The Tax Guide

from Tax Smart Retiree

Tax Planning in Retirement

With the prospects of living longer also comes the need for fiscal knowledge and responsibility to ensure that your money lasts as long as you do!

In addition, the single biggest threat to your retirement and your security may be taxes. With our national debt at all-time highs of more than $30 trillion dollars, do you believe taxes will be able to stay at all-time lows? Over the last 100 years, the highest tax rate has averaged 61%. Today, our top tax rate is 39.6%, meaning that taxes are discounted by more than 20% relative to the last 100 years. So, you must ask yourself, "Does it make sense to defer taxes during this super low tax period?" The answer is probably somewhere in the middle, deferring some and paying some in different savings vehicles. At Tax Smart Retiree we focus on helping you determine the right mix of taxable, tax-free, and tax-deferred savings and investment vehicles you're most comfortable with, as no one knows for sure where taxes will be when they retire.

Eye Opening Statistics 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!

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

- 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!

This tax guide reviews the basics of income and tax planning, and will assist you in thinking about your own retirement income needs!

Section 1: Overview of fundamental income and investment concepts

Section 2: Overview of taxes and the tax system

Section 3: Social Security and taxation

Section 4: Ten Tax Saving Strategies

Section 5: Tax Optimization Strategy – A Case Study

Section 6: Conclusion – Retirement Planning Matters

What you will learn from this tax guide:

- Retirement Distribution Planning: positioning savings with asset location to minimize taxes, maximize cash flow in retirement, and efficiently harvest income sources.
- Maximizing Social Security: impact of Social Security taxation on your retirement, including provisional income and IRS thresholds that cause Social Security taxation, and strategies to put you in a position to receive your Social Security free from tax.
- Protecting Against Market Loss: safeguarding against the two types of investment risk.
- Generating Tax-Free Income: using a little-known IRS code to potentially generate tax-free and non-reportable income.
- Tax Rate Risk: strategies you can implement that may help insulate your assets from the impact of potentially higher taxes in retirement.

Tax efficiency planning can potentially add 5-10 of life to your portfolio, provide more spendable cash and/or allow you to leave more money to your heirs.

Section 1: An Overview of some fundamental investment concepts

A Proper Retirement Income Plan is MORE than just an investment portfolio. To create an Efficient & Sustainable-for-Life Retirement Income Strategy, there are four key strategies:

1. Tax minimization (or elimination)
2. Proper Social Security timing
3. Portfolio Management & Volatility Reduction that combines traditional investments, insurance, and/or annuities
4. Leveraging housing wealth

The Reality vs. the Rhetoric

In order to maximize these strategies, proper financial advice is critical. These strategies are not based on speculations or conventionally-held wisdom but are informed by several research studies in tax planning that support these findings. A study by Morningstar Star Gamma suggests that dynamic withdrawal strategies, together with proper asset class selection and allocation and product selection, can add a value of up to 1.59% a year. In addition, advice on appropriate tax-efficient withdrawal ordering and asset location add to the full economic benefits of proper planning.

A Vanguard Advisor Alpha study indicates that advice on investment selection and systematic rebalancing, tax-efficient withdrawal ordering, asset location, and behavioral coaching can increase economic benefits by up to 3% a year. Likewise, a study by Envestnet Capital Sigma found that financial planning advice/dynamic withdrawal strategies, asset class selection together with allocation and product selection, investment selection, systematic rebalancing, and tax loss harvesting can give results greater than 3% per year.

A Balanced Advice Option

While such strategies can increase portfolios' values, the question remains where a retiree can get the help needed to obtain maximum yields. Traditionally, most retirees have had to rely on a "siloed" Financial Services industry, consisting of CPAs, Insurance Agents, and Investment Advisors. This outdated approach has left many retirees unprepared for today's complex and highly-volatile financial market.

While CPAs have been necessary for filing tax returns, they are not necessarily the best source for tax planning. Insurance agents have typically focused on annuities and life insurance to the

same extent. Still, they don't usually have the proper training or credentials to help decide on investments that could benefit a retiree. Likewise, investment advisors have typically focused on traditional investments without considering the ramifications of taxes and clients' other holdings.

As a result, an alternative approach to these three "siloed" fields of the financial industry is what is known as a Hybrid Retirement Advisor. A Hybrid Retirement Advisor focuses on integrating all these disciplines to develop and maintain a balanced, comprehensive, and efficient retirement plan that offers the best potential retirement outcome without a retiree worrying about running out of money.

Taxes in Retirement

Many people wonder if taxes really matter in retirement. Well…taxes in retirement **do** matter! While taxes are often considered a boring personal finance topic, it should be regarded as one of the most interesting! Why? Proper tax planning is a critical part of retirement income planning. Taxes affect almost every aspect of personal finance, and with the appropriate guidance, retirees can learn how to legally pay fewer taxes, which results in more dollars available to them.

There are many financial strategies to keep more of what you earn. We will begin by briefly covering a few tax-related issues.

Section 2: Overview of Taxes and the Tax System

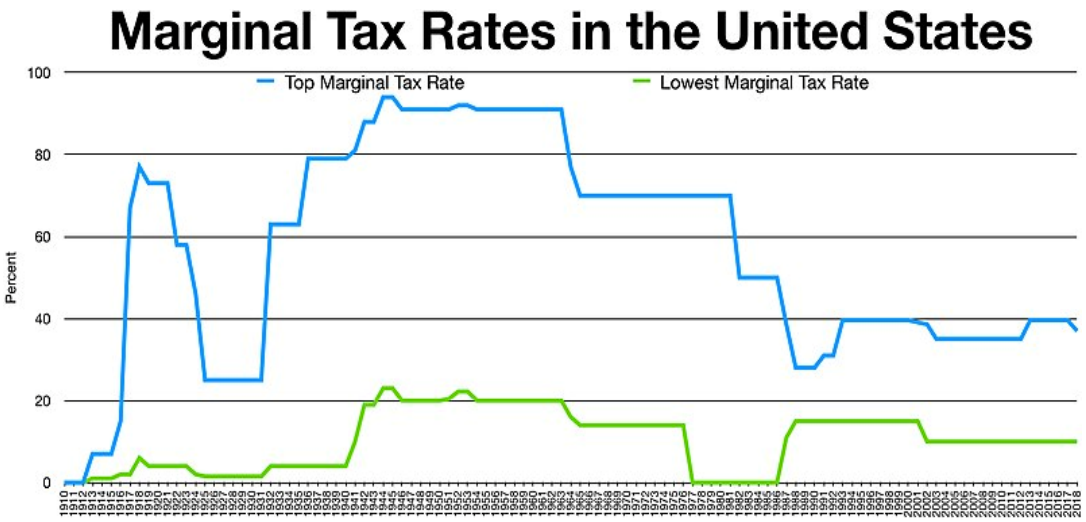
Our tax dollars provide many social benefits and are simply a fact of life. However, proper planning can save you thousands of dollars and extend your retirement income for years. Some points to think about when planning for your retirement:

- Tax dollars are not available for your financial needs
- Tax planning is a critical part of financial planning
- There are many financial strategies to keep more of what you earn
- Today's tax laws will likely be repealed or changed in the future
- Don't base your entire financial plan on current tax laws

When withdrawing income, utilizing the proper tax planning strategy can add five to ten years or more of life to your retirement portfolio.

