Do Taxes in Retirement Matter?

ABSOLUTELY!

Utilizing the *proper tax planning* ***strategy*** can potentially *add 5-10 years or more of life to your retirement portfolio* when withdrawing income.

How would you like to be tax smart and add more life to your portfolio? Answer in the chat window.

Eye-Opening Stats to Consider…

- **37% of retirees admit they did not consider how taxes would impact their retirement income.***
  - As a result, Nationwide Retirement Institute says, they may have lost the opportunity to save six years' worth of income in retirement!

- 60% percent of pre-retirees, 70% of recent retirees, and 75% of those who have been retired for more than 10 years say they are only somewhat knowledgeable or not at all knowledgeable about tax planning!

- 52% percent of pre-retirees and 47% of recent retirees wish they better understood how their income in retirement will be taxed!

- 46% percent of recent retirees wish they had better prepared for paying taxes in retirement, and 24% said they have paid several thousands of dollars more in taxes than they had expected!

Retirees Lack Awareness of Income Tax Hits: Nationwide Research, Think Advisor, By Elizabeth Festa | November 02, 2018

*https://www.plansponsor.com/exclusives/income-taxes-follow-participants-retirement

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You DON'T Have to Be a Statistic

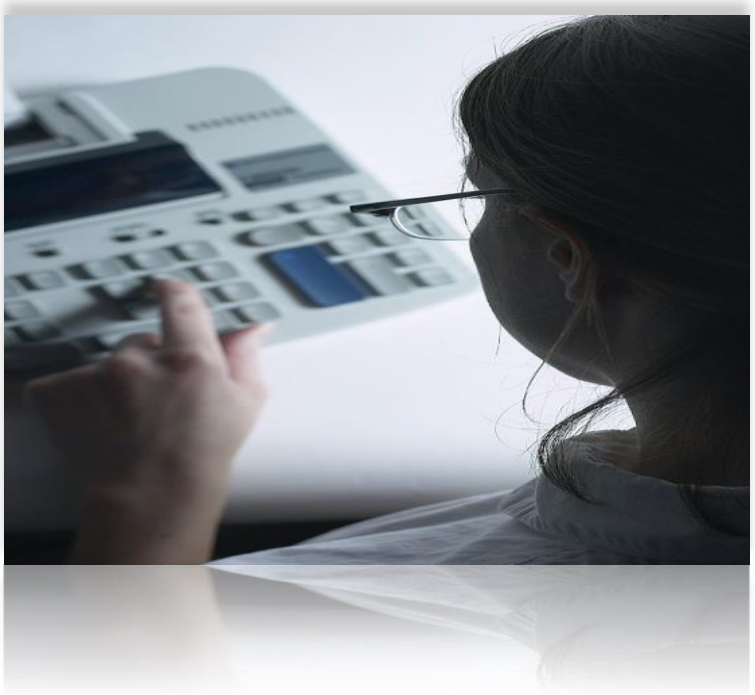
Let's find out how YOU can be tax smart & tax efficient.

Tax Risk

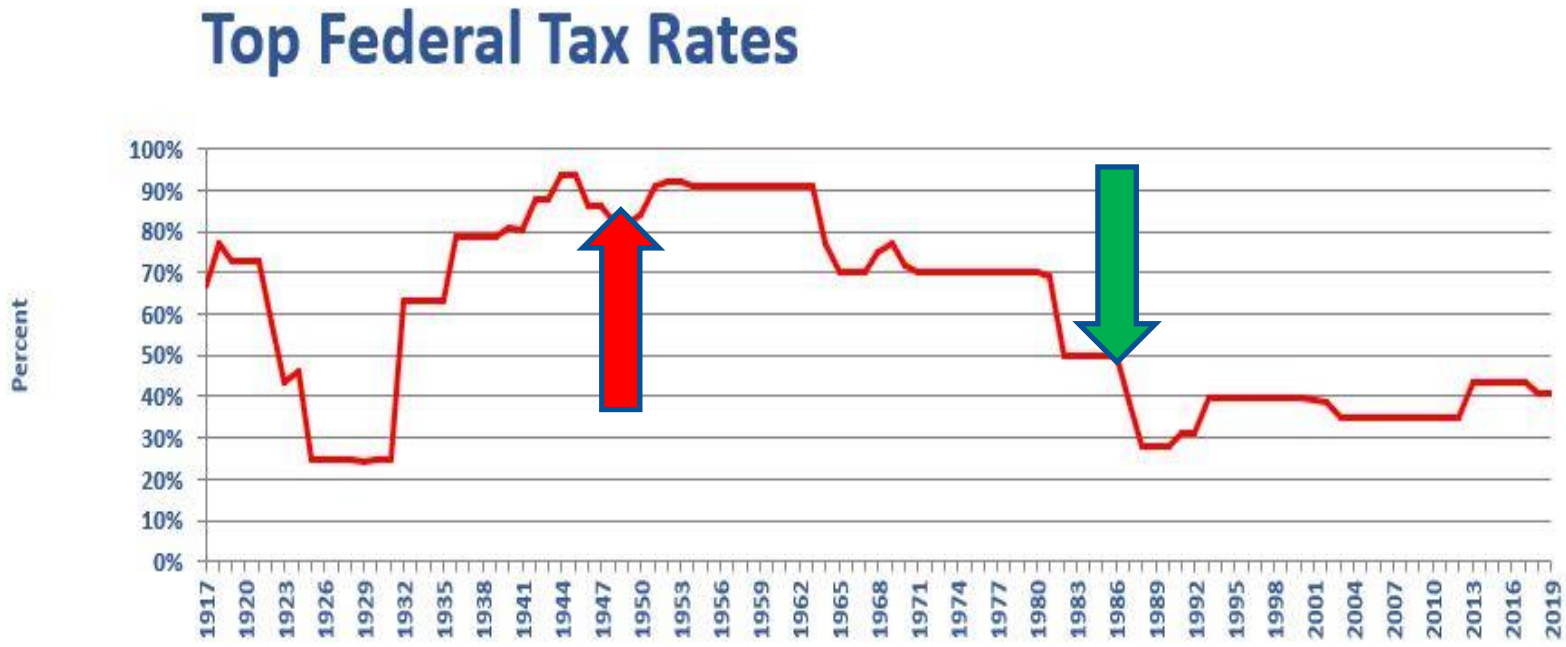
Tax liability in retirement has an impact on portfolio survival rates…**future tax rate increases may be the biggest challenge retirees face.**

