Retirement & The Tax Man
BI Consortium

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Objectives

- Learn how tax policy, Social Security and Medicare overlap.
- Review tax brackets for 2023 and 2024.
- Learn about tax strategies to lower life-time tax burden.

Tax Brain Teaser

- Bill is retired and has taxable income of $46,138 (22% bracket)
- Includes $38,000 in IRA income
- Plus $37,500 in Social Security benefits
- He taps his IRA for an extra $1,000 for a concert road trip

2023 IRS Single Filer Tax Brackets	
Rate	Income Over
10%	$0–$11,000
12%	$11,001–$44,725
22%	$44,726–$ 95,375
24%	$95,376–$182,100
32%	$182,101–$231,250
35%	$231,251–$578,125
37%	$578,125+

How much will he owe in taxes on that extra $1,000?

How much tax will he owe on the extra $1,000?

He pays $.22 in federal income taxes for every additional dollar. Therefore, if he took $1,000, he should owe $220, right?...

Protecting Your Portfolio

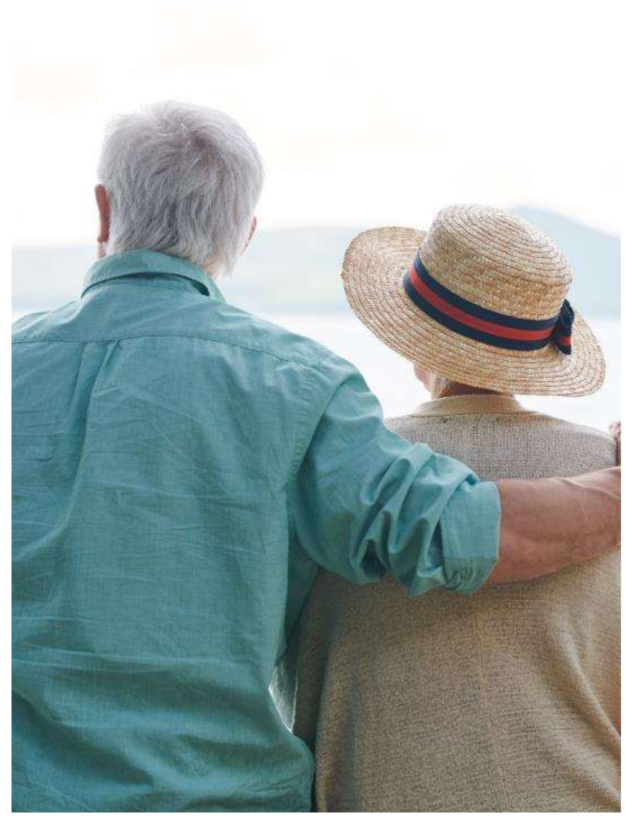
WRONG!

He owes $407* in tax—a 40.7% tax rate on that income!

*Always consult a tax professional before taking action.

A New, Complex World

- Taxes in accumulation phase (saving) vs taxes in distribution phase (spending)
- No more: child tax credits, mortgage interest deduction, tax-free employer-paid medical insurance, contributions to 401(k) or similar
- New: Social Security, RMDs, paying for Medicare, long-term care

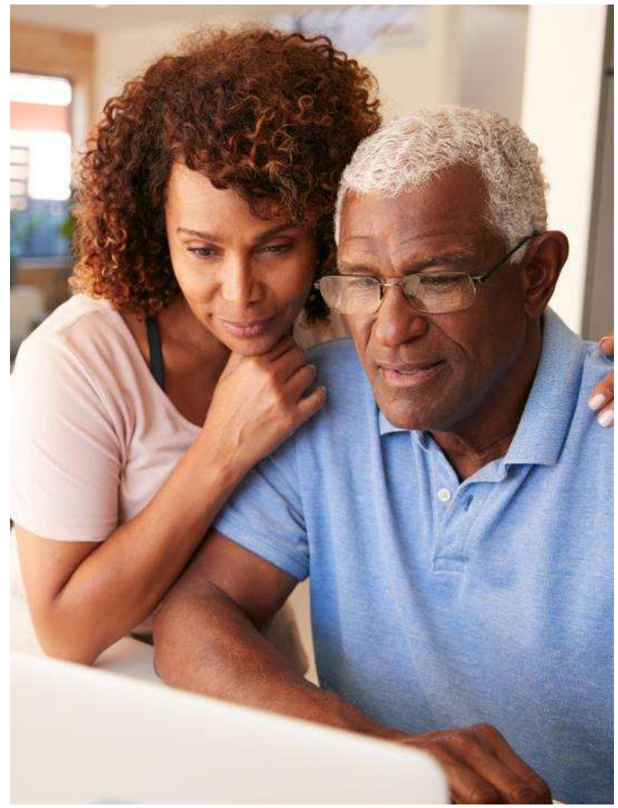


- PROBLEM

People often pay more taxes in retirement than expected because a confusing system treats various income types differently and contains hidden taxes and penalties.

Developing a Solution

Because your tax exposure will change throughout four stages of retirement, you'll need a strategy that anticipates both traditional taxes AND possible taxes, surcharges, and penalties related to Social Security, Medicare, and other income*.