The History Behind Today's Tax System

Now that you have considered the absolute need for tax planning in preparation for retirement, we should think about where tax rates may be in the future. As the chart below indicates, the top marginal tax bracket rates have gone up and down from 1910 through 2018.



The chart starts in 1910, three years before any systematized taxation system. In 1913, the 16th amendment to the Constitution made the income tax a permanent fixture in the U.S. tax system. The top marginal tax bracket jumped as high as 75% and was as high as 94% in the 1940s. If we move ahead on the chart, we see that by the 1980s, when Ronald Reagan was President, marginal tax brackets were at a significantly lower rate—in fact, they were at the lowest rates seen since 1916.

While taxes over the past couple of decades have been at their lowest in nearly a century, we need to consider our national debt. In 1990, the debt was only $2 trillion. Less than 32 years later, our national debt has increased almost tenfold and stands close to nearly $30 trillion.

With the current debt level and low, but rising interest rates, we need to consider the impact on future taxes. If we do the simple math, most likely, we will face higher taxes at some point in the future.

While we usually think of taxes and national debt as national issues, individuals closing in on retirement need to consider the effect of taxes and future tax rates on their retirement.

Tax Rate	Married Filing Jointly or Qualified Widow(er)	Single	Head of Household	Married Filing Separately
10%	$0 - $19,750	$0 - $9,875	$0 - $14,100	$0 - $9,875
12%	$19,750 - $80,250	$9,875 - $40,125	$14,100 - $53,700	$9,875 - $40,125
22%	$80,250 - $171,050	$40,125 - $85,525	$53,700 - $85,500	$40,125 - $85,525
24%	$171,050 - $326,600	$85,525 - $163,300	$85,500 - $163,300	$85,525 - $163,300
32%	$326,600 - $414,700	$163,300 - $207,350	$163,300 - $207,350	$163,300 - $207,350
35%	$414,700 - $622,050	$207,350 - $518,400	$207,350 - $518,400	$207,350 - $311,025
37%	Over $622,050	Over $518,400	Over $518,400	Over $311,025

2020 Marginal Tax Brackets

Importance of Diversification

When considering taxes, we need to look at how retirees accumulate money and when it is available in retirement. We also need to consider how taxes impact savings when we make withdrawals.

We can better understand these matters by looking at three categories or buckets. We can categorize assets by their characteristics, such as qualified, capital, and tax-free assets.

- **Qualified assets** are 401(K), traditional IRAs, and pension plans.
- **Capital assets** include blocks, businesses, real estate, and mutual funds.
- **Tax-free assets** are Roth IRAs, Municipal funds, 7702 plans, and life insurance.

When considering where tax rates are headed in the future and your retirement, you need to consider each of these buckets.

How do tax rates affect these various forms of assets in retirement? Let's take a look at each bucket**.**

Qualified Assets and Taxes (tax-deferred)

The Tax-Deferred bucket includes any retirement accounts to which you have contributed money on a tax-deductible or pre-tax basis, such as most IRAs, 401(k)s, 403(b)s, and others. These accounts typically allow for tax-deferred growth, which means that you are not taxed on

income or gains as they occur, but when you eventually take retirement income, the funds you withdraw will be taxed as ordinary income. Even with these deferments, there are tax implications in the present and the future.

Your tax rate may vary, but for simplicity's sake, let's use a taxable income rate of 50 percent as an example. If you were to withdraw $100,000 from your qualified assets, it would be taxed at a 50 percent tax rate, so your net after-tax withdrawal would be reduced to $50,000. In other words, due to taxation, your qualified asset withdrawals are essentially reduced by half.

However, if you were just at the upper end of the next-lower 35% tax bracket, only a slight increase in taxable income could bump you up to the 50% tax bracket, which would sharply increase your taxes on the $100,000 by an additional $15,000. If you withdraw wisely in retirement, you could save this additional tax expenditure. If you are like most people, you might not have a good sense of what tax bracket you will be in during retirement? This could be costly.

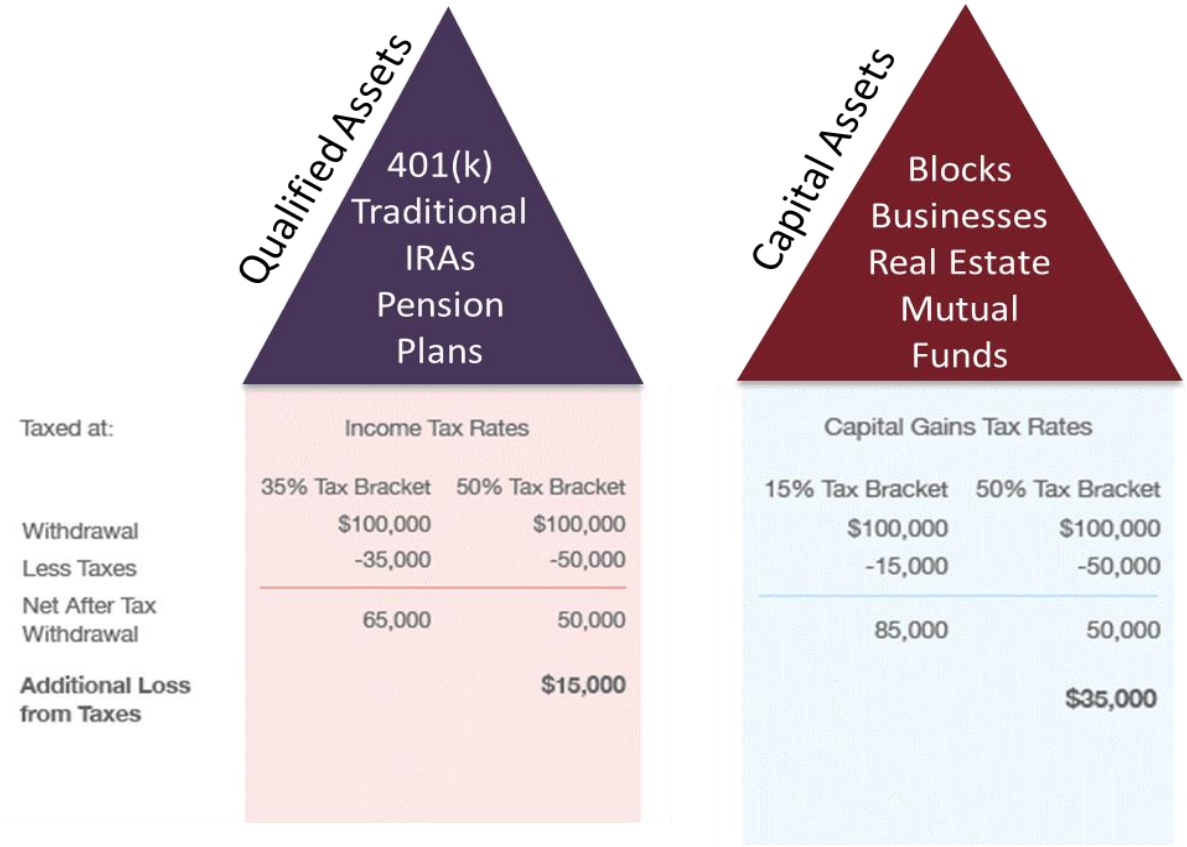
Taxed at:	Income Tax Rates	
	35% Tax Bracket	50% Tax Bracket
Withdrawal	$100,000	$100,000
Less Taxes	-35,000	-50,000
Net After Tax Withdrawal	65,000	50,000
Additional Loss from Taxes		**$15,000**