Tax Reduction Strategies

- Roth Conversions
- Tax Loss Harvesting
- Annuities
- Tax-Free Investments
- Tax Optimized Withdrawals
- Asset Location



History of Federal Tax Brackets



1. http://www.usgovernmentdebt.us/
Source: http://www.macrotrends.net/2526/sp-500-historical-annual-returns/

The Future of Taxes – Federal Government Deficit

The Debt-to-GDP ratio - compares a country's sovereign debt to its total economic output for the year. Its output is measured by gross domestic product

- Used to gauge a country's ability to pay off its debt
  - **High ratio -** a country isn't producing enough to pay off its debt
  - **Low ratio -** there is plenty of economic output to make the payments

SOURCE: The Balance; Debt-to-GDP Ratio, Its Formula, and How to Use It, Kimberly Amadeo - Updated February 28, 2019

The Future of Taxes – Federal Government Deficit

US historical Debt-to-GDP ratio

- 1985 = 42%
- 1995 = 65%
- 2005 = 61%
- 2015 = 100%
- 2019 = 106%
- 2020 = 129%
- 2021 = Anticipated ??? % *

SOURCE:

- The Balance; Debt-to-GDP Ratio, Its Formula, and How to Use It, Kimberly Amadeo - Updated February 28, 2019
- FITCH WIRE, Mar 9,2021 US Stimulus Will Boost Growth at a Cost of Higher Deficits, Debt; fitchratings .com/

The Future of Taxes – Federal Government Deficit

Debt-to-GDP Ratio comparison

- Germany at 56.93% - Healthy Economy
- Greece at 176.64% - Unhealthy Economy

- 2021 United States at 130% ????
  - **$22.7 trillion U.S. debt** as of September 2019
  - **$27.0 trillion U.S. debt** as of October 2020

Statistica.com, Germany: National debt in relation to gross domestic product (GDP) 2014 to 2024
Statistica.com, Greece: National debt in relation to gross domestic product (GDP) 2014 to 2024

The Future of Taxes – Federal Government Deficit

Potential tax rate increases make tax planning more important and more beneficial…

Where do you think tax rates are heading???

Comment in the chat.

_____ Decreased Tax Rates
_____ Increased Tax Rates
_____ Remain the Same

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Tax Basics

Marginal Tax Brackets

SINGLE					
$0	$9,950	$0	+	10.0	$0
$9,950	$40,525	$995	+	12.0	$9,950
$40,525	$86,375	$4,664	+	22.0	$40,525
$86,375	$164,925	$14,751	+	24.0	$86,375
$164,925	$209,425	$33,603	+	32.0	$164,925
$209,425	$523,600	$47,843	+	35.0	$209,425
$523,600		$157,804.25	+	37.0	$523,600
HEAD OF HOUSEHOLD					
$0	$14,200	$0	+	10.0	$0
$14,200	$54,200	$1,420	+	12.0	$14,200
$54,200	$86,350	$6,220	+	22.0	$54,200
$86,350	$164,900	$13,293	+	24.0	$86,350
$164,900	$209,400	$32,145	+	32.0	$164,900
$209,400	$523,600	$46,385	+	35.0	$209,400
$523,600		$156,355	+	37.0	$523,600
MARRIED FILING JOINTLY AND SURVIVING SPOUSES					
$0	$19,900	$0	+	10.0	$0
$19,900	$81,050	$1,990	+	12.0	$19,900
$81,050	$172,750	$9,328	+	22.0	$81,050
$172,750	$329,850	$29,502	+	24.0	$172,750
$329,850	$418,850	$67,206	+	32.0	$329,850
$418,850	$628,300	$95,686	+	35.0	$418,850
$628,300		$168,993.50	+	37.0	$628,300

