAGI Single (for *2014*)	MAGI Joint (for *2014*)	Part B Monthly Premium	Part D Addition to Premium
$85,000 or less	$170,000 or less	$121.80	$0
$85,001 to $107,000	$170,001 to $214,000	$170.50	$12.70
$107,001 to $160,000	$214,001 to $320,000	$243.60	$32.80
$160,001 to $214,000	$320,001 to $428,000	$316.70	$52.80
$214,001 +	$428,001 +	$389.80	$72.90

Part B Deductible	$166
Coinsurance	20% of Medicare-approved amount for most services

Long Term Care Insurance: Potential Deductibility of Premiums for Qualified Policies (medical expenses are subject to % of AGI thresholds)

Age	Amount of premium that may be treated as "medical care"
40 or less	$390
41 to 50	$730
51 to 60	$1,460
61 to 70	$3,900
71 +	$4,870

Source: www.irs.gov, IRS Rev. Proc. 2015-53, IR-2015-118, Centers for Medicare & Medicaid Services.
The data contained on this sheet is for informational purposes only and should not be interpreted as tax or investment advice.
Consult your tax professional for specific advice about your personal situation.