Capital Assets and Taxes (taxable)

Capital Assets are made up of stocks, mutual funds, and the like. Basically, any type of investment in which you receive a 1099 on an annual basis. These funds receive no special tax

treatment, and you will typically be taxed on interest and dividends as they are paid, in addition to any gains you make upon the sale of investments in this bucket.

If we use the same example as above, where we start with $100,000 and run it through capital gains tax exposure, the capital gains taxes fall within the 50 percent bracket. Consequently, withdrawals would be reduced by 2 to 1. However, here's where qualified assets differ from capital assets. The lower tax bracket for capital assets is 15 percent. In other words, if you were in the 15 percent tax bracket, you would receive $85,000, rather than $50,0000, after taxes. Hence, if you withdraw without proper planning, you could see a loss of as much as a $35,000 net after-tax withdrawal.



These taxes are a real financial threat, but they could also impact your retirement when you need to access your assets!

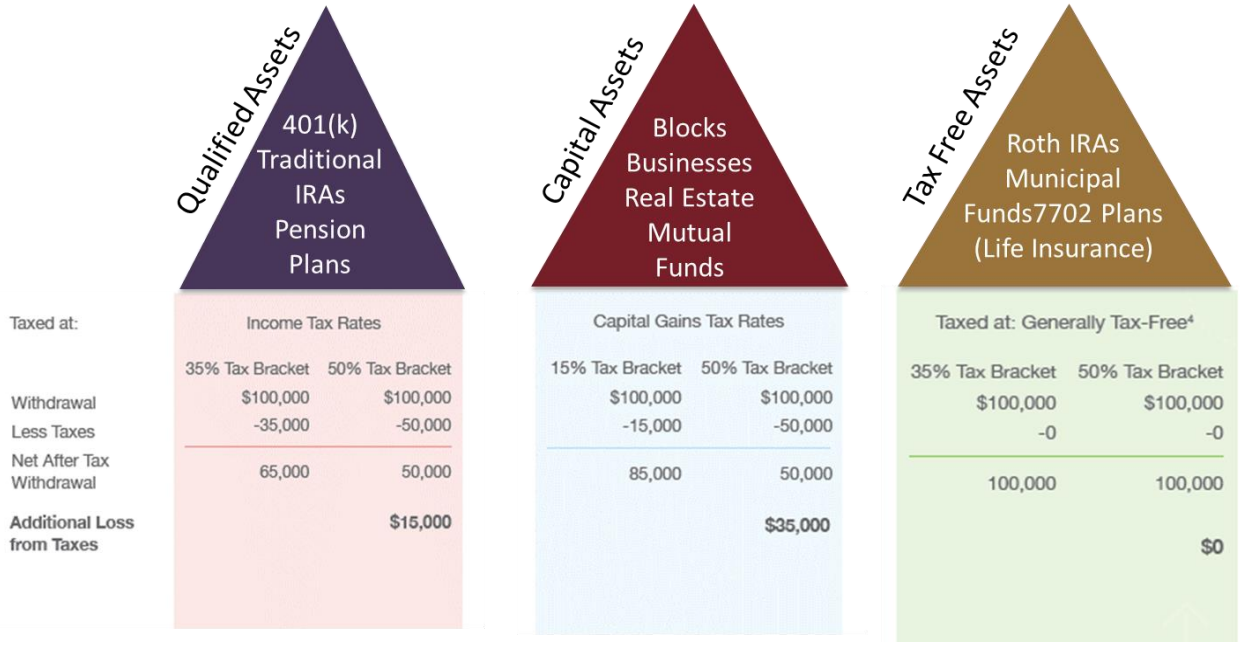
Depending on the stock or real estate markets, withdrawing or selling your assets during a low period could dramatically impact your long-term retirement values. This could be a real timing challenge. Questions you need to ask yourself regarding capital assets include: Do you

withdraw assets when the markets are good? What if the markets have a few underperforming years? Do you have alternative sources to access funds in the interim?

Tax-Free Assets and Taxes

Finally, the Tax-Free bucket includes accounts to which you contribute after-tax money, such as Roth IRAs, Roth 401(k)s, and others. You do not get any special tax breaks upfront in this bucket, but all contributions and growth can be withdrawn income-tax-free for qualified reasons (which is generally once you are at least 59½ years old and the account has been established for at least 5 years).

No matter which tax bracket you are in, you are sheltered from taxes in retirement. Using the same example from above of a $100,000 withdrawal, we can see whether you are in the 50 percent bracket or the 35 percent tax bracket. In other words, when you choose to withdraw from this bucket, you will receive dollar for dollar.



When your funds are essentially sheltered, wouldn't you want to put all of your assets in the tax-free assets bucket? Why does it make sense to have funds in all three buckets?

Is the Tax-Free Option Overlooked?

Tax-smart strategies help protect wealth. In a perfect world, what would your ideal portfolio look like? You might have some improved tax strategies that include:

- Tax-deferred growth
- Tax-free income, non-reportable income
- Tax-free death benefit for loved ones
- Ability to save outside of Internal Revenue Service limitations

Let's look at the reasons why individuals use tax-free assets to build retirement growth.

First, tax-free assets can be considered tax-deferred growth. Second, tax-free assets are non-reportable income, which means withdrawals from this bucket will not affect your aggregate gross income and cannot tip you into a higher tax bracket. Third, tax-free assets like the 7702(N) can also offer a tax-free death benefit, so if the unexpected happens, your loved ones could be taken care of—just to reiterate, tax-free.

Finally, tax-free assets allow you to save outside the Internal Revenue Service's limitations. For instance, if we look at Roth IRA, which most would know, it is an incredible retirement tool. However, the annual contribution limit for 2022 is $6,000, or $7,000 if you're age 50 or older. While this amount can add up over the years, it won't provide you with the kind of funds you will need in retirement, and in some cases, if you make too much money, you cannot contribute to a Roth IRA. However, there is a back door Roth option. You can also think about a life insurance retirement plan, which provides the tax benefits of a Roth IRA without the income restrictions.

Roth IRAs.

A Roth IRA is a special retirement account where you pay taxes on money going into your account and then all future withdrawals are tax-free. Roth IRAs are best when you think your taxes will be higher in retirement than they are right now. They can be especially good for young savers or in years when you don't have much other income.

