6 Tax

This is a retiree's guide to taxes. You have more control over your taxable income in retirement than you did while working. You can minimize your retirement taxes by understanding these concepts and strategies. In many cases, you will need your financial advisor and accountant to guide you.

A RETIREE SHOULD SEEK TO UNDERSTAND THESE THREE TOPICS:

1. Income Categories
2. Tax Rules for Retirees
3. Retiree Tax Strategies

Income Categories

REGULAR INCOME

Most income sources are regular income. Many people make the mistake thinking that if they cross over into the 22% tax bracket, all their income will be taxed at 22%. This is not true. Only the income above the threshold is taxed at the higher rate. The lower portions are taxed at 10% and 12%. This is called "marginal" taxes.

SHORT-TERM CAPITAL GAINS

Investments sold within 1 year are considered short term and taxed as regular income.

LONG -TERM CAPITAL GAINS

Investments sold after a 1-year holding period are considered long term and are taxed at a lower rate. Typically, you will save around 7% - 10% of your capital gain if it can be taxed as long-term capital gains as opposed to short-term capital gains or regular income.

INTEREST

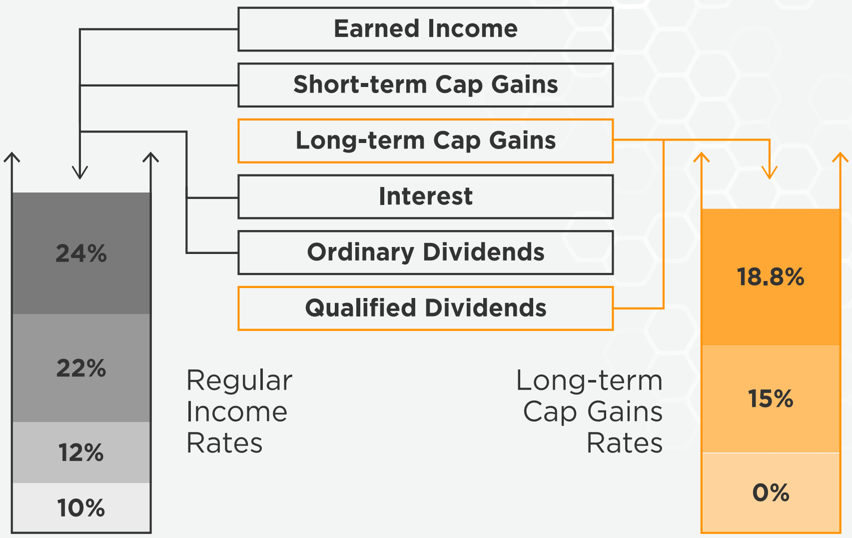
Interest is paid from bonds, CDs, and loans. Interest is typically taxed as regular income.

ORDINARY DIVIDENDS

Stocks pay dividends to shareholders. Ordinary stock dividends are taxed as regular income.

QUALIFIED DIVIDENDS

Some stock dividends may be considered “qualified”. If qualified, the dividends are taxed at a lower long-term capital gain rate.



Tax Rules for Retirees

SOCIAL SECURITY

Social Security is taxed as regular income, however not all your Social Security is included. This is an area of much confusion. There is a two-part calculation being done. One of the calculations is simple. It is 85% of your benefits. The second calculation is more involved.

It is a three-step process using something called Provisional Income. For example, a couple (the Browns) with $70,000 total income, has $50,000 of Social Security Income and $20,000 of other income.

85% OF SOCIAL SECURITY

Browns would pay taxes on $42,500

PROVISIONAL INCOME CALCULATION

Browns would pay taxes on $6,850

The IRS allows the Browns to pay taxes on the lesser of these two calculations. In this case, the Browns will pay taxes on $6,850. It is important to work with a knowledgeable professional who has the tools to compare both methods to get as much of your Social Security back tax free as possible.

We've done the calculations many times. Here is a guide:

Joint Filing Status

OTHER INCOME	SOCIAL SECURITY INCOME					
	$10,000	**$20,000**	**$30,000**	**$40,000**	**$50,000**	**$60,000**
$10,000	0%	0%	0%	0%	3%	7%
$20,000	0%	0%	5%	10%	14%	19%
$30,000	15%	20%	23%	28%	31%	33%
$40,000	69%	56%	51%	49%	48%	47%
$50,000	85%	85%	80%	70%	65%	61%
$60,000	85%	85%	85%	85%	82%	75%
$70,000	85%	85%	85%	85%	85%	85%
$80,000	85%	85%	85%	85%	85%	85%

Single Filing Status

OTHER INCOME	SOCIAL SECURITY INCOME					
	$10,000	**$20,000**	**$30,000**	**$40,000**	**$50,000**	**$60,000**
$10,000	0%	0%	0%	6%	11%	16%
$20,000	0%	13%	18%	24%	28%	30%
$30,000	54%	48%	46%	45%	45%	44%
$40,000	85%	85%	75%	67%	62%	59%
$50,000	85%	85%	85%	85%	79%	73%
$60,000	85%	85%	85%	85%	85%	85%
$70,000	85%	85%	85%	85%	85%	85%
$80,000	85%	85%	85%	85%	85%	85%

