SMART INSIGHTS FROM FINANCIAL PROFESSIONALS

5 Tax Strategies to Help You Hold on to Your Money in Retirement

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Preparing for retirement requires a lot of adapting — not just emotionally, but financially. The closer you get, the more important it becomes to look at your budget, your asset allocation and where your income will come from when you're creating your own paycheck.

It's also critical to make tax efficiency a priority in your planning.

Taxes can take a giant bite out of retirement income year after year. And yet, even people who have done a great job of investing and saving for retirement tend to overlook the tax planning that's necessary to hold on to more of their nest egg.

That may be because many people have been told their taxes are destined to go down in retirement. If you're spending less, you'll require less income, which means your taxes will be lower, right? Not always. Many people spend the same or more in retirement — at least for the first few years, when they may be doing more traveling, spending time with family and friends, or taking up new hobbies. Also, required minimum distributions for many people can force distributions above and beyond their spending levels, which can increase taxable income and create a tax nightmare.

What can you do to soften the blow? Here are a few strategies to consider:

KEEP AN EYE ON INCOME TO LIMIT TAXES ON CAPITAL GAINS

Depending on your income, you might not have to pay any federal income taxes on qualified dividends or gains from selling stocks, mutual funds or other capital assets you've owned for more than a year. In 2020, married couples who file jointly can qualify for the 0% long-term capital gains tax rate if their taxable income is $80,000 or less. For single filers, the 2020 threshold is $40,000.

How can proactive tax planning help you land in a lower tax bracket during those early retirement years? One move might be to delay taking your Social Security benefits for a few years while you live off your capital gains. And if you need additional income during those years, you might choose to withdraw the funds from a Roth account, since that won't increase your taxable income.

MOVE MONEY FROM A TRADITIONAL IRA TO A ROTH

If you've been putting most of your savings into a tax-deferred investment account, converting all or a sizable chunk of those funds to a Roth could help defuse the ticking tax time bomb that's waiting for you in retirement. This is especially true if you expect to have a long retirement or if you believe taxes are bound to be higher in the future. The tax bracket overhaul put in place by the Tax Cuts and Jobs Act is set to expire at the end of 2025, bumping up taxes to where they were in 2017. Most experts are predicting they could go even higher, given that the national debt is now at $25 trillion and growing, and Social Security, Medicaid and Medicare will likely need funding help in the future.

Finding the optimal Roth conversion strategy for your

particular set of circumstances can potentially result in hundreds of thousands of dollars in tax savings over the course of your retirement. Once your money is in a Roth, it can continue to grow without growing your tax bill. (Your adviser should be able to fill you in on all the rules that apply to a Roth conversion.)

PLAN FOR THE HIDDEN MEDICARE TAX

Here's another place where doing a Roth conversion now could help mitigate taxes in retirement. Many people don't know this, but individuals and couples with higher incomes may be required to pay an income-related monthly adjustment amount (IRMAA) in addition to their Medicare Part B and Part D premiums. The Social Security Administration (SSA) determines whether you're subject to these surcharges based on the income you reported on your tax return two years ago. (So, for example, in 2020, the SSA will look at your 2018 return.)

Currently, there are six income tiers that determine both surcharges. Individuals with modified adjusted gross income (MAGI) of $87,000 or less and married couples with a joint MAGI of $174,000 or less are in the first tier; they aren't subject to IRMAA surcharges in 2020. After that, the extra costs kick in — and they increase at each income tier. That means affluent retirees who keep their money in tax-deferred accounts for years, until they're required to take minimum distributions at age 72, could end up paying thousands more for Medicare coverage every year. Only careful planning can reduce that unexpected tax bill.

TAKE ANOTHER LOOK AT YOUR LEGACY

If leaving a legacy is a priority for you, you should know that the new SECURE Act now forces non-spouse beneficiaries (with some exceptions) to take a full payout from an inherited IRA within 10 years of the original account holder's death. The income from these RMDs will go on top of those beneficiaries' existing income, potentially pushing them into a higher tax bracket. And if they forget or fail to distribute the IRA within 10 years, there is a 50% penalty on top of the income taxes due.

Again, moving the money to a Roth may be appropriate. Your beneficiaries will be required to take RMDs from an inherited Roth IRA — and pay a penalty if they don't — but they won't have to pay taxes on those withdrawals.

TAKE CARE OF YOUR SURVIVING SPOUSE

When one spouse dies, the survivor's tax status changes to single filer. That means the widow or widower will face a lower income threshold for calculating income taxes, whether his or her Social Security benefits will be taxed and whether an IRMAA will affect future Medicare premiums. It's important to keep the surviving spouse's filing status in mind when making your income plan. A Roth can provide tax-free income. So can life insurance. It's not atypical to see taxes increase 40%-60% just from losing a spouse, while income usually decreases due to losing a Social Security check.

It's easy to become so focused on saving on taxes right now that you lose sight of the future consequences. A professional analysis of your overall financial plan can help put things in perspective and can allow you to develop strategies that will make sense with respect to your needs and objectives now and in retirement.

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