2021 Federal Income Tax Tables

2021 Standard Deduction Amounts

- $12,550 for single taxpayers.
- $12,550 for married taxpayers filing separately.
- $18,800 for heads of households.
- $25,100 for married taxpayers filing jointly.

* Married over age 65 add $1,350 each or $2,600 total to the standard deduction
* Single over age 65 add $1,700 to the standard deduction

How Are Taxes Calculated?

Married Couple - Filing Joint Return
Joint Earned Income: $145,000.

Deductions
401(k) Deductible Contributions: $22,700.
Standard Marital Deduction: $25,100

Adjusted Gross Income (AGI) of $97,200

$0 to $19,900 @ 10% = **$1,990 tax**
$19,901 to $81,050 (the next $61,149) @ 12% = **$7,338 tax**
$81,051 to $172,750 (the next $16,151) @ 22% = **$3,553 tax**

Income Tax Due …… $ 12,881

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Seven Tax Strategies that Can SAVE YOU A LOT!

Tax Strategies to Consider

Strategy #1: Consider Opening a Health Savings Account (HSA)

TRIPLE TAX FREE!

- Tax-deductible contributions
- Tax-free growth
- Tax-free withdrawals (for qualified health care expenses)

Tax Strategies to Consider

Health Savings Accounts

According to the Fidelity Health Care Cost Estimate, an average retired couple age 65 in 2018 may need approximately $280,000 saved (after tax) to cover health care expenses in retirement.

Source: Fidelity Investments, How to Plan for rising health care cost, Apr 18 2018

Tax Strategies to Consider

Health Savings Accounts (2021)

Tax-Deductible Contributions

- $3,600 max annual contribution (catch-up $1k age 55+) – Individual
- $7,200 max annual contribution (catch-up $1k age 55+) – Family

Tax-Free Accumulation

- Any funds in HSA accounts that are not used before the end of year are rolled over and accumulate tax-free

Tax-Free Distributions (if used for qualified medical expenses)

- **Not Subject to Provisional Income**
- **Not Subject to RMDs**
- Taxable distributions for non-qualified expenses

Consult your tax advisor pertaining to your specific situation.

Tax Strategies to Consider

Strategy #2: Consider Investments with Tax Advantages

- **Municipal Bonds/Funds**
  - Tax-Deferred Growth
  - Tax Free income (dividends and interest)
  - **Income included for provisional income calculation**
  - **No RMD**

- **Tax-Deferred Annuities (Non-Qualified)**
  - Tax-deferred Accumulation
  - Preferential tax treatment based upon the Exclusion Ratio (NQ Annuities)
    - **Percentage of income included for provisional income calculation**
    - **No RMD**

- **Life Insurance Retirement Plans (LIRP)**
  - Tax-Free Death Benefit
  - Tax deferred growth (Variable or Fixed returns)
  - Tax-Free Income (withdrawals to basis then loans)
  - **Not included in Provisional Income calculation**
  - **No RMD**

Note: There are many exceptions to all of these general rules. Certain items such as phase outs and alternative minimum tax can change your various scenarios. Consult your tax advisor pertaining to your specific situation.

Required Minimum Distributions (RMDs)

Must take required distributions from all qualified retirement accounts at age 72

- Mandatory withdrawals are based on age, an IRS life expectancy table and value of accounts each year
- Must take your first RMD by April 1st following the year you turn age 72
- Withdrawals must be taken by 12/31 of each year after age 72
- Missed RMD…50% penalty (assessed on amount that should have been distributed)

NOTE: RMDs were not required for 2020 due to the COVID-19 pandemic

Required Minimum Distributions (RMDs)

RMD Calculation: Retiree Age 72

- $500,000 Value on 12/31/2021
  - $500,000 / 25.6 = $19,531 RMD (must be taken by 12/31/2022)
  - 3.90% withdrawal

Table III (Uniform Lifetime)

Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
70	27.4	**82**	17.1	**94**	9.1	**106**	4.2
71	26.5	**83**	16.3	**95**	8.6	**107**	3.9
72	25.6	**84**	15.5	**96**	8.1	**108**	3.7
73	24.7	**85**	14.8	**97**	7.6	**109**	3.4
74	23.8	**86**	14.1	**98**	7.1	**110**	3.1
75	22.9	**87**	13.4	**99**	6.7	**111**	2.9
76	22.0	**88**	12.7	**100**	6.3	**112**	2.6
77	21.2	**89**	12.0	**101**	5.9	**113**	2.4
78	20.3	**90**	11.4	**102**	5.5	**114**	2.1
79	19.5	**91**	10.8	**103**	5.2	**115 and over**	1.9
80	18.7	**92**	10.2	**104**	4.9		
81	17.9	**93**	9.6	**105**	4.5		

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The RMD Problem

Uniform Lifetime Table

Age	Divisor Balance	% Account	Age	Divisor Balance	% Account
70	27.4	3.65	86	14.1	7.09
71	26.5	3.77	87	13.4	7.46
72	25.6	3.91	88	12.7	7.87
73	24.7	4.05	89	12.0	8.33
74	23.8	4.20	90	11.4	8.77
75	22.9	4.37	91	10.8	9.26
76	22.0	4.55	92	10.2	9.80
77	21.2	4.72	93	9.6	10.42
78	20.3	4.93	94	9.1	10.99
79	19.5	5.13	95	8.6	11.63
80	18.7	5.35	96	8.1	12.35
81	17.9	5.59	97	7.6	13.16
82	17.1	5.85	98	7.1	14.08
83	16.3	6.13	99	6.7	14.93
84	15.5	6.45	100	6.3	15.87
85	14.8	6.76	101	5.9	16.95

Source: IRS Publication 590

How Do RMDs Effect Retirement?

Age 72:
$500,000 IRA / 25.6 = $19,531 / 3.90%

Age 80:
$500,000 IRA / 18.7 = $26,738 / 5.35%

Age 90:
$500,000 IRA / 11.4 = $43,850 / 8.77%

Age 100:
$500,000 IRA / 6.3 = $79,365 / 15.87%

Tax Strategies to Consider

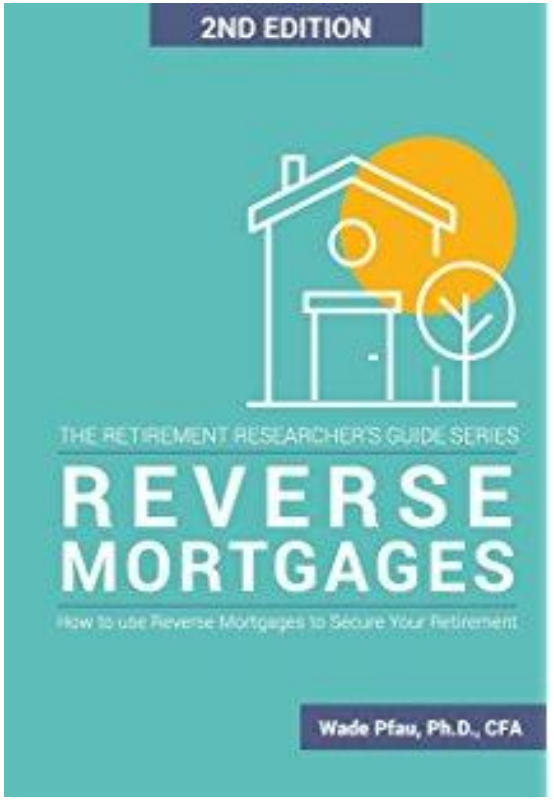
Strategy #3: Consider Reverse Mortgages for Tax-Free Income or a Tax-Free Safety Net

How to use Reverse Mortgages to Secure Your Retirement By Wade Pfau, Ph.D, CFA,February 27, 2017

"Though reverse mortgages have long held a bad reputation, research and Public policy in recent years are shedding a new light on their potential uses in retirement."

"Financial planning research has shown that coordinated use of a reverse Mortgage starting earlier in retirement outperforms waiting to open a reverse mortgage as a last resort option once all else has failed."

NOTE: It is imperative to calculate the effect of a reverse mortgage on each individuals personal situation to determine the negative or positive effect on the overall retirement outcome. Each retiree's situation and asset levels different and outcomes will vary based upon these nuances.



Tax Strategies to Consider

HECM Loans (Reverse Mortgages)

Can I tap into my home equity to support myself in retirement?

