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*John Hancock*<sup>®</sup>



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# *Tax diversification*

## Client guide





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# The case for tax diversification in retirement planning

## Don't put all your tax eggs in one basket

It's a reality that taxes impact retirement goals. Does your current retirement plan contemplate future tax exposure? Many retirees are often shocked by the toll that taxes can take on their investment portfolios when they begin to access money for retirement.

If you are concerned about potential tax exposure in retirement, the good news is there are planning decisions available today that can help alleviate your tax exposure in the future.

## Why consider diversification for tax purposes:

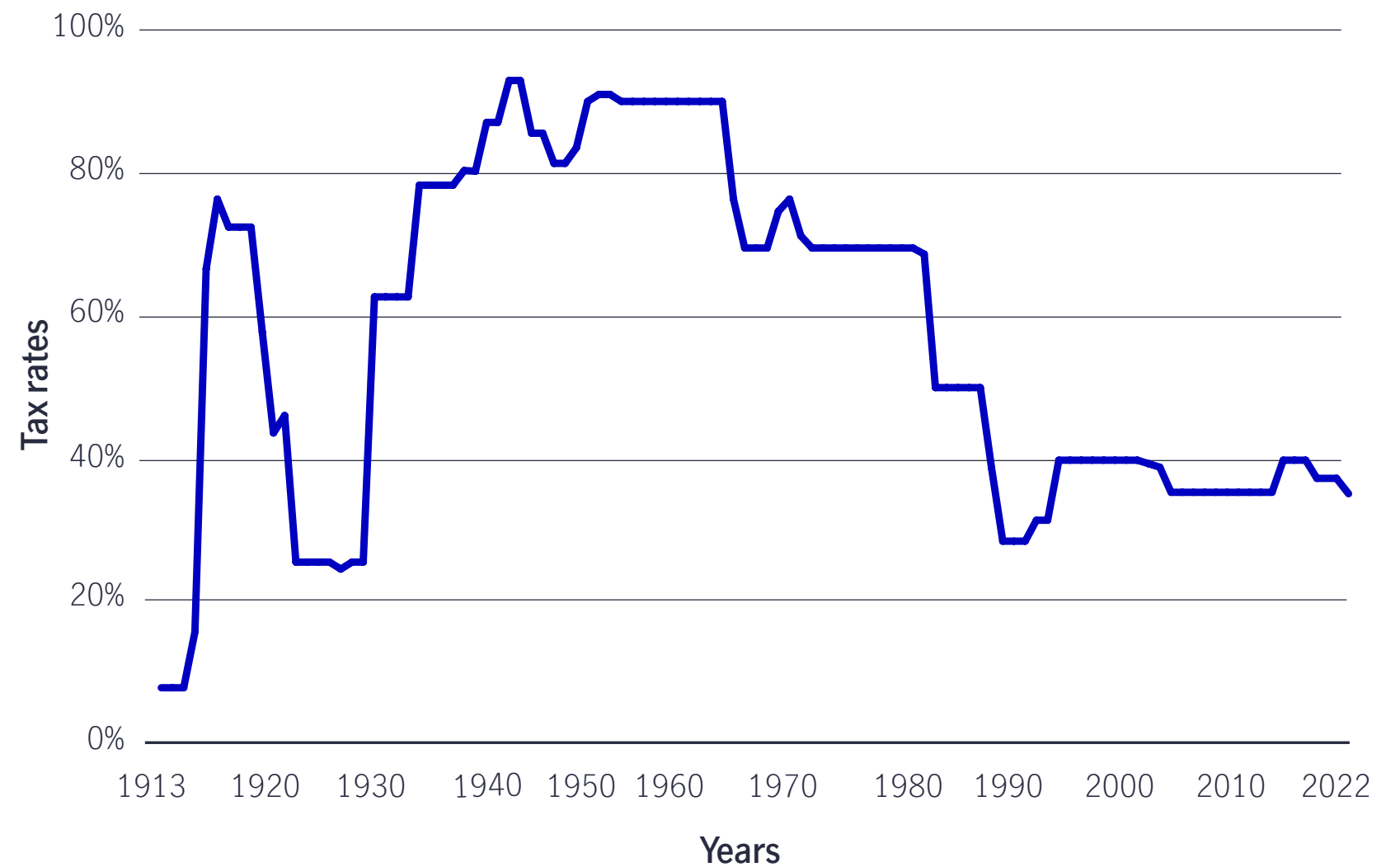
- Taxes and tax rates change
- Tax-deferred growth is a good thing
- Taxes impact growth, distributions, benefits, and more

## Will taxes be higher or lower during retirement?

The answer is unknown, but the expectation should be that taxes may increase not only at the beginning of retirement, but also might shift during the retirement years.