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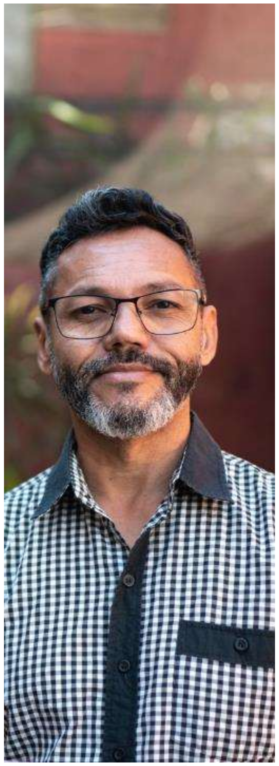
Four Stages of Retirement

1 Pre-retirement
- **Age:** 50-60
- **Description:** Work & save years

2 Early Retirement
- **Age:** 60-70
- **Description:** Go-go years

3 Middle Retirement
- **Age:** 70-80
- **Description:** Go-slow years

4 Late Retirement
- **Age:** 80+
- **Description:** No-go years



Protecting Your Portfolio

"Okay, so what's the first thing I need to understand about retirement and taxes?

- KEY #1:

> You need to know what your “after-tax” retirement savings picture looks like BEFORE retiring.

If you save $500,000 in your 401(k)/IRA, it's not really $500,000

- **If you are married filing jointly, your $500,000 could actually be*…**
  - $325,000 (35% tax rate)
  - $315,000 (37% tax rate)
- **In addition, you must take required minimum distributions (RMDs) each year after you turn 73/75**

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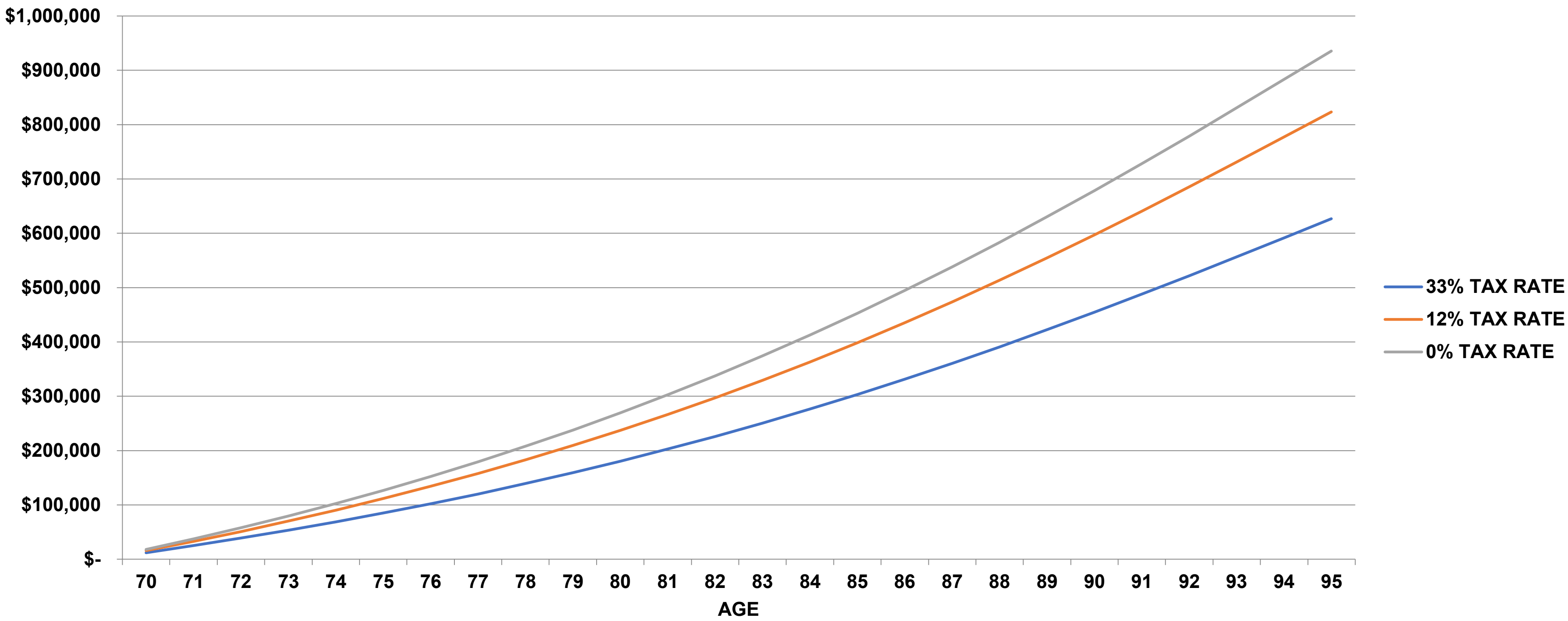
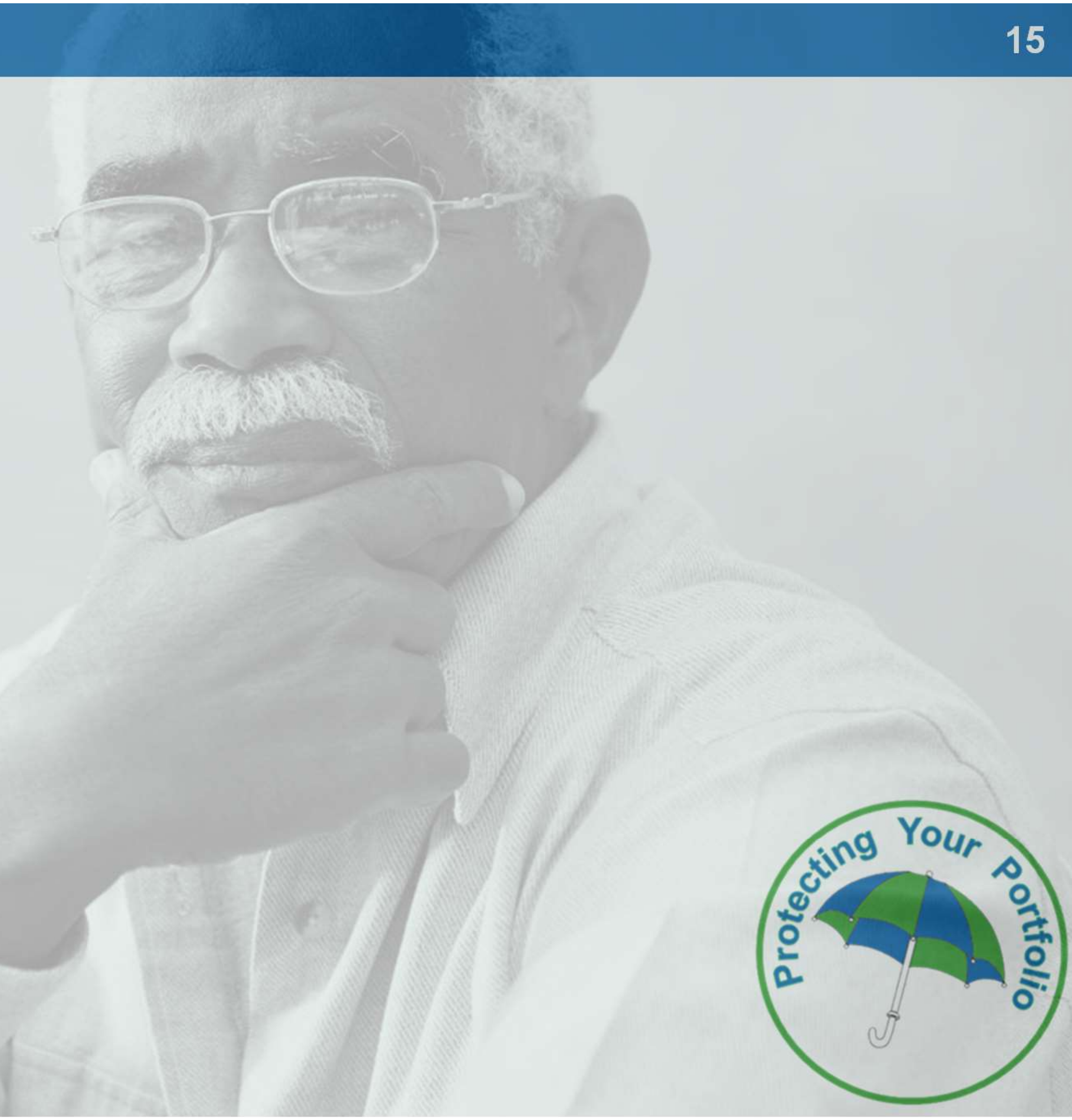
Cumulative After-tax Distributions