- Must be 62 Years of age
- Typically need 50-60% equity to qualify
- Owners must maintain the home as well as pay property taxes
- **Income NOT subject to income tax**
- **Income NOT subject to SSI Provisional Income**

Tax Strategies to Consider

Strategy #4 - Consider Contributing to a Roth IRA or 401(k)

Overview

- **After tax contributions -** Contributions must be made using after-tax dollars
- **Tax-deferred growth -** Contributions and earnings compound tax-deferred
- **Tax-free withdrawals -** Contributions and earnings can be withdrawn tax free
  - Subject to five-year holding period plus age restriction
- **Tax planning flexibility**
  - No RMD's Required
  - NOT subject to Social Security Provisional Income calculation

Tax Strategies to Consider

Roth Contribution Limits

Roth IRA

- Roth IRA contribution limits are $6,000 per year in 2021 (people 50 or older can add $1,000 to those amounts).
- Roth IRA income limits in 2021 are $140,000 of modified adjusted gross income for singles and $208,000 of modified adjusted gross income for joint filers

Roth 401(K) or Roth 403(b)

- Roth 401(k) contribution limits are $19,500 (under age 50) & $26,000 age 50 +

NOTE: Both Roth IRA & Roth 401(k) can be split with Traditional IRA & Traditional 401(k) contributions but cannot exceed the maximum aggregate noted above

Tax Strategies to Consider

An Exception to the Roth Income Requirements Rule…

The Backdoor Roth

- Contribute to your Traditional IRA and convert the non-deductible contribution to a Roth IRA in the same tax year
- Must pay tax on the conversion to the Roth IRA in the tax year converted

Tax Strategies to Consider

Taking Money Out of a Roth Tax-Free

- Must satisfy two Triggering Events
  - Age 59 ½
  - Owned Roth for 5 years

- 10% penalty and tax on EARNINGS for withdrawals before satisfying BOTH triggering events
- Allowed to take CONTRIBUTIONS at any time
- Exception allowed - $10,000 withdrawal (including growth) for 1st time purchase of a home

Tax Strategies to Consider

Strategy #5 - Consider Intelligent Roth Conversions

To Convert of Not to Convert??

The Trade Off:

- Convert your Traditional IRA to a Roth IRA, you:
  - Pay income taxes at your current tax rate on conversion
  - Tax-free growth
  - Tax-free withdrawals during retirement
    - Must satisfy two triggering events
      - Age 59 ½
      - ***5-year wait on each conversion***

Tax Strategies to Consider

Strategy #5 - Consider Intelligent Roth Conversions

All or Nothing

- If you convert your Traditional IRA to a Roth IRA over the course of multiple years:
  - You may pay less total tax than if you convert during a single year
  - Future tax increases make conversion to Roth more advantageous

Additional Benefits

- Pass Roth assets to heirs income tax-free (subject to restrictions)
- Not Subject to SSI Provisional Income Calculation
- No RMDs

Tax Strategies to Consider

Strategy #6 – Manage Social Security Taxation

Social Security Taxation

Will Your Benefit Be Taxable?

NO!

Unless Your ***SSI Provisional Income*** Exceeds Certain Limits

Social Security Income

What is SSI Provisional Income???

SSI Provisional Income = adjusted gross income + nontaxable income (municipal bonds) + ½ of Social Security benefit income

Hypothetical Provisional Income Calculation:

- AGI = $45,000 IRA withdrawal or RMD (-) $24,800 Standard Marital Deduction = $20,200 AGI
- Muni Bond Income = $10,000 earnings
- Social Security Income = $20,000 (1/2 of $40,000 SSI)

Total Provisional Income $50,200

Social Security Taxation

Will Your Benefit Be Taxable? Depends on your Provisional Income …

Up to 50% of benefit may be taxable if your combined income* is:
$25,000 to $34,000 and you file as single
$32,000 to $44,000 and you file as married filing jointly

Up to 85% of benefit may be taxable if your combined income* is:
Over $34,000 and you file as single
Over $44,000 and you file as married filing jointly

Tax Strategies to Consider

Strategy #7 – Use Cash Value Life Insurance

Whole Life – earns interest at rate set by carrier

Universal Life – earns interest variable rate set by carrier

Variable Life – Cash Value invested in sub-accounts performance based on return of those accounts