<b>INSURANCE PRODUCTS:</b>		
Not FDIC Insured	Not Bank Guaranteed	May Lose Value
Not a Deposit	Not Insured by Any Federal Government Agency	

## Highest marginal tax rate 1913-2022



Source: Tax rates shown are from the Tax Foundation. [taxfoundation.org](https://taxfoundation.org)



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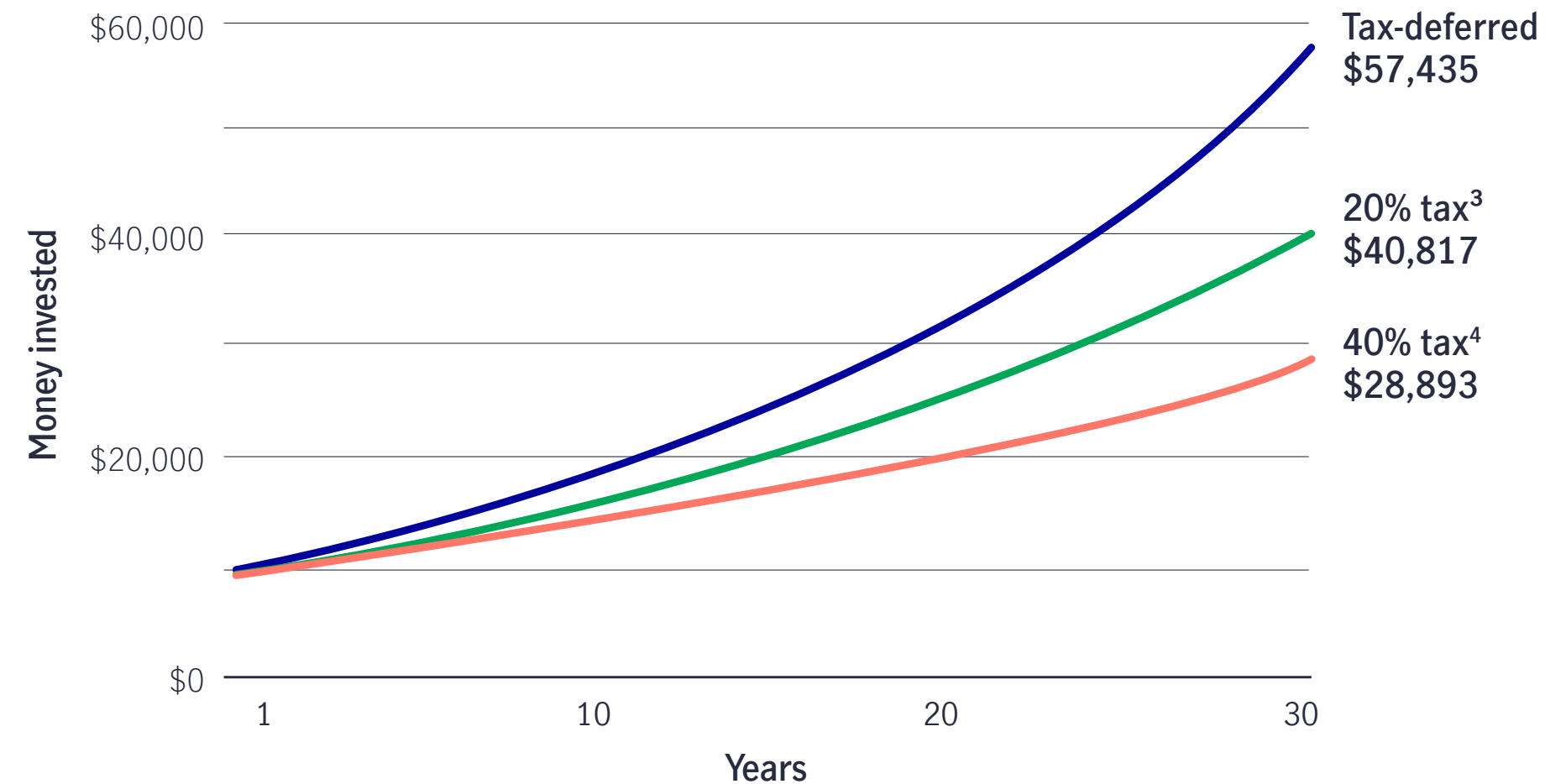
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# Tax deferred growth is a good thing

No matter your age, income or financial goals, taxes can take a bite out of long-term savings. That's why it makes sense to take advantage of as many opportunities as possible to set aside money in tax-deferred accounts. Over long periods of time, tax deferral makes a difference in the amount of money you have in an account.