*Note: This illustration is hypothetical and assumes a 6% rate of return. This does not represent the performance of any investment product, and your results may vary. Ordinary income tax rates will apply to withdrawals from a tax-deferred investment. An investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision.

“Ok, but at least I’ll still have Social Security to supplement my income and Medicare to pay my health costs.



- KEY #2:

Social Security and Medicare have their own tax traps and you need to plan for them, too.

- **EXAMPLE #1:**

Remember Bill's 40.7% tax rate?

Before concert trip:

- IRA income = $38,000
- Social Security benefits = $37,500
- AGI = $61,838
- Taxable Income = $46,138
- Income tax = $5,458

After concert trip:

- IRA income = $39,000
- Social Security benefits = $37,500
- AGI = $63,688
- Taxable Income = $47,988
- Income tax = $5,865

Actual increase in income from scenario #1 to scenario #2

$1,000

Protecting Your Portfolio

Bill got hit by the Social Security tax torpedo!*

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Increase in AGI/taxable income from scenario #1 to scenario #2

$1,850

$1,850 ÷ $1,000 = $1.85

For every additional dollar of income Bill received, an additional $1.85 was added to his AGI and his taxable income!

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Increase in income tax from scenario #1 to scenario #2

$407

$407 ÷ $1,000 = 40.7%

Effective marginal tax rate of 40.7%
vs.
Stated marginal tax rate of 22%

Protecting Your Portfolio

Different retirement approaches

- Retire completely
- Semi-retire with fewer hours in existing job
- Semi-retire to a passion-driven job
- Retire and volunteer

Working and Social Security: The Good

- Social Security benefit is calculated using highest 35 years of earnings
- Earnings after 62 can still increase Social Security retirement benefit IF they replace $0 or low-earnings years

Protecting Your Portfolio

Working and Social Security: The Bad

- If you take Social Security “early” AND continue to work, your benefits COULD be reduced
- $1 of benefits withheld for every $2 earned over $21,240 for 2023
- Withheld amounts added back to your benefit calculation at full retirement age

Working and Social Security: The Ugly

- You still pay Social Security tax:
  - Even when you work in retirement
  - Even when you're receiving benefits and working
- It only increases your benefit if it is one of your top 35 years of earnings

Protecting Your Portfolio

• **EXAMPLE #2:**

Watch out for the Medicare IRMAA cliff

George and Martha

- Have Medicare Parts B and D
- $306,000 MAGI in 2021
- Sell stock for $1,000 gain
- Owe $188 tax ($150 + $38)

They'll pay an 18.8% rate*, right?