Ability to borrow or distribute cash value tax-free

Tax-free transfer of wealth to your heirs

Tax Strategies to Consider

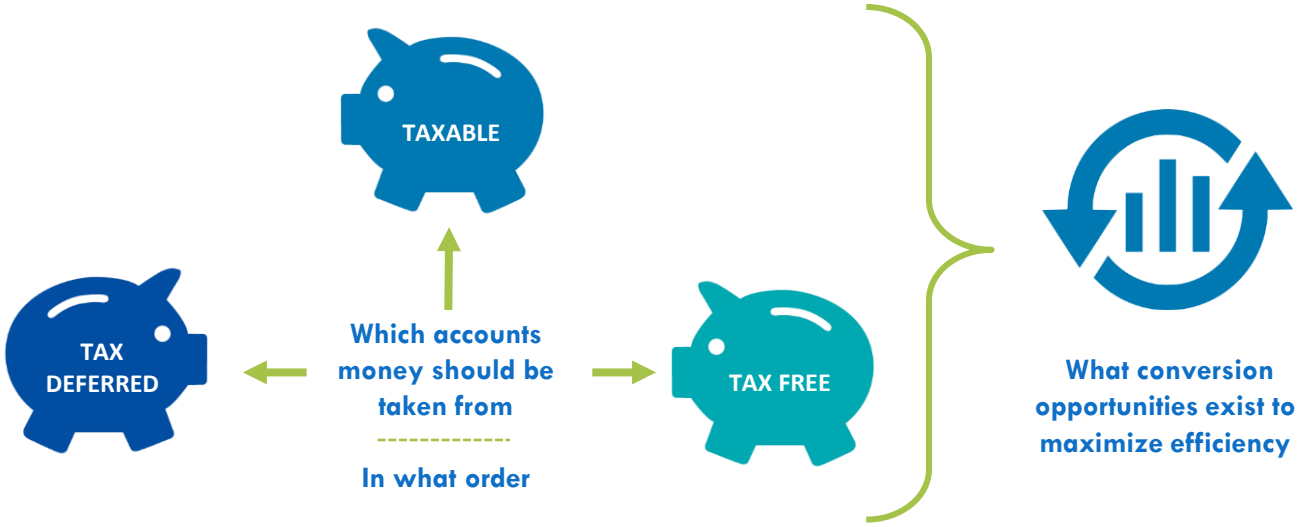
Strategy #8 – Tax Diversification

- *Create Your Buckets!*
- Tax Diversification - Having tax-free, taxable and tax-deferred investments in retirement offers the ability to create a *tax efficient income distribution strategy.*

Tax Strategies to Consider

Strategy #9 – Income Distribution

Your strategy for **withdrawing** retirement assets is as important as your strategy for **accumulating** them… **BUT MUCH MORE COMPLEX!**



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Three Drawdown Strategies To Consider

PRO RATA STRATEGY

- Withdraw from taxable, tax deferred, and tax-free accounts proportionally
- **Not optimal in most cases**

SEQUENTIAL STRATEGY

- Withdraw from taxable accounts first; then tax deferred accounts; lastly tax free
- **The Traditional approach, but not the most efficient in most cases**

SEQUENTIAL WITH ROTH CONVERSION STRATEGY

- Withdraw from taxable accounts first; then tax deferred accounts; lastly tax free
- Roth conversions are executed to take advantage of periods of lower tax brackets
- **Most Optimal in most cases**

Tax Efficient Retirement Distribution

Not all retirement savings assets are equal from a taxability standpoint:

- Taxable
- Tax deferred
- Tax free

An efficient retirement plan should illustrate:

- Which accounts money should be taken from
- In what order
- What conversion opportunities exist to maximize efficiency

A customized tax efficient distribution strategy could save you significant value and extend the time horizon of your retirement assets.

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Before you implement any strategy to reduce your tax liability, make sure it complements your overall financial plan.