To understand the basics, let's look at a simple example. The accompanying chart shows a hypothetical \$10,000 investment,<sup>1</sup> returning a steady 6% in three tax situations: tax-deferred,<sup>2</sup> a 20% rate and a 40% rate. As you can see, the tax-deferred account grows faster than the accounts that pay taxes each year.

## \$10,000 invested at 6%



1. This example is hypothetical and does not represent any particular investment.  
 2. Taxes would be due upon withdrawal for the tax deferred investment.  
 3. Assuming 15% Federal and 5% state tax rates.  
 4. Assuming 35% Federal and 5% state tax rates.



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# Taxes impact growth, distributions, benefits, and more

Will you have less to invest due to taxes? Let's consider the tax categories that may have the biggest impact on your financial planning — now and in the future:

		2022 tax rate
<b>Top federal tax rates</b>	Individuals with income over \$539,900 (\$647,850 for married filing jointly)	<b>37%</b> (ordinary and earned income)
	Individuals with income over \$459,750 (\$517,200 for married filing jointly)	<b>20%</b> (long-term capital gains & qualified dividends)
<b>Top state tax rates</b>	Depending on the state you live in or own/hold property, you may have additional income and capital gains tax liability	<b>Depends on the state</b>
<b>Medicare payroll tax</b>	This tax is an additional tax imposed on wage and self-employment income for individuals earning more than \$200,000 (\$250,000 for married filing jointly)	<b>0.9%</b>
<b>Net investment income tax</b>	This tax is imposed on the lesser of an individual's net investment income or modified adjusted gross income (MAGI) exceeding \$200,000 (\$250,000 for married filing jointly)	<b>3.8%</b>

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# Taxes impact growth, continued

## Qualified plan limitations

For many individuals, a primary way to save for retirement is through the use of pre-tax deductions via qualified plans. Unfortunately, limitations on contributions to qualified plans and income restrictions may prevent high income earners from doing substantial planning in qualified plans and/or Roth IRAs:

## Additional tax considerations in retirement

Retirement does not necessarily mean that you will be in a lower tax bracket. During retirement your income might even affect your Social Security Benefits and Medicare Premiums:

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5. These are only a subset of qualified plan limitations.

6. An additional \$6,500 catch-up is available for those ages 50+.

7. An additional \$1,000 catch-up is available for those ages 50+.

		2022
<b>Qualified plan contribution limits<sup>5</sup></b>	Maximum elective deferral to retirement plans (e.g., 401(k), 403(b), 457(b))	<b>\$20,500<sup>6</sup></b>
	Maximum IRA contribution limit	<b>\$6,000<sup>7</sup></b>
<b>Qualified plan income limitations for contributions</b>	Maximum compensation limit for employer	<b>\$305,000</b>
	Roth IRA phase out (married filing jointly)	<b>\$198,000-\$208,000</b>
	Roth IRA phase out (single, head of household, married filing separately)	<b>\$125,000-\$140,000</b>

<b>Social Security</b>	Up to 85% of social security benefits are subject to income taxes if your income exceeds certain thresholds
<b>Medicare premium</b>	The standard monthly Medicare Part B premium in 2022 is \$170.10, but could be up to \$578.30 depending on your income



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# Investment options

## Pre-Tax

### What are they?

These are traditional 401(k)s, profit-sharing plans, IRAs and other qualified plans.

### How are they funded?

They are funded using pre-tax dollars.

### How is the growth taxed?

These accounts grow tax deferred.

### What about distributions?

Distributions are taxed as ordinary income. Distributions prior to 59½ result in a 10% penalty and Required Minimum Distributions (RMD) have to be made starting at 72.

### Benefits

Pre-tax contributions, and potential for employer contribution match.

### Considerations

Limited access to accounts without penalty, and distributions are taxable. Distributions (RMD) have to be made starting at 72.

## Pre-tax contributions



Pre-Tax Contributions  
401(k), IRA



Withdrawals may  
be subject to 100%  
income tax

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# Investment options, continued

## Taxable

### What are they?

These are mutual funds, stocks, bonds, real estate, and other investments.

### How are they funded?

They are funded with money that has already been taxed (i.e., after-tax money).

### How is the growth taxed?

Dividends and capital gains can be assessed depending on the type of investment.

### What about distributions?

Capital gains may also be assessed on the growth during distributions

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## Benefits

There are no contribution limits, and accounts fully accessible (i.e. no penalty if accessed prior to 59½).

## Considerations

Investments may be subject to ongoing taxation, which will affect overall growth.