Protecting Your Portfolio

Part B 2023 IRMAA charge: about $200 monthly

MAGI Single Filers	MAGI Married-Joint	Total monthly premium amount	Monthly increase compared to lowest premium
≤ $97,000	≤ $194,000	$164.90	N/A
$97,001–$123,000	$194,001–$246,000	$230.80	$65.90
$123,001–$153,000	$246,001–$306,000	$329.70	$164.80
$153,001–$183,000	$306,001–$366,000	$428.60	$263.70
$183,001–$500,000	$366,001–$750,000	$527.50	$362.60
≥ $500,000	≥ $750,000	$560.50	$395.60

Protecting Your Portfolio

Part D 2023 IRMAA charge: about $39 monthly

MAGI Single Filers	MAGI Married-Joint	Total monthly premium amount
≤ $97,000	≤ $194,000	Plan Premium
$97,001–$123,000	$194,001–$246,000	Plan Premium + $12.20
$123,001–$153,000	$246,001–$306,000	Plan Premium + $31.50
$153,001–$183,000	$306,001–$366,000	Plan Premium + $50.70
$183,001–$500,000	$366,001–$750,000	Plan Premium + $70.00
≥ $500,000	≥ $750,000	Plan Premium + $76.40

- **EXAMPLE #2:**

1-Year
IRMAA total
charges:
$2,834.40

	Monthly IRMMA surcharge	12-month total
George	Extra Part B $98.90 per month Extra Part D $19.20 per month	$1,186.80 $230.40
Martha	Extra Part B $98.90 per month Extra Part D $19.20 per month	$1,186.80 $230.40
Combined		$2,834.40

• EXAMPLE #2:

Stock sale tax
+ IRMAA
Total Damage:
$188
+ 2,834.40
$3,022.40

- ✓ Sold stock: $1,000 income gain
- ✓ Stock sale tax: $188 (18.8% rate)
- ✓ Stock sale triggers new IRMAA income tier
- ✓ Total IRMAA surcharges: $2,834.40

$1,000 extra income triggers taxes of $3,022.40—302% real tax rate!

Protecting Your Portfolio

- **EXAMPLE #3:**

Medicare enrollment: Coverage gaps and late penalties

Jim and Ann

- Jim and Ann are 68
- Jim retired at 65 and Ann, one year later, at 66
- They get coverage through Ann's employer, who offers retiree health insurance

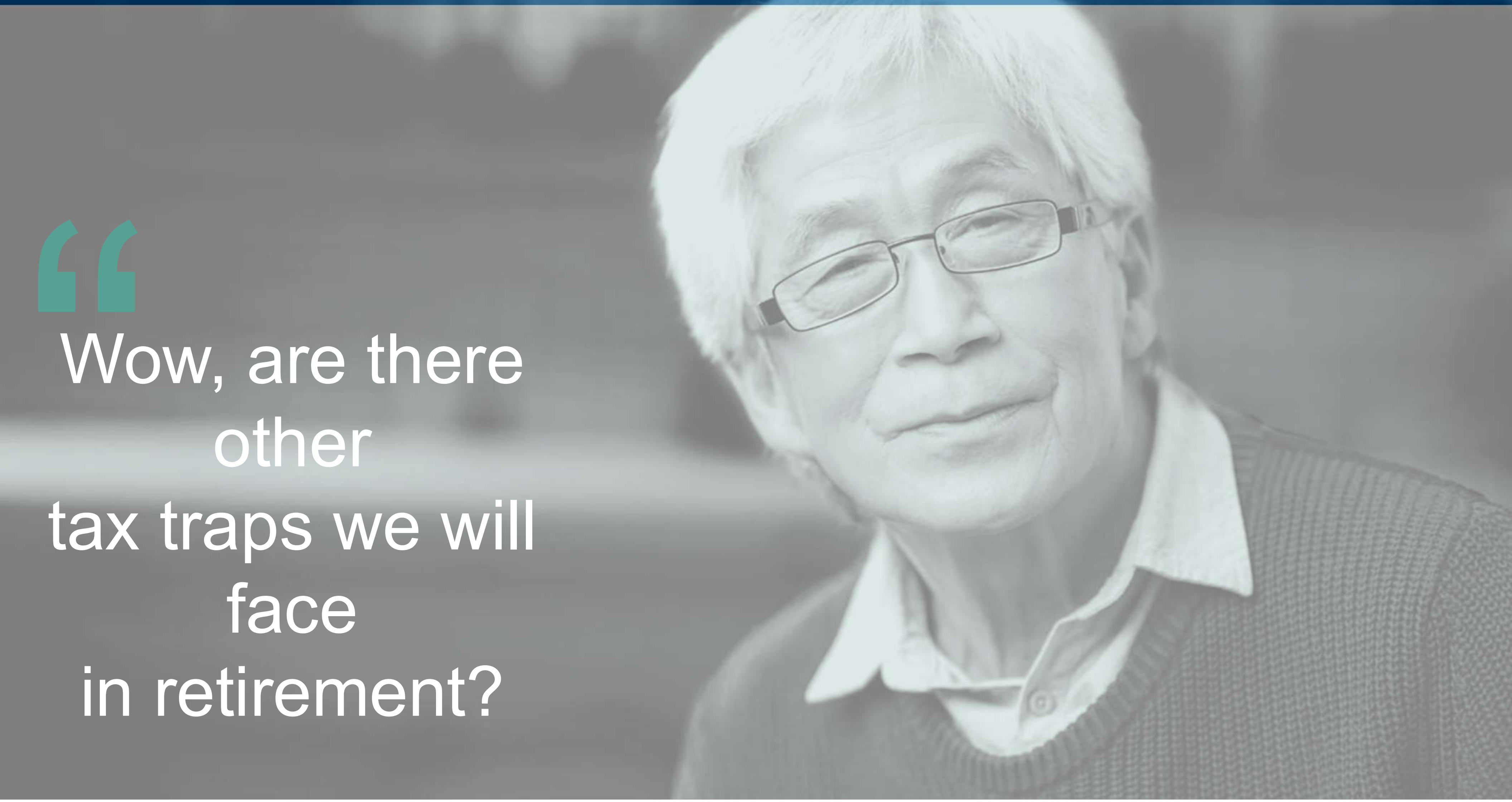
When should they enroll in Medicare Part B?