Her Retirement
CASE STUDY
RIGHTCAPITAL

Meet the Brady's

Mike and Amanda — married

Current Ages — 56/54

Target Retirement Age — 65/65

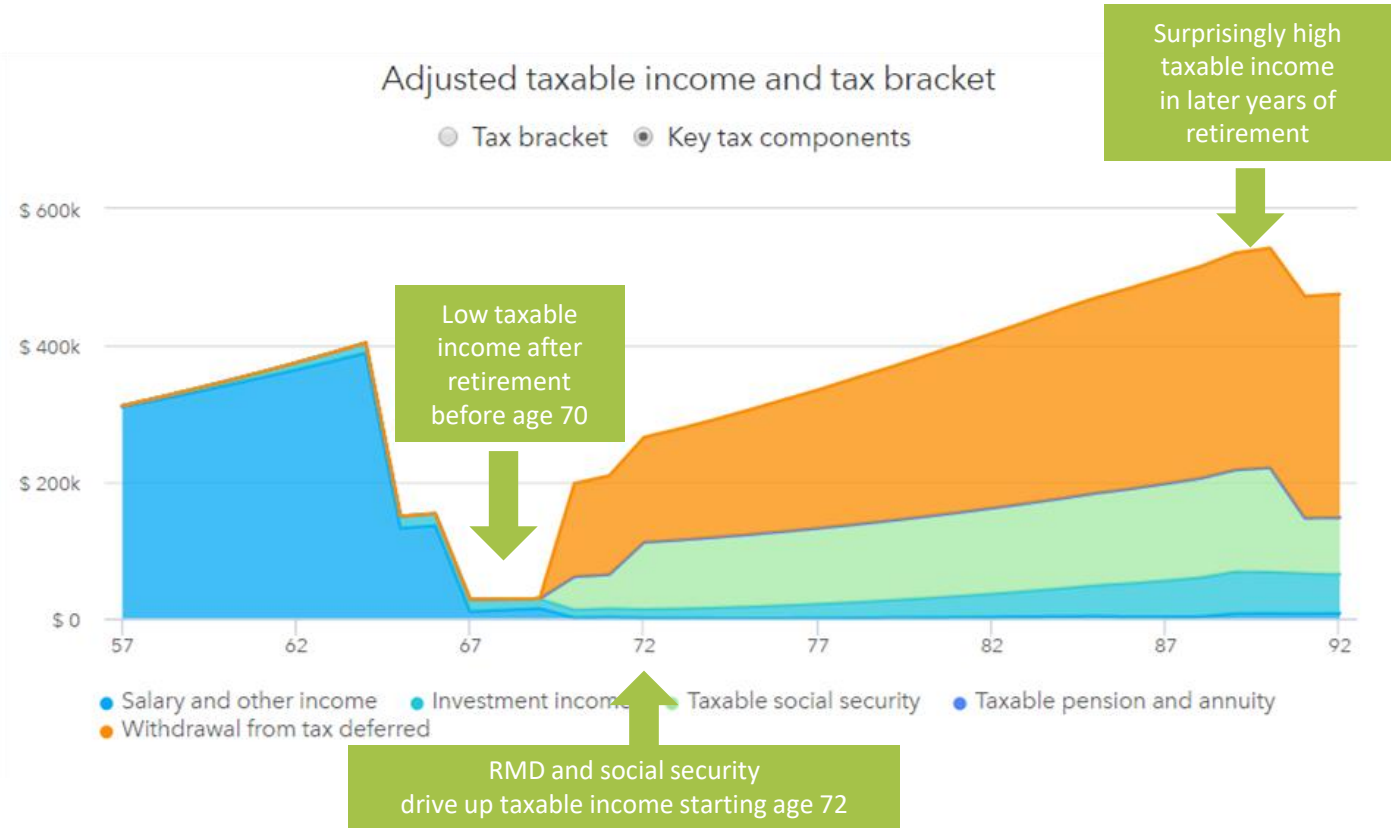
Salary — $200K/$50K

Social Security — 70

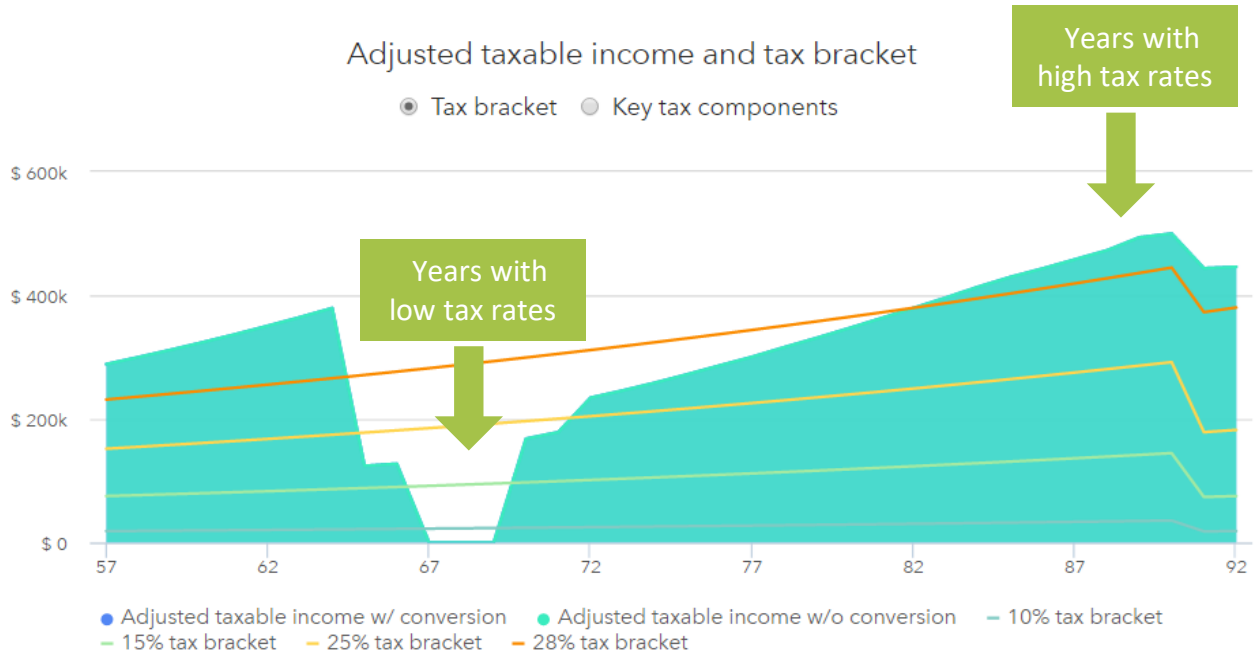
Monthly Expenses in Retirement — $9K

Invested Assets — $1.0 MM qualified & $100K non-qualified

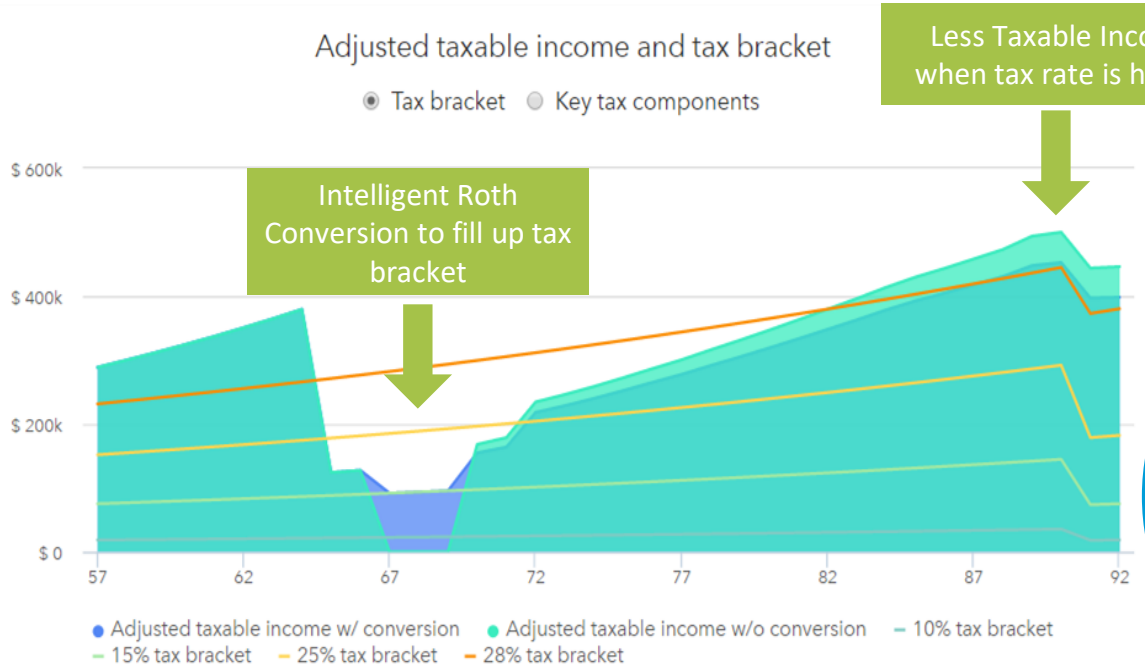
Tax Brackets During Retirement Can Be Surprising – Before Tax Planning



Large IRA RMD Distributions Drive Up Tax Brackets – Without Tax Planning



Smoothing Out The Tax Liability – With Tax Planning