## After-tax contributions



### Taxable

- Mutual Funds
- Stocks
- Annuities
- Real Estate



Withdrawals may be subject to capital gains, and even ordinary income tax

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# Investment options, continued

## Tax advantaged

### What are they?

These are municipal bonds, Roth IRAs, and cash value life insurance.

### How are they funded?

They are funded with after-tax money.

### How is the growth taxed?

They grow tax deferred.

### What about distributions?

Distributions are generally tax free, but Roth IRA accounts distributions have to be made after 59½, otherwise there is a 10% penalty.

## Benefits

Accounts grow tax deferred and are generally distributed income tax free

## Considerations

Income limits may prevent you from contributing directly to a Roth IRA.

A 10% penalty also applies when funds are withdrawn from a Roth prior to age 59½.

## After-tax contributions



### Tax advantaged

- Muni Bonds
- Roth IRA
- Life Insurance



Withdrawals can be accessed income tax-free

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# Why tax diversification is important

Deciding where to invest today may affect retirement savings as it pertains to taxes. Diversifying the income tax treatment of investments can reduce income taxes in retirement.

## Let's take a look at a \$120k withdrawal

### Non-diversified withdrawals

Let's assume Mary and John Smith withdrew \$120,000 from their 401(k); they would be left with \$78,000 (assuming a 35% tax rate).

#### 100% ordinary income tax



401(k) plan  
\$120,000  
withdrawal



Mutual fund  
\$0 withdrawal



JH Life policy  
\$0 withdrawal

**\$78,000**  
potential  
net income



### Diversified withdrawals

Instead, if they took \$40,000 from each of the three alternatives – \$40,000 from their 401(k), \$40,000 from a mutual fund, and \$40,000 from a John Hancock permanent life insurance policy – they could potentially receive net income of \$100,000 (assuming a 35% income tax bracket and 15% in capital gains taxes).

#### 100% ordinary income tax



401(k) plan  
\$40,000  
withdrawal



Mutual fund  
\$40,000  
withdrawal

#### Tax-free



JH Life policy  
\$40,000  
withdrawal

\$26,000



\$34,000



\$40,000



**\$100,000**  
potential  
net income

## Advantages of diversifying with cash value life insurance

Regardless of when you decide to retire, a John Hancock life insurance policy can help protect your savings and provides the following tax advantages:

- **Retirement income from policy withdrawals and loans, which do not affect your:**
  - Income tax bracket
  - Medicare premiums
  - Capital gains
  - AGI or MAGI
  - Social Security
- **Income tax-free death benefit for your beneficiaries**
- **Tax-deferred growth**
- **No retirement contribution limits**
- **Potential to access cash prior to age 59½**



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# What life insurance could do for you in retirement

## Pre-tax & taxable accounts vs permanent life insurance

### Pre-tax & taxable accounts

#### Distributions from pre-tax investments

taxed as ordinary income and subject to 10% penalty

#### Distributions from pre-tax and taxable investments

are subject to income tax and increase MAGI

#### Distributions from pre-tax, taxable and tax-exempt investments

may cause you to pay more in Medicare premiums, which are affected by increases in your MAGI

Starting after age 72\*, you are required to take distributions (“RMDs”) from your pre-tax investments

Before age 59½

After age 59½

After age 65

At age 72

### Permanent Life insurance

Income-tax free distributions without any penalties and tax-free growth of cash value

Income-tax free distributions that do not increase MAGI

Distributions not considered as part of MAGI, thus having no effect on Medicare premium costs

You are never required to take any distributions from your policy; access to cash value is completely in your control

\*The SECURE act changed the RMD from age 70½ to 72.



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Life Insurance can offer tax free distributions as long as the policy is structure properly. Modified endowment contracts (MEC), lapsing or surrendering a contract may cause income taxation. Roth IRAs can offer tax free distributions, but if money is accessed prior to 59½, the distributions may be subject to income tax and 10% penalty. There are also income limitations on Roth Contributions. Pretax accounts, generally include 401(k)s and IRAs. Withdrawals prior to age 59½ may result in a 10% penalty and taxes.

This material does not constitute tax, legal, investment or accounting advice and is not intended for use by a taxpayer for the purposes of avoiding any IRS penalty. Comments on taxation are based on tax law current as of the time we produced the material.

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Loans and withdrawals will reduce the death benefit and the cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Withdrawals in excess of the cost basis (premiums paid) will be subject to tax and certain withdrawals within the first 15 years may be subject to recapture tax. Additionally, policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½.

Withdrawals are available after the first policy year.

Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02210 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.

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MLINY111521288-1



For more information on using life insurance to help with tax diversification, please contact your financial professional.