- **EXAMPLE #3:**

Enroll in Part B as soon as they retire, but…

- You can’t get Medicare coverage instantly
- Missed enrollment penalty: 10% of the base premium for LIFE
  - For 2023 = 10% x $164.90 = $16.49 x 12 = $197.88 x 2 = $395 for the couple
  - Premiums tend to increase every year – so do the penalties!
  - Could translate to a lifetime $10,000 mistake

Watch for coverage gaps!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Wow, are there
other
tax traps we will
face
in retirement?

- KEY #3:

> You must plan how and when you will use taxable, tax-deferred, and tax-free assets to manage your income and tax brackets efficiently.

- **EXAMPLE #4:**

Which accounts to spend first*?

Sam's IRA
$450,000

Mary's IRA
$450,000

Sam and Mary
Want to spend
$8,500/month

Sam's Roth IRA
$60,000

Mary's Roth IRA
$60,000

Joint Bank Account
$300,000

- **EXAMPLE #4:**

Conventional Wisdom*

Which accounts do I spend first?

- Spend taxable money first (bank accounts), then…
- Spend tax-deferred money (IRAs), then…
- Spend tax-exempt money

*Always consult a tax professional before taking action.

- **EXAMPLE #4:**

Alternative Approach*

Which accounts do I spend first?

- Spend taxable money first (bank accounts), but also…
- Convert IRAs to Roths in low tax years, then…
- Spend tax-deferred money until depletion, then…
- Spend tax-exempt money

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• EXAMPLE #5:

Consider Roth IRA conversions*

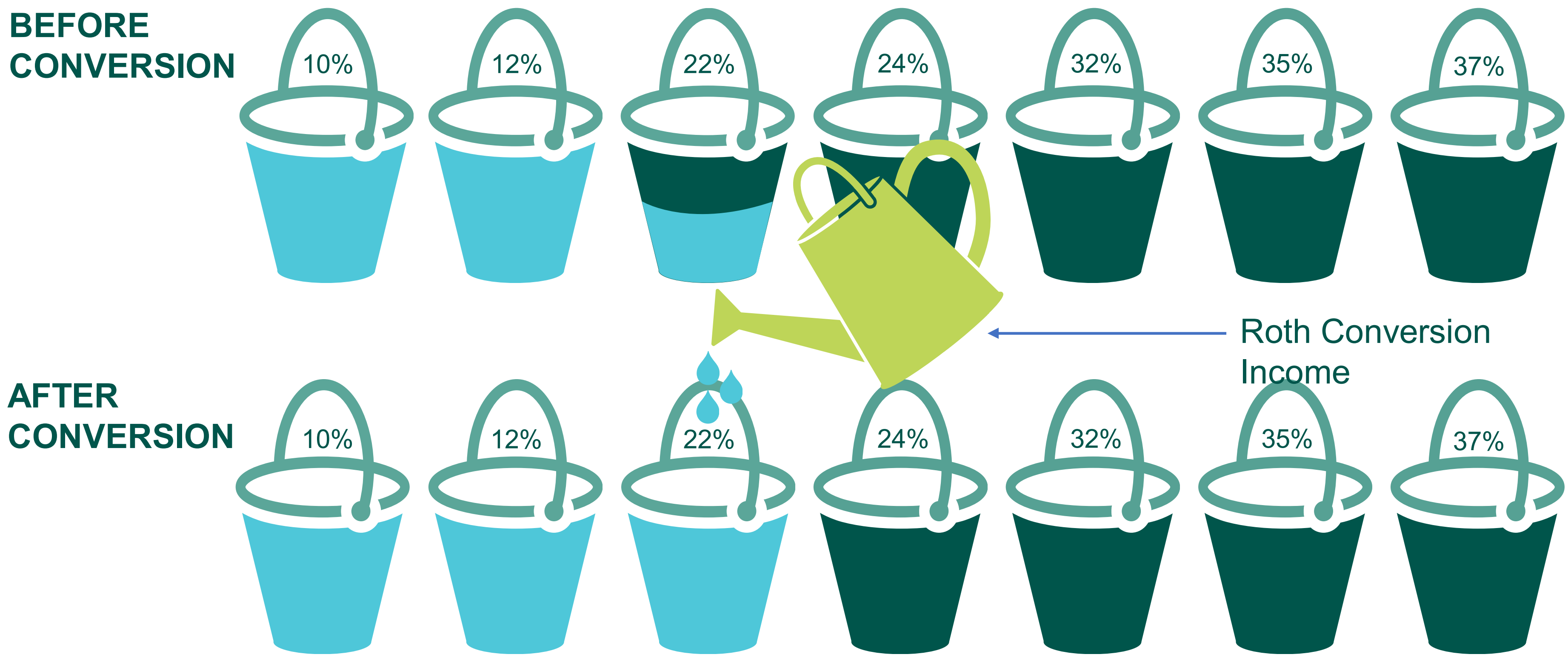
- IRA (or similar retirement funds) are moved to a Roth IRA
- Taxable amount converted is added to your income

Example:

Jill converts $100,000 from her IRA to a Roth IRA

- Jill will have to add $100,000 to her income
- The conversion income will be taxed at Jill's rate

"Filling up the bracket" Roth IRA Conversion Strategy



Low-income years good for Roth conversions

- Roth IRA conversions in years with unusually low income may be beneficial

Common examples:

- Business owner with unusually low sales
- Business owner with unusually high expenses
- High non-recurring medical bills
- After retirement, but before receiving Social Security benefits, pensions, and/or IRA distributions

Important guiding question: What's the goal?