PROPOSED STRATEGY:

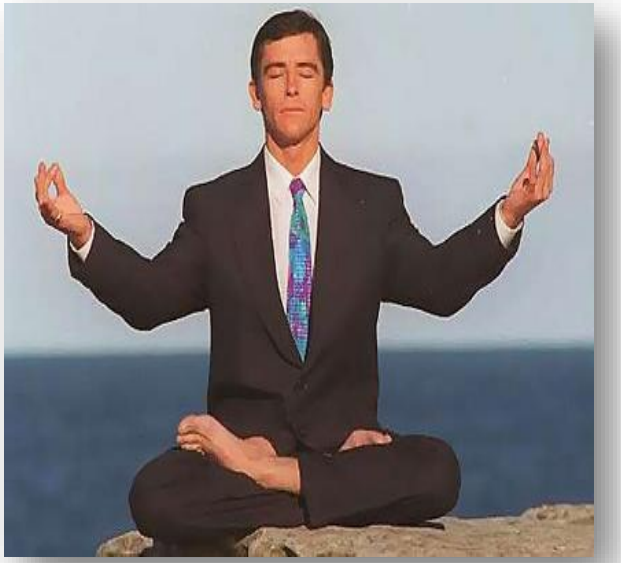
$1,136,742 MORE

Tax-adjusted ending portfolio rather than a pro-rata withdrawal strategy w/o conversion

Taxes DO Matter in Retirement!

Key Takeaways

- ✓ Create your Buckets (tax-deferred, tax-free & taxable)
  - Tax diversification
- ✓ Utilize an HSA for triple tax advantages
- ✓ Implement Tax-Efficient Withdrawal Sequencing, coupled with Roth Conversions

Result

- Minimize RMD effect
- Reduced Social Security Provisional Income
- Reduced Medicare premiums with lower income
- Reduced taxes annually to increase net spendable income