Converting a portion of a traditional IRA into a Roth IRA is a good idea this year if you have a big tax deduction this year and your marginal tax rate is lower than normal. If you have money in a traditional IRA, any withdrawals are going to be taxable. A useful tax rule-of-thumb is to take withdrawals from these plans at a lower-than-normal tax rate. If you do not need withdrawals to live on, convert it to a Roth IRA (and pay taxes at the low rate) and future earnings are now tax-free.

Roth IRA contributions are made on an after-tax basis. However, keep in mind that your eligibility to contribute to a Roth IRA is based on your income level. Below you will find a breakdown of the 2022 updates to the Roth IRA contribution income limits:

YOUR FILING STATUS	YOUR 2021 INCOME	YOUR 2022 INCOME	YOU MAY CONTRIBUTE:
Single, head of household or married filing separately (and you did not live with your spouse at any time during the year)	Less than $125,000	Less than $129,000	Up to the annual limit
	$125,000 to $140,000	$129,000 to $144,000	A reduced amount
	More than $140,000	More than $144,000	Zero
Married filing jointly or qualified widow(er)	Less than $198,000	Less than $204,000	Up to the annual limit
	$198,000 to $208,000	$204,000 to $214,000	A reduced amount
	More than $208,000	More than $214,000	Zero
Married filing separately	Less than $10,000	Less than $10,000	A reduced amount
	More than $10,000	More than $10,000	No deduction

There is a 4th tax bucket which offers triple tax advantages. In this bucket are Health Savings Accounts. Not to be confused with Flexible Spending Accounts or FSAs.

Health savings accounts (HSAs) are tax-advantaged savings accounts designed to help people who have high-deductible health plans (HDHPs) with paying for out-of-pocket medical expenses. While these accounts have been available since 2004, too few eligible Americans are taking advantage of them. Many corporations offer them as part of their employee benefits packages. In addition, small business owners can open their own private HSAs.

According to the Fidelity Retiree Health Care Cost Estimate, an average retired couple age 65 in 2022 may need approximately $315,000 saved (after tax) to cover health care expenses in retirement. To help fill a gap in saving for health care expenses, consider increasing contributions to your HSA.

Tax-Deductible Contributions

- $3,650 max annual contribution (catch-up $1k age 55+) – Individual
- $7,300 max annual contribution (catch-up $1k age 55+) – Family

Tax-Deferred Accumulation

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

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

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

According to a July 2015 report from the Employee Benefit Research Institute (EBRI), about 17 million people had HSA-eligible health insurance plans in 2014, but only 13.8 million of that number had opened an HSA. An April 2018 survey of its member insurers by America's Health Insurance Plans (AHIP) reported 21.8 million HSA enrollees in 52 HDHP plans in 2017, up from 20.2 million the previous year. These types of health plans are offered by about 43% of employers right now. EBRI found that virtually no one contributes the maximum, and nearly everyone takes current distributions to pay for medical expenses.

All of this means that consumers who have HSAs—as well as consumers who are eligible for HSAs but haven't opened one—are missing out on an incredible option for funding their later years. In addition, many people don't understand that an HSA is an investment account like any other investment account and offers tremendous growth opportunity.

Key Takeaways:

- The high-deductible health plan you need to qualify for an HSA may be more budget-friendly than it seems because premiums are so low.
- Unlike a Flexible Spending Account, your HSA money is yours forever, and it's portable.

- You can contribute to an HSA until age 65, even when you're not working.
- Invest your HSA money; don't just leave it in a savings account.
- Keep receipts for unreimbursed medical expenses since you got your HSA. You can use them to get tax-free funds from your account.

Deciding Which Tax Buckets to Use?

Which bucket to use depends in part upon what will happen in the future. In order to use the different buckets most efficiently, we believe you should not only understand how much you are paying in income taxes while contributing, but also what your income taxes may be in the future when withdrawing from the accounts. Based on the income sources you anticipate being available to you in retirement, you may be able to estimate what your future income taxes will be; however, there is the possibility (and some experts say probability) that income tax rates may increase in the future.

If you were able to predict your future tax bracket, and your income tax rates were going to be lower in retirement than they are now, it may make sense to invest in a tax-deferred account during your higher income-earning years and claim the deduction to reduce your current taxable income. The intent then would be that when you begin taking an income stream from this tax-deferred account in the future/retirement, you would pay a lower rate of income taxes upon withdrawal than you would have owed earlier if you hadn't been able to claim the initial deduction.

However, if you believe that your income will be higher in retirement or that tax rates will increase, it may make sense to invest in a tax-free account during your earning years (and pay taxes on the funds upfront) so that you can withdraw funds in retirement tax-free. Unfortunately, there is no crystal ball available to know what the future will hold. Some investors choose to hedge their bets and invest in both buckets, giving them flexibility and tax diversification in their retirement years. A retirement planner well versed in tax strategy can help you make the best choices for your goals.

How are Income taxes calculated? Marginal Tax Rate

Income tax in the USA is based on a marginal tax rate. The idea of a marginal tax rate is often misunderstood. Your marginal tax rate is the share of each extra dollar of income to the IRS. Marginal tax rates apply different tax rates to varying income levels; as income rises, it is taxed at a higher rate.

The marginal rate is applied to income after deductions. For example, if you are a single person whose gross earned income is $67,000 and you contribute $5,000 to a 401(K) plan, your taxable

income would be $67,000 minus $5,000, minus a $12,000 standard deduction on a 1040, or $50,000. On this $50,000 taxable income, the first $9,225 is taxed at 10%, earned dollars between $9,225 and $37,450 are taxed at 15%; finally, your dollars between $37,450 and $50,000 are taxed at 25%. In such a case, total taxes will be $952 plus $3,500 plus $2,485 for a total due of $6,927, or a 10.35% effective tax.

Capital Gains Tax

Capital gains are profits from the sale of an asset (shares of stock, land, business). A capital gain is an increase in the value of a capital asset that gives it a higher value than the purchase price. However, this gain is not realized until the asset is sold. "Realized gains" for assets held 12 months or less are taxed at the same rate as ordinary income. Assets held for more than 12 months are usually taxed at a lower rate. This is the government's way of encouraging investors to "buy and hold" rather than sell for a quick profit.

Capital gains tax is assessed depending on filing status. Here is the 2022 rates:

Long-term Capital Gains Tax Rates for 2022

Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household
0%	$0 – $41,675	$0 – $83,350	$0 – $41,675	$0 – $55,800
15%	$41,675 – $459,750	$83,350 – $517,200	$41,675 – $258,600	$55,800 – $488,500
20%	$459,750+	$517,200+	$258,600+	$488,500+

Capital Gain Tax Exclusion for Home Sales

If you sell your home for a profit, you may be able to exclude, i.e., not pay federal income tax on part of or all of the gains. The exclusion is up to $250,000 of gains for single filers and up to $500,000 of gains for a married couple (filing jointly).