PENSION-TAXED AS REGULAR INCOME

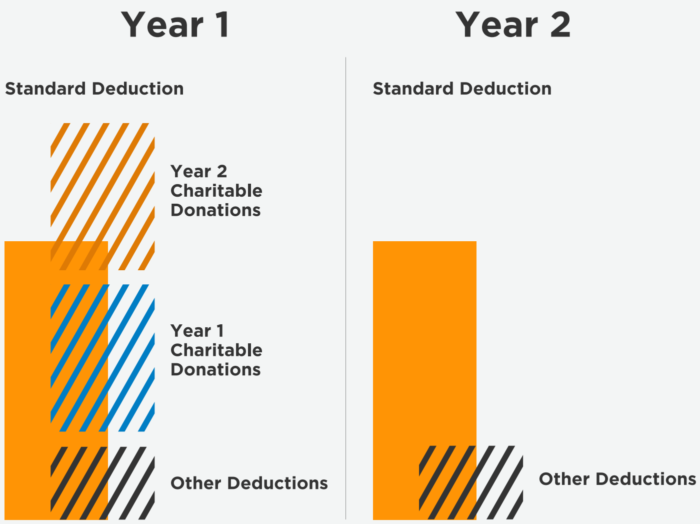
Monthly pension income is taxed as regular income as you receive it each year. If you choose a lump sum pension, it will be taxed as you remove it from a tax-deferred status. Many retirees assume taking a lump sum pension will cause taxes on their entire pension balance. This is not true if you roll the lump sum into another tax-deferred retirement account like an IRA or 401(k). Some retirees will take into consideration the tax flexibility of the pension lump sum vs monthly withdrawals when making the pension decision.

Retiree Tax Strategies

The government allows you to reduce your income by using “deductions”. A deduction is a government approved expense that can be used to reduce your taxable income. Some tax filers add up all their deductions and itemize them on their return. Many who used to itemize during their working years now use the standard deduction because of recent tax changes. The standard deduction is an amount you may use and then ignore all your itemized deductions.

BUNCHING DEDUCTIONS

If you can stack two years of charitable giving into one year, you may allow some of your itemized deductions to exceed the standard deduction. The following year you take the standard deduction. We find this can save some retirees thousands of dollars every other year.



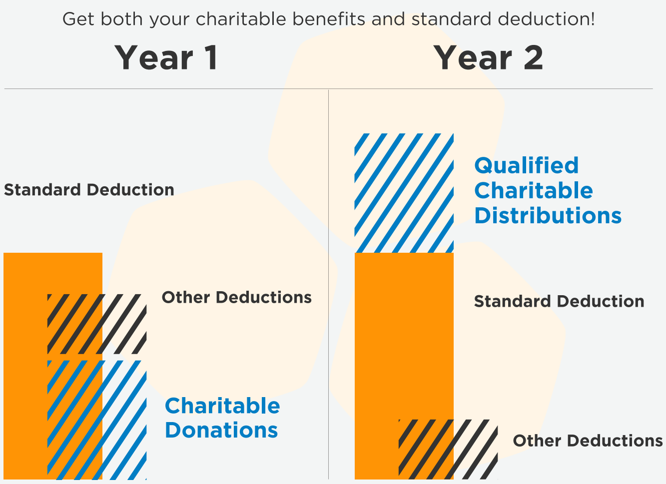
DONATING APPRECIATED SECURITIES

You may donate investments which have been held for more than 1 year to charities and avoid any capital gain tax on the increase.

UTILIZING A QUALIFIED CHARITABLE DISTRIBUTION (QCD)

A QCD is an IRA withdrawal that you send directly to a charity. You may start doing QCDs after you reach age 70.5. You don’t need to report that withdrawal as taxable income on your tax return.

You could reduce your income and still take the standard deduction.



USE TAX LOSS HARVESTING (TLH)

Tax loss harvesting is when you purposefully sell an investment to show a loss on your taxes. You reinvest the proceeds so that you participate when the market returns. You can use these losses to offset some regular income and to delay paying taxes on capital gains for years. This requires some knowledge of wash-sale rules which we won't cover here.

SEEK QUALIFIED DIVIDENDS OVER ORDINARY DIVIDENDS

Work with your financial professionals to have more and more of your dividends categorized as qualified to get a favorable tax treatment.

EMPLOY ASSET LOCATION

You can allocate your dividend and income paying investments in your retirement accounts where all income is tax-deferred. You can allocate your higher growth stocks outside your retirement accounts where you can benefit from long-term capital gains rates.

BE AWARE OF LONG-TERM CAPITAL GAIN PERIODS

Some investors ignore the holding period of investments. Waiting for 12 months can often save you approximately 7%-10% of the gains in taxes.

USE MARGINAL TAX BRACKET MANAGEMENT

Lastly, a well-prepared retiree has many options. This requires a keen eye to be aware of the many applicable tax lines. Marginal tax bracket management is when you purposefully structure your income to avoid tax lines or fill up space below them. Examples might include:

- Fill up the 10% and 12% tax brackets with pensions, SS income, and IRA withdrawals. Next, withdraw from non-retirement accounts and avoid any 22% taxable income

- Avoid Medicare Part B premium increases when possible

- Do gradual and partial Roth conversions to move money from a pre-tax status to a tax-free status. This allows you to control the tax rate you pay and provides more tax flexibility in retirement.

The well-prepared retiree has many options.

Summary

Taxes are one of the most complicated aspects of retirement planning. Most people don’t understand the basics so strategizing may feel impossible. Capita pays for tax analysis software which allows our advisors to audit returns and model scenarios. Contact us if you need help creating your retirement tax plan.

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If You'd Like To Learn More Reach Out To Us Today

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