DUGAN, SCOTTI & ZOCH, P.A.

Certified Public Accountants

161 McKINLEY STREET • P.O. BOX 576 • CLOSTER, NJ 07624

PHONE: (201) 767-6270 • FAX: (201) 767-0920

www.dszcpa.com

Abstract: There's a common misconception that, after retirement, tax bills shrink, tax returns become simpler and tax planning is a thing of the past. That may be true for some, but many people find that the combination of Social Security, pensions and withdrawals from retirement accounts *increases* their income in retirement and may even push them into a higher tax bracket. This article provides five tax-planning tips for retirees.

5 tax planning tips for retirees

There's a common misconception that, when you retire, your tax bills shrink, your tax returns become simpler and tax planning is a thing of the past. That may be true for some, but many people find that the combination of Social Security, pensions and withdrawals from retirement accounts *increases* their income in retirement and may even push them into a higher tax bracket.

If you're retired or approaching retirement, consider these five tax-planning tips:

1. Take inventory. Estimate how much money you'll need in retirement for living expenses and inventory your income sources. These sources may include taxable assets, such as mutual funds and brokerage accounts; tax-deferred assets, such as IRAs, 401(k) plan accounts and pensions; and nontaxable assets, such as Roth IRAs, Roth 401(k) plans or tax-exempt municipal bonds. Social Security benefits may be nontaxable or partially taxable, depending on your other sources of income.

Develop a plan for drawing retirement income in a tax-efficient manner, being sure to keep state income tax, if applicable, in mind. For example, you might minimize current taxes by tapping nontaxable assets first, followed by assets that generate capital gains, and putting off withdrawals from tax-deferred accounts as long as possible.

On the other hand, if you're approaching age 72 and will have substantial required minimum distributions (RMDs) from tax-deferred accounts when you reach that age (see No. 3 below), it may make sense to withdraw some of those funds earlier. Why? It can help you avoid having large RMDs that would push you into a higher tax bracket later.

For example, you might withdraw as much as you can from IRAs or 401(k) accounts each year without exceeding the lower tax brackets. That way, you keep current taxes on those funds at a reasonable level while reducing the size of your accounts and, in turn, the size of your RMDs down the road. You can obtain additional funds from nontaxable or capital gains assets, if needed.

2. Consider the timing of Social Security benefits. You can begin receiving Social Security benefits as early as age 62 or as late as age 70. The later you start, the larger the benefit amount — so, if you don't need the money right away, putting it off may be a good investment. Also, benefits are reduced if you start them before you reach full retirement age and continue to work.

Keep in mind that, if your income from other sources exceeds certain thresholds, your Social Security benefits will become partially taxable. For example, married couples filing jointly with combined income over $44,000 are taxed on up to 85% of their Social Security benefits. (Combined income is adjusted gross income plus nontaxable interest plus half of Social Security benefits.)

3. Make qualified charitable distributions. You're required to begin RMDs from tax-deferred retirement accounts once you reach age 72 (up from 70½ for people born before July1, 1949) though you're able to defer your first distribution until April 1 of the year following the year you reach age 72. RMDs generally are taxed as ordinary income and you must take them regardless of whether you need the money. As noted in No. 1, a large RMD can push you into a higher tax bracket.

One strategy for reducing the amount of RMDs, at least if you're charitably inclined, is to make a qualified charitable distribution (QCD). If you're age 70½ or older (this age didn't increase when the RMD age increased), a QCD allows you to distribute up to $100,000 tax-free *directly* from an IRA to a qualified charity and to apply that amount toward your RMDs.

The funds aren't included in your income, so you avoid tax on the entire amount, regardless of whether you itemize. In addition, the income-based limits on charitable deductions don't apply. Any amount excluded from your income by virtue of the QCD is similarly excluded from being treated as a charitable deduction.

4. Pay estimated taxes. Your retirement income sources may or may not withhold income taxes. To avoid tax surprises and penalties, estimate whether your withholdings will be sufficient to pay your tax liability for the year and make quarterly estimated tax payments to cover any expected shortfall.

5. Track your medical expenses. Currently, medical expenses are deductible only if you itemize and only to the extent they exceed 7.5% of your adjusted gross income. If you have significant medical expenses, track them carefully. Then if you exceed this threshold or are close to exceeding it, consider bunching elective expenses into the year to maximize potential deductions.

If you're nearing retirement age and have questions on how your tax situation may change, contact your tax advisor.

© *2021*