However, several tests must be passed to be eligible:

- **Ownership test:** During the five years ending on the date of the sale, you must have owned the home for at least two years

- **Use test:** During the same five-year period, you must have used the property as your primary residence for at least two years.
- **Previous sale test:** During the two years ending on the date of the sale, you did not exclude gains from the sale of another home
- **Joint-filer test:** To be eligible for the $500,000 joint-filer exclusion, at least one spouse must pass the ownership test, and both spouses must pass the use test

Required Minimum Distributions (RMD) at age 72

Tax-deductible and tax-deferred retirement accounts (IRAs, 403bs, SEP IRAs, etc.) allow tax-deductible contributions. These accumulated contributions are tax-deferred until age 72 when you must begin to withdraw funds. Mandatory withdrawals are based on age, life expectancy, and the value of accounts each year. Withdrawals must be taken by December 31st of each year after age 72, or a 50% penalty must be assessed on a missed RMD (assessed on the amount that should have been distributed).

- 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 turned 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)

RMD's Effect on Retirement

RMDs are assessed according to a retiree's age divided by the expected distribution period (life expectancy) for that given age. For instance, at age 72, the expected distribution period is 27.4 years (2022 and after). An IRA valued at $100,000 would come out to an RMD of 3.649% percent, or $3,659 ($100,000/27.4). At age 80, the calculation is based on a distribution period of 20.2. An IRA valued at $100,000 would come out to $4,950 or 4.95%. At 90, the RMD would be $100,000 divided by 12.2, which equals $8,196 or 8.196%. The big problem with RMDs is that you are forced to take out a larger amount of money each year and these are taxed as well. This causes you to take (and potentially use) more than you need, which could lead to portfolio overdraft (i.e. running out of money). The RMD effect MUST be managed by your retirement tax advisors.

Distribution Periods 2021 and Before		Distribution Periods 2022 and After	
Age	Distribution Period	Age	Distribution Period
72	25.6	72	27.4
73	24.7	73	26.5
74	23.8	74	25.5
75	22.9	75	24.6
76	22.0	76	23.7
77	21.2	77	22.9
78	20.3	78	22.0
79	19.5	79	21.1
80	18.7	80	20.2
81	17.9	81	19.4
82	17.1	82	18.5
83	16.3	83	17.7
84	15.5	84	16.8
85	14.8	85	16.0
86	14.1	86	15.2
87	13.4	87	14.4
88	12.7	88	13.7
89	12.0	89	12.9
90	11.4	90	12.2

The 2017 Tax Cut and Jobs Act

The Tax Cuts and Jobs Act of 2017 (set to expire in 2025) made several significant changes to the individual income tax, including reforms to itemized deductions and the alternative minimum tax, an expanded standard deduction and child tax credit, and lower marginal tax rates across brackets.

- These changes simplify the individual income tax for millions of households, as 28.5 million filers would be better off taking the newly expanded standard deduction, instead of itemizing various deductions, reducing compliance costs.
- The Internal Revenue Service estimates the average time to complete an individual tax return will decrease by 4–7%. Converting this to dollar terms, we estimate compliance savings could range from $3.1 billion to $5.4 billion.
- Under the new tax law, new limits apply to some itemized deductions, including deductions for state and local taxes paid and mortgage interest, which broadens the tax base and reduces distortions in the tax code.
- The individual income tax changes are scheduled to expire after December 31, 2025.
- It's recommended that you speak to a qualified tax specialist to make sure you are taking proper advantage of these changes.

Section 3: Social Security Benefits and Taxation

Many people assume that they have to begin receiving Social Security retirement benefits as soon as they retire and stop working. But that is not the case. Retiring and claiming Social Security benefits are two different things. You have options! Learning about them may help you make a well-informed decision about when to start receiving your benefits.

As you approach retirement, one of the most significant financial decisions you will need to make is when to claim your Social Security retirement benefits. Should you begin receiving benefits at your full retirement age, which is 66 to 67, depending on your birth year? Or, should you start receiving a smaller monthly benefit before your full retirement age, as early as age 62? Or, might you want to wait past full retirement age to receive a larger monthly benefit? (You can actually delay receiving benefits up to age 70).

Taxes may be a consideration for when to claim your Social Security benefits, depending on your income and your Social Security benefits. Taxes will not be a big concern for everyone; if you have little or no income other than Social Security, your Social Security income generally won't be taxable. However, you may have to pay federal income taxes on your benefits if you have income from sources other than Social Security. As shown on the chart below, 50% to 85% of your Social Security benefit may be taxable, depending on your combined income from Social Security and other sources and your tax filing status.

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

***Provisional Income =** Adjusted Gross Income (AGI) + nontaxable income + ½ of Social Security benefit income

For example, if you are single and collect a Social Security benefit of $20,000 per year and have $35,000 in earnings from a job, up to 85% of your benefit may be taxable because your

adjusted gross income (after standard deductions) plus one-half of your Social Security income is greater than $34,000 per year.

The important point to remember is that when you're making your decision about when to begin receiving your Social Security benefits, federal and, in some cases, state income taxes may be a consideration if you have substantial taxable income such as earned income, taxable pension income, or investment income!

Social Security – What You Need to Know

As a starting point, if you haven't already done so, you should go to the Social Security website, where you have a couple of relatively easy ways to estimate what retirement benefits you might receive. First, you can sign up to access your Social Security Statement online to view your actual earnings record and what you can expect to receive under the current law if you apply at age 62, at full retirement age, and age 70. If you are already age 60, you can also receive this statement in the mail every year, about three months before your birthday. The second way to estimate your Social Security benefit is to use the SSA's Retirement Estimator, also available on the SSA website. This calculator allows you to input various scenarios based on current law, to estimate your future benefits.

As you near age 62, you should also contact the Social Security Administration to discuss your options. Representatives are not allowed to give you advice about when to start your benefits, but they will be happy to explain your options and the rules that apply. When it comes time to apply for Social Security benefits, you can do that online, by phone, or in person.

Section 4: Ten Tax Saving Strategies

You can use ten strategies to save money on this year's taxes. Before implementing any strategy to reduce your tax liability, ensure it complements your overall financial plan. Often, it is advisable to examine your tax situation two years at a time. The goal is to reduce your tax liability over both years.

1. Participate in your Employer-Sponsored Retirement Plan

In many employer-sponsored retirement plans, your contributions are pre-tax, reducing your taxable income. Employer-sponsored retirement plans also provide long-term tax benefits since your principal and earnings grow tax-deferred until withdrawn.

2. Contribute to a Traditional IRA

If you do not have an employer-sponsored plan available to you, consider making contributions to a Traditional IRA. Depending upon your income, you may be able to deduct your contributions. Like a 401k, your IRA provides the long-term benefit of tax-deferred growth. For 2022, individuals may contribute up to the lesser of $6,000 if you're under age 50 and $7,000 if you're age 50 or older, or 100% of earned income.

3. Contribute to a Health Savings Plan/Flexible Spending Account

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.[1] With a Health Savings Plan, employees can set aside pre-tax dollars for qualified dependents or for health care expenses. In order to do so, an employee must be enrolled in a High Deductible Health Plan ($1,200 Individual Deductible Plan; 2,500 Family Deductible Plan).