- You must know whether you're trying to keep income below a bracket threshold to avoid bumping up to the next highest tax rate…
- Or whether you're trying to increase income to fill up a bracket to take advantage of that tax rate

Other possible approaches to managing tax brackets*

*Always consult a tax professional before taking action.

- Withdrawing tax-free money from life insurance policies to keep income low
- Selling highly appreciated stock for low or no capital gains
- Taking distributions from IRAs or 401(k)s to take advantage of a lower tax rate
- Using a reverse mortgage to access equity or buy a home

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Two other pre-retirement strategies

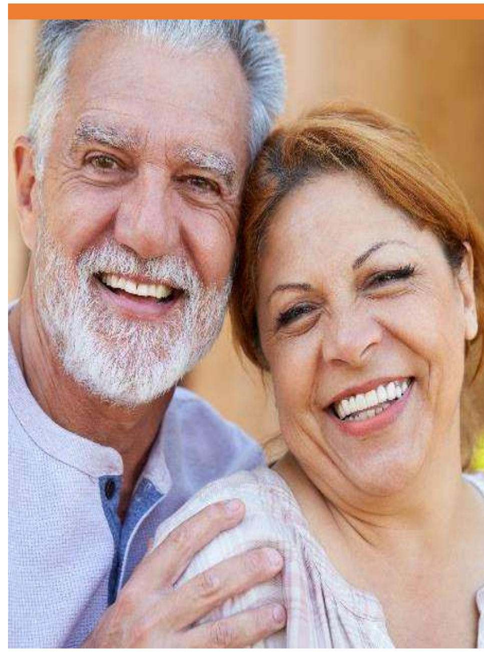
If you qualify:

- Use a Health Savings Account (HSA) strategically
- Use the Qualified Business Income (QBI) deduction after funding a company pension

Protecting Your Portfolio

• EXAMPLE #6:

Charitable giving and tax planning



Albert and Shirley

- 24% bracket
- Give $5,000 to charity
- $15,000 existing itemized deductions
- 2023 Standard Deduction is $30,700
- $5,000 donation—no federal tax benefit

Protecting Your Portfolio

Qualified charitable distribution (QCD): Giving after 70½*

- Up to $100K from IRA per person
- Must go directly to the charity
- Counts as an RMD but not reported as income
- No deduction on income tax

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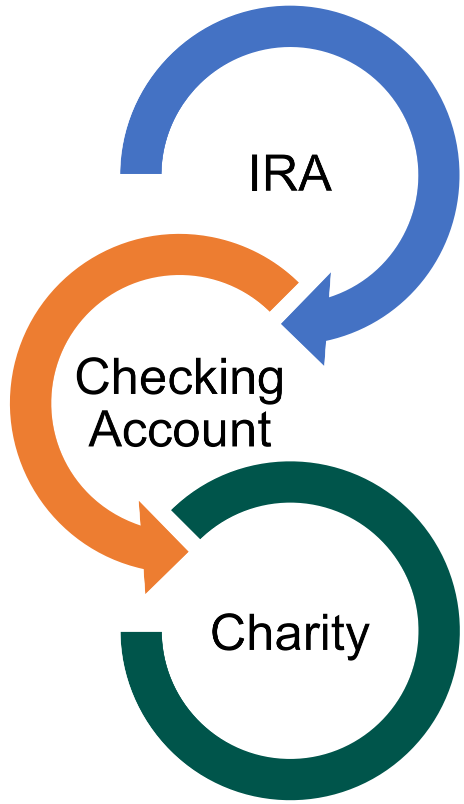
Option #1: What's the cost of a non-QCD contribution?*

- Charity gets $5,000
- $5,000 satisfies RMD
- $5,000 is reported as taxable income
- Tax bill on distribution at 24% tax bracket equals $1,200
- Total cost of charitable contribution: $6,200



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Option #2: What's the cost of a QCD contribution?*

- Charity gets $5,000
- $5,000 satisfies RMD
- $5,000 is EXCLUDED from taxable income
- Tax bill on distribution equals $0
- Total cost of charitable contribution: $5,000–a $1,200 saving from the non-QCD option