Like a Health Savings Plan, sometimes employers provide Flexible Spending Accounts to enable their employees to set aside pre-tax dollars from their paychecks for qualified dependent or health care expenses throughout the year. There is a $3,650 maximum annual contribution for individuals and a $7,300 maximum annual contribution for families.

These contributions to a Flexible Spending Account also reduce your taxable income. However, you should plan carefully because any funds in certain types of Flexible Spending Accounts that are not used before the end of the year might be forfeited. For instance, many cafeteria plans used for expenses, e.g., child care, often require you to use all money in the account before the end of the year or else it is forfeited. On the other hand, unused contributions to plans, including Health Savings Accounts (HSAs), may be rolled over for future years.

4. Itemize tax Deductions[2]

You might consider whether you would benefit from itemizing your deductions instead of taking the standard deduction. There are a variety of expenses that may be deductible when you itemize: Mortgage interest and points; property taxes; state and local income taxes or sales taxes; medical and dental expenses above a certain percentage of your adjusted gross income; charitable contributions; losses from casualty or theft (subject to restrictions); and miscellaneous itemized deductions which include unreimbursed employee expenses and tax

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

2 For some higher income taxpayers, itemized deductions are partially phased out. Consult your tax advisor pertaining to your specific situation.

preparation fees that when combined exceed 2% of your adjusted gross income. A standard deduction for a single person is $12,950, a married couple is $25,900, and a head of household is $19,400.

5. Consolidate Deductible Expenses

If you do not have enough deductions to itemize for each year, consider when to spend money on deductible expenses. Slight modifications in spending may allow you to save by itemizing one year and taking the standard deduction the following year. There are several ways to modify your spending to maximize your deductions. For instance, you could:

- Have all non-essential dental or medical work performed in the same calendar year.
- Make charitable contributions in the same calendar year by giving next year's contribution at the end of this year.
- When making charitable contributions, consider donating appreciated long-term securities to get a full fair market value deduction and pay no tax on capital gains.
- Consider selling depreciated securities to receive the loss as a tax deduction, then donate the cash to charity.
- Make your mortgage payment for January in the prior year. If you send your payment well in advance, your payment will be reflected on the 1098 form sent to the IRS.
- Prepay your estimated state income tax balance due instead of waiting until next April.
- Prepay the second installment of your property tax (assuming you are not subject to the Alternative Minimum Tax).

6. Use Capital Loss Rules to Your Advantage

Capital losses (securities sold for less than their purchase price) may be used to offset capital gains as long as the securities are in a taxable account. Suppose your capital losses exceed your capital gains during the tax year. In that case, you may use up to $3,000 ($1,500 for each married person filing separately) of losses to offset earned income and reduce your taxable income. Losses above $3,000 can be carried forward to offset gains in future years with no expiration date.

According to the Wash Sale Rule, a loss is not allowed for income tax purposes if you sell a security at a loss and buy back the same security within 30 days of the sale. If you do not want to be out of the market for a month, you may consider finding a similar (but different) investment (usually in the same asset class) to replace the sold security.

7. Consider Reverse Mortgages for Tax-Free Income or a Tax-Free Safety Net

- 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

8. Consider Investments with Tax Advantages

Several investments provide both short-term and long-term tax advantages. Municipal Bonds/Funds offer tax-deferred growth, and the dividends and interest provide tax-free income. However, remember that the income generated is included in the provisional income calculation.

Tax-Deferred Annuities provide tax-deferred accumulation and are a guaranteed income stream with preferential tax treatment. Tax-deferred annuities have partial, provisional income exclusion.

Life Insurance Retirement Plans (LIRP) are little known in the tax code but have multiple advantages. LIRPs provide tax-free death benefits, tax-deferred growth on both variable or fixed returns, and tax-free income on withdrawals to basis and loans on accumulated value. LIRPs are not included in provisional income calculations.

9. Roth Conversions

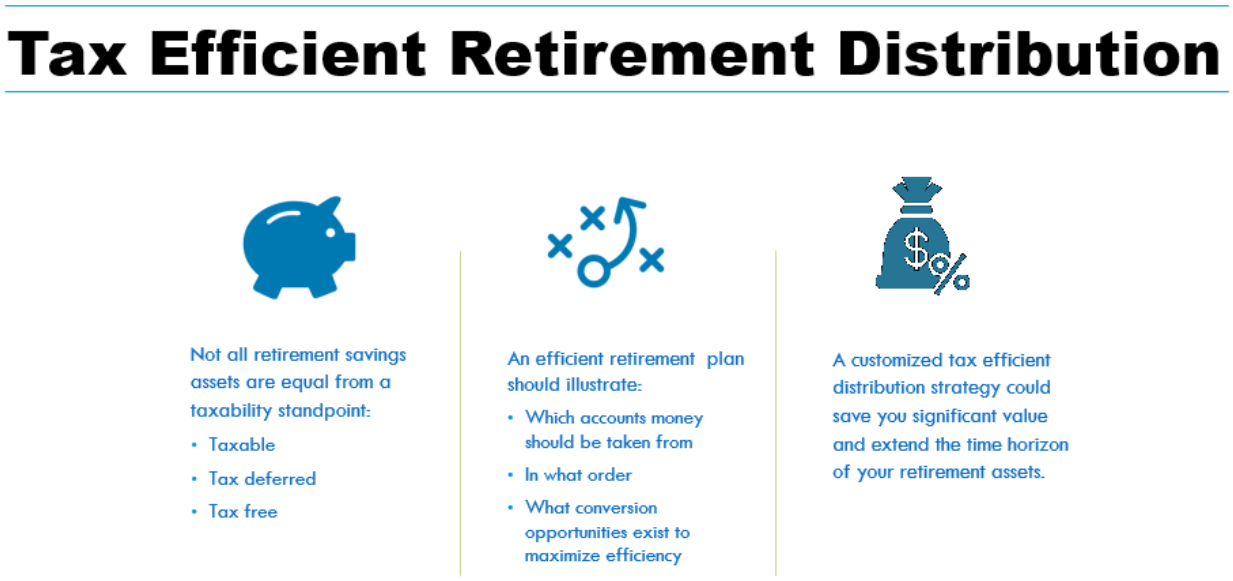
While traditional IRA contributions are tax-deductible for the year you make the contribution. Withdrawals in retirement will be taxed at ordinary income tax rates. While Roth IRAs provide no tax break for contributions, earnings and withdrawals are generally tax-free in retirement. The question, then, is to convert or not to convert. If you convert a traditional IRA to a Roth IRA, you will pay income taxes at the current tax rate upon conversion but receive tax-free growth and can make tax-free withdrawals during retirement. You can pass Roth assets to heirs, income tax in retirement is free as well, and the income is not included in your provisional income calculation.

One option with a Roth is to convert your Traditional IRA to a Roth IRA over the course of multiple years, so you may pay less total tax than if you convert during a single year. Future tax increases make converting to a Roth more advantageous.