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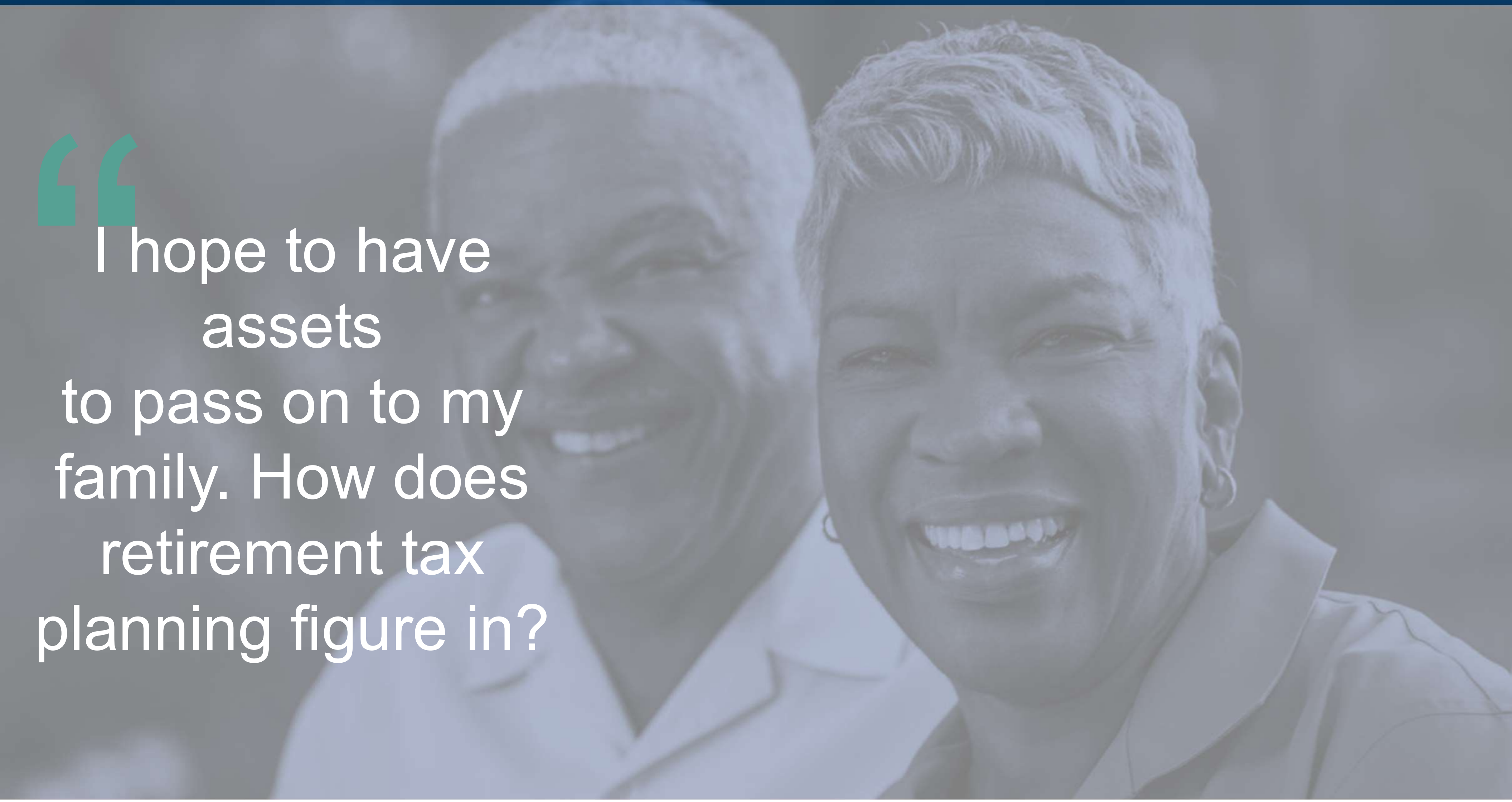

"I hope to have assets to pass on to my family. How does retirement tax planning figure in?

- KEY #4:

Organize your assets for your family’s benefit—estate planning still matters!

• EXAMPLE #7:

Step-up in basis strategy*

Definition: The rule treats a beneficiary as if they purchased the inherited asset on the day it was left to them. Future gain or loss is based on the asset price on that day.

Phil and Mary

- Hold taxable investments in a joint brokerage account (JTWROS)
- JTWROS: Joint Tenants With Rights of Survivorship
- The $120,000 investments have a long-term capital gain
- Phil is diagnosed with a terminal illness—18 months to live

• **SCENARIO #1:**

Do nothing after diagnosis*

*Always consult a tax professional before taking action.

- Phil dies and Mary inherits Phil's half of the joint account
- The step up in basis eliminates the long-term capital gain on Phil's $60,000
- If she sold all the investments, she'd only owe income tax on her gains
- Her gains = long-term capital gains on her $60,000 plus any gain on remainder after Phil's death
- Bottom line: Mary owes tax on her $60,000 of gain (plus any on the half AFTER Phil's death)

SCENARIO #2:

After diagnosis, move all investments into one account in Phil’s name*

- Phil dies 18 months later
- Mary inherits Phil’s entire account of $120,000
- Mary can sell and pay $0 in taxes

*Always consult a tax professional before taking action.

When you go to sell your investments, would you rather owe tax on $60,000 of gain or no tax?*

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• EXAMPLE #8

Inheriting IRAs: Choices

Pamela (65 years old)

- Son: Kyle (40 years old)
- Pamela dies and leaves 100% of IRA to son Kyle
- IRA Balance: $400,000
- 6% average rate of return

Protecting Your Portfolio

• SCENARIO #1:

Kyle takes distributions over 10 years to minimize tax*

- Kyle was listed as the sole beneficiary
- He has 10 years to take all the required minimum distributions (RMDs) and empty the account
- 6% average rate of return
- $400,000 IRA balance
- Annual distribution to Kyle = $54,347

*Always consult a tax professional before taking action.

• SCENARIO #2:

Kyle does nothing years 1-9, takes full distribution in year 10*

- Kyle was listed as the sole beneficiary
- He has 10 years to take all the required minimum distributions (RMDs) and empty the account, but decided to wait until year 10 to take a full distribution
- 6% average rate of return
- $400,000 IRA balance
- Year 10 distribution to Kyle: $716,339

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• EXAMPLE #9:

IRA or Life/LTC hybrid to pay for costs?

Florence (widow)

- Qualifies for LTC benefits
- Receives in-home care benefits: $60,000/yearly
- $20,000/year in Social Security
- $400,000 in IRA
- Life insurance with LTC rider
  - $500,000 to children upon death
  - Or up to $10,000/month for LTC costs

Protecting Your Portfolio

• SCENARIO #1

Florence Uses LTC Policy to Pay for Five Years of Care

- Florence pays little to no income tax during last 5 years (high deductibles for unreimbursed medical expenses)
- Her LTC insurance pays the $300,000 for in-home care ($60K yearly)
- Kids inherit tax-free life insurance of $200,000 as well as $400,000 of taxable IRA funds

• SCENARIO #2:

Florence Uses IRA to Pay for Care*

- Florence pays little to no income tax during last 5 years
- Uses IRA money to pay $300,000 for in-home care ($60K yearly)
- Kids inherit tax-free life insurance of $500,000, as well as $100,000 of remaining taxable IRA funds