With a Roth, you will be able access funds tax free after satisfying 2 triggering events: You have reached age 59 1/2 and at least 5 years have passed after establishing your first Roth IRA.

10. Withdrawal Sequencing

Sequential Withdrawal Strategy refers to the proper withdrawal sequence for maximum tax benefits. A recommended basic retirement withdrawal sequence would be made up of first withdrawing from RMDs (accounts with required minimum distribution). Next you should withdraw from taxable accounts, then tax-deferred accounts and finally tax-exempt accounts. [3]



Section 5: Tax Optimization Strategy – A Case Study 1

The following case study illustrates the tax benefit of implementing just 1 of the 10 strategies. In this case study, we will look at how you could optimize your tax benefit by using Tax Strategy number 8, Sequential Withdrawals.

Conventional Wisdom tells us to withdraw portfolio assets for retirement income in the following order:

1. Taxable Accounts
2. Tax Deferred Accounts
3. Tax Exempt Accounts (Roth)

[3] this withdrawal sequence is for illustrative purposes only, every individual will have an optimal sequence based upon his or her individual asset mix

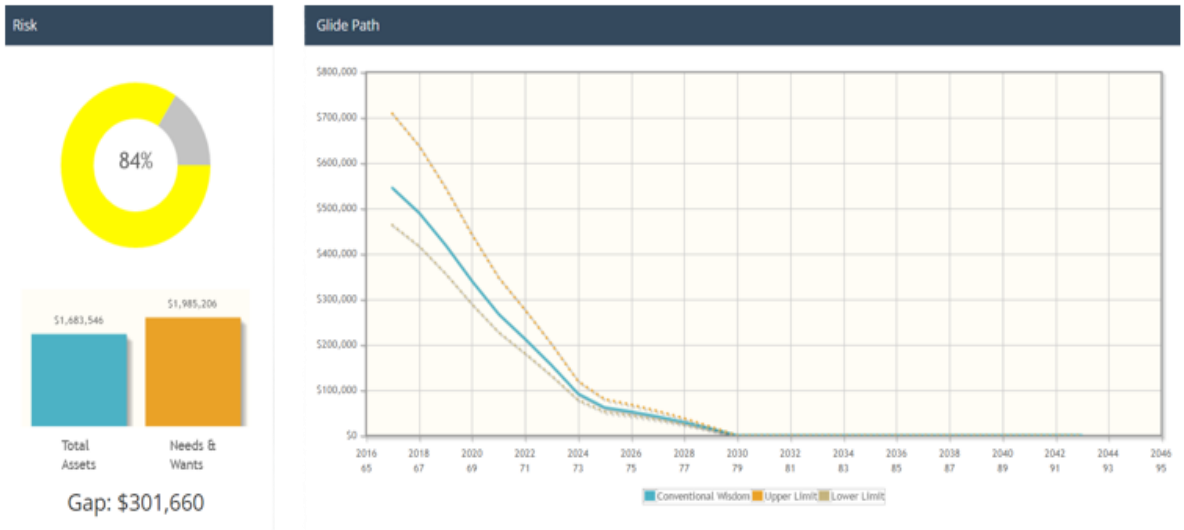
4. Non-Deductible IRA
5. Non-Qualified Annuity

But how wise is conventional wisdom?

In this case study, we'll look at the retirement planning for a couple, Nate and Denise, in three different scenarios. Nate and Denise have $679,000 in total retirement assets, made up of $500,000 in their 401(k), $125,000 in taxable assets, and $54,000 in a Roth IRA.

Scenario A

For the first scenario, let's look at the following graph. Using conventional wisdom to determine the order of withdrawal, we see that only 84% of Nate and Denise's needs are covered, and they will run out of money by age 79, probably well before the end of their retirement.



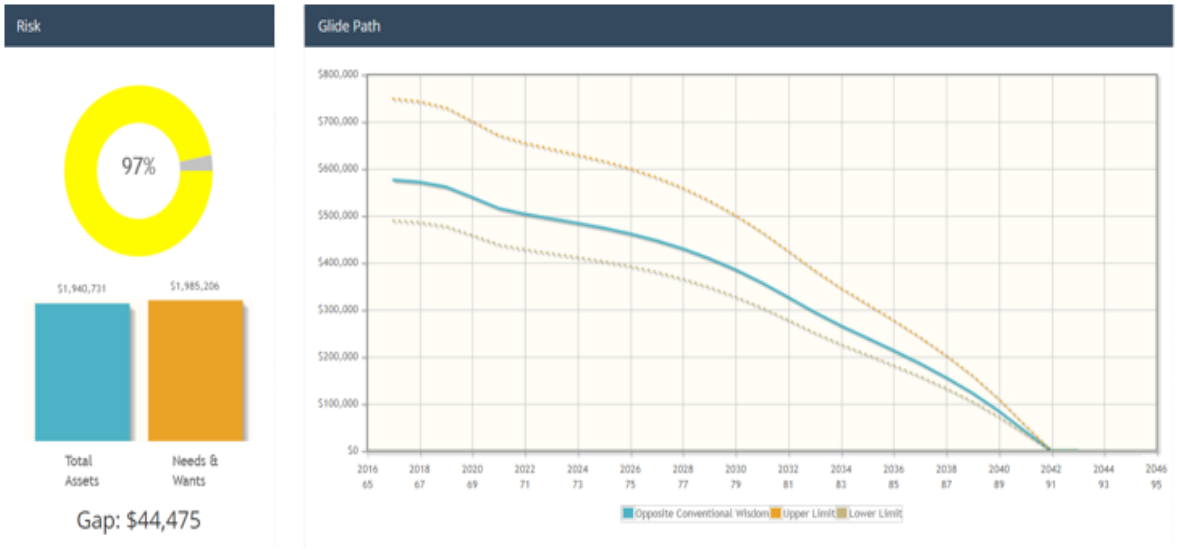
Scenario B

Using a different scenario (and some unconventional wisdom), the following order of withdrawal might look like the following:

1. Tax-Exempt Accounts (Roth)
2. Tax-Deferred Accounts
3. Taxable Accounts

4. Non-Qualified Tax-Deferred Accounts

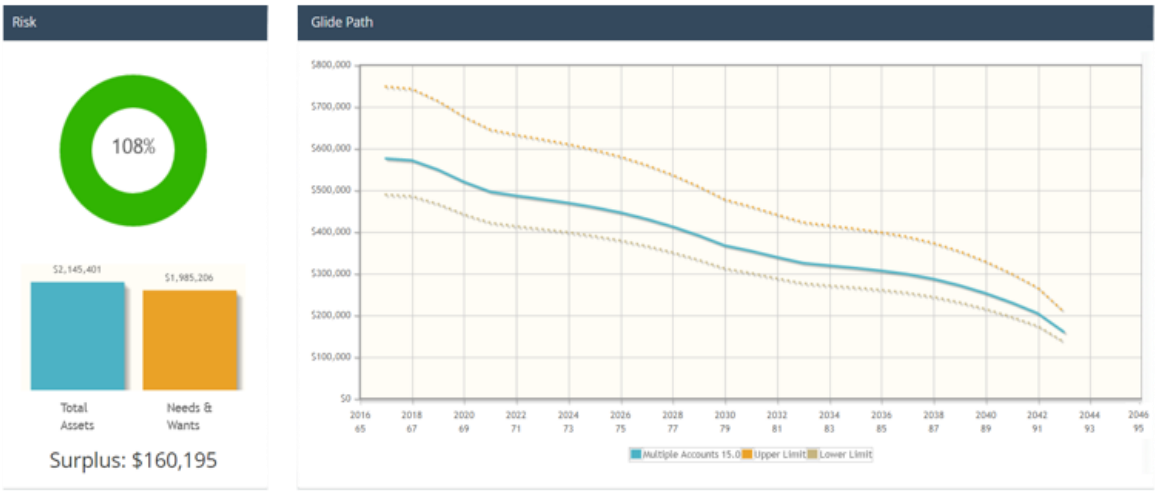
In this second scenario, using an alternative order of withdrawal, we see from the graph below that 97% of Nate and Denise's needs would be covered, and their money would run out only at age 91. This scenario is better than the first, but Nate and Denise could still possibly run out of money before the end of their retirement.



Scenario C

Finally, we will take a look at a third scenario, using the method of Multiple Account Withdrawals, or, as we called it above, Optimized Sequential Withdrawals. Nate and Denise would withdraw from multiple accounts each year in a tax-efficient manner rather than draw from a single account each year.

If we look at the following graph, we see that in this scenario, using Optimized Sequential Withdrawals, 108% of Nate and Denise's needs are covered, and the couple will NOT run out of money but rather will have a surplus of $160,195 at age 95.



This method of withdrawal takes advantage of the tax treatment of each type of account. With this strategy, Nate and Denise will continue to have income from savings and Social Security benefits. Rather than declining, their savings actually grows to more than what they started with, with a portfolio surplus of more than $160,000 after Denise passes away.

Just to remember, the **only** tax optimization strategy used in this scenario was to change the sequence and order in which Nate and Denise draw down on their savings!

Conventional Wisdom is Not a Wise Strategy!

By executing proper Retirement Income Optimization, including tax planning, Nate and Denise will have a surplus in retirement, but they will have the confidence and security they need throughout retirement.

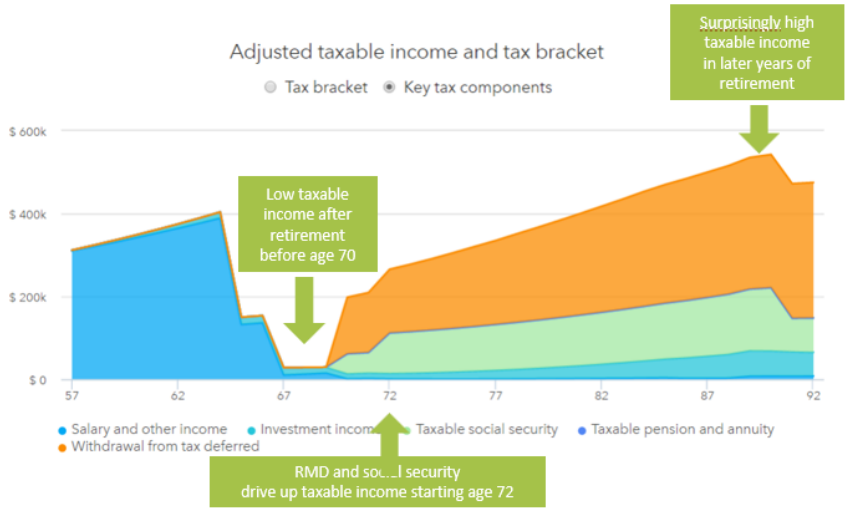
Section 5: Tax Optimization Strategy – A Case Study 2

In this case study you'll meet Mike and Amanda Brady. Here's a summary of their financial situation.

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

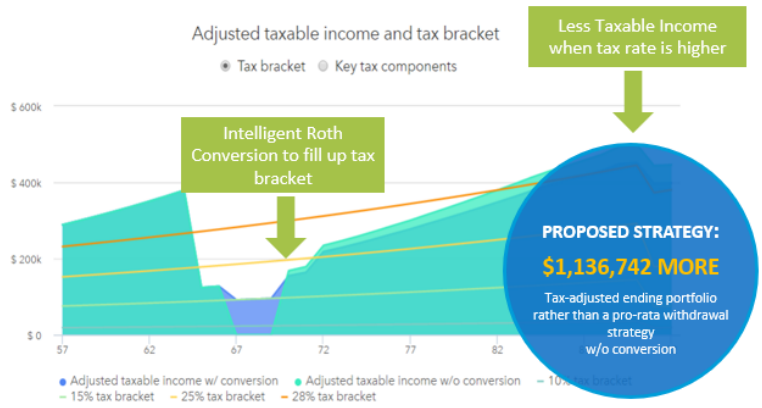
Tax brackets during retirement can be surprising. As you can see below the Brady's income between age 57 and 767 in blue. Between age 67 and 70 is a period of low taxable income. At age 72, RMDs and Social Security begin driving up taxable income.

Tax Brackets During Retirement Can Be Surprising



By doing Roth Conversions during the years of low tax burden, you'll reduce future tax burden and increase your portfolio value.

Smoothing Out The Tax Liability



Proper tax optimization utilizing multiple strategies means better retirement outcomes and more confidence in retirement!

Section 6: Conclusion - Retirement Planning Matters!

To recap, this guide looked at some general information on the implications of taxes on your long-term planning.

An efficient retirement plan incorporating tax optimization can save you thousands of dollars in retirement and potentially create an increased income for life. Such a retirement plan includes several strategies, including:

- Income distribution planning
- Maximizing social security benefits
- Protecting against market loss
- Generating tax-free income
- Addressing and mitigating retirement risks

Where Do You Go from Here?

One of the first steps is knowing where to find help!

"Efficient" retirement planning requires expertise in multiple disciplines. Many CPAs, Investment Advisors, and Insurance Agents lack training in taxes or retirement optimized strategies.

Tax Smart Retiree offers proper, proactive tax planning to help you make the most of old and new tax laws, helping you catch up on opportunities you may have missed already. It's all about helping you keep more of your hard earned money.

What is the Process?

When you decide to engage with Tax Smart Retiree for your tax planning, we focus on educating you first. We suggest you take our tax quiz to test your tax planning knowledge.

We then conduct a Tax Efficiency Assessment to determine which strategies will offer you the most benefits. We then create and implement your plan.

Tax Smart Retiree cannot tell you how much you can save in taxes or which strategies will be most beneficial until we sit down with you and review your assessment. However, we can tell you that most individuals and business owners waste thousands of dollars a year in taxes they

simply didn't know they did not have to pay. You owe it to yourself to make sure you are not one of them!

Congratulations on taking the first step toward a potentially tax-free retirement!

www.TaxSmartRetiree.com