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Comparison of care costs:

Use $300,000 taxable money vs. $300,000 tax-free money

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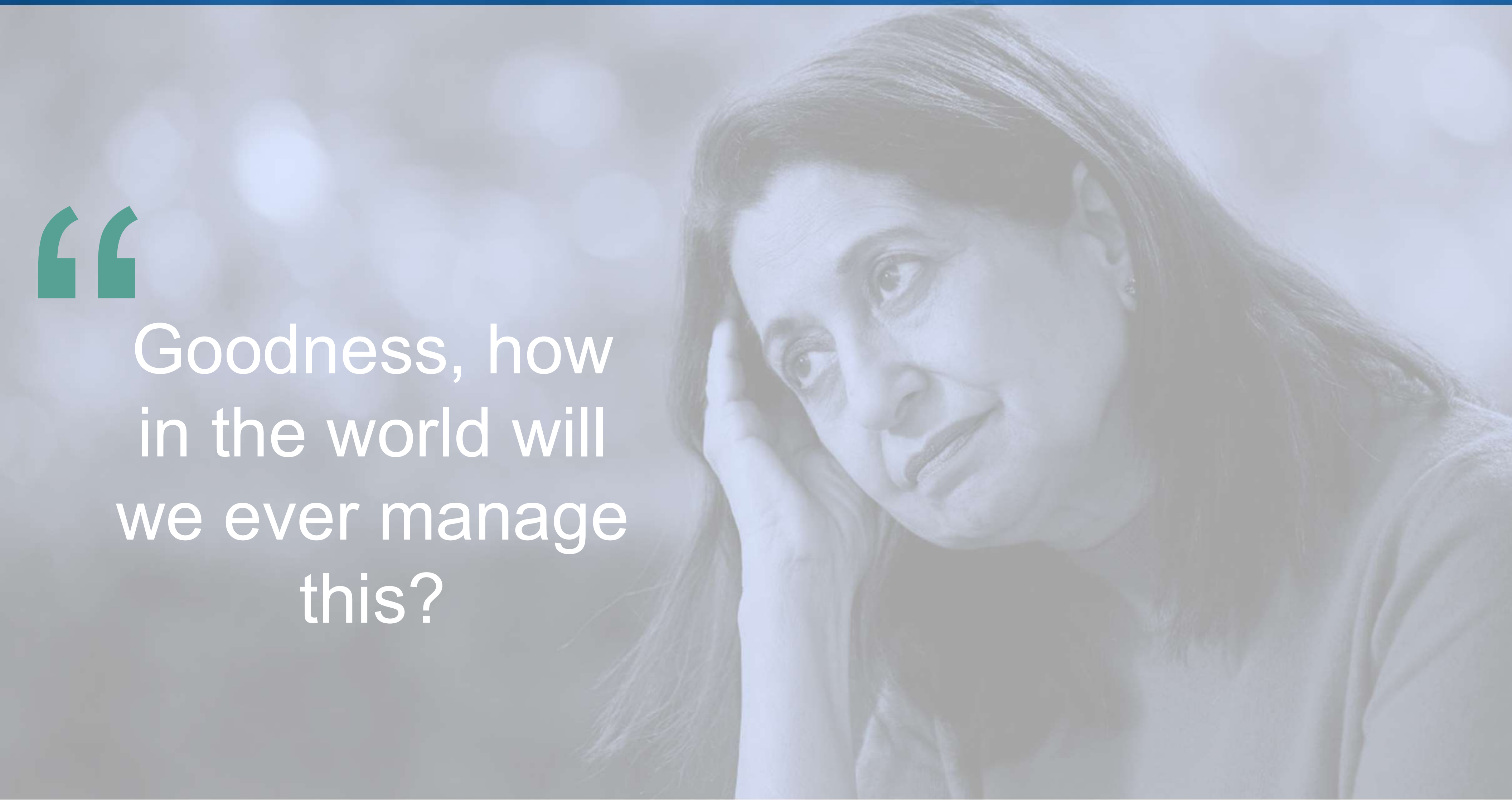
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Goodness, how in the world will we ever manage this?

Taxes and retirement highlights*

*Always consult a tax professional before taking action.

Pre-retirement	✓ Know your after-tax savings BEFORE retiring ✓ Fund Roth accounts
Early Retirement	✓ Understand S.S. and Medicare “taxation” ✓ Fill tax brackets in low-income years
Middle Retirement	✓ Manage your planned RMDs
Late Retirement	✓ Organize your assets for tax efficiency in estate planning

- SOLUTION

Because your tax exposure will change throughout retirement, you need a tax strategy* that:

- Anticipates how and when you tap assets to cover your personal expenses
- Understands the range of taxes you will face at various stages
- Manages your actions so you pay the lowest tax rate possible

Summary

- We’ve reviewed a wide variety of tax traps retirees face and supplied questions and strategies to deal with 4 key areas.
- We’ve provided tax information so you can visualize your personal tax picture using 7 examples.
- We’ve discussed non-traditional ways to think about where and how you take profits or access assets.

Tax and Retirement Studies

- **Converting to Roth IRA under New Tax Law:** a Decision Framework, by Kenneth E. Anderson and David S. Hulse, Journal of Financial Service Professionals, 2007
- **The Effects of Social Security Benefits and RMDs on Tax-Efficient Withdrawal Strategies,** by Greg Geisler, Ph.D.; and David S. Hulse, Ph.D., Journal of Financial Planning, 2018
- **Tax-Efficient Withdrawal Strategies,** by Kirsten A. Cook, William Meyer, and William Reichenstein, CFA. Published in Financial Analysts Journal, 2015

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