

## 12 Questions Retirees Often Get Wrong About Taxes in Retirement

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Taxes in retirement can be a nightmare for many people with today's complex rules and regulations. 401(k) plans, IRAs and other retirement accounts come with many tax traps that even the smartest investors fail to see. Therefore, it shouldn't be a big shock that retirees

aren't always up to date on every part of the tax code and, as a result, end up paying more in taxes than is necessary. Now that you've put together your retirement nest egg, you want to make sure that you're not overpaying Uncle Sam. To help you evaluate your current tax knowledge, here are **12 questions retirees often get wrong about taxes in retirement**. Take a look and see how much you really understand about your own tax situation.

(And check out our [State-by-State Guide to Taxes on Retirees](#) to learn more about how you will be taxed by your state during retirement.)



## Tax Rates in Retirement

**Question:** When you retire, is your tax rate going to be higher or lower than it was when you were working?

**Answer:** It depends. Many people make their retirement plans with the assumption that they'll fall into a lower tax bracket once they retire. But that's often not the case, for the following three reasons.



- 1. Retirees typically no longer have all the tax deductions they once did.** Their homes are paid off or close to it, so there's no mortgage interest deduction. There are also no kids to claim as dependents, or annual tax-deferred 401(k) contributions to reduce income. So, almost all your income will be taxable during retirement.
- 2. Retirees want to have fun — which costs money.** If you're like many newly retired folks, you might want to travel and engage in the hobbies you didn't have time for before, and that doesn't come cheap. So, the income you set aside for yourself in retirement may not be much lower than what you were making in your job.
- 3. Future tax rates may be higher than they are today.** Let's face it...tax rates now are low when viewed in a historical context. The top tax rate of 37% is a bargain compared with the 94% of the 1940s and even the 70% range as recently as the 1970s. And considering today's political climate and growing national debt, future tax rates could end up much higher than they are today.

## Taxation of Social Security Benefits

**Question:** Are Social Security benefits taxable?

**Answer:** Yes. Depending on your "provisional income," up to 85% of your Social Security benefits are subject to federal income taxes. To determine your provisional income, take your modified adjusted gross income, add half of your Social Security benefits and add all of your tax-exempt interest.



If you're married and file taxes jointly, here's what you'll be looking at:

- If your provisional income is less than \$32,000 (\$25,000 for singles), there's no tax on your Social Security benefits.
- If your income is between \$32,000 and \$44,000 (\$25,000 to \$34,000 for singles), then up to 50% of your Social Security benefits can be taxed.
- If your income is more than \$44,000 (\$34,000 for singles), then up to 85% of your Social Security benefits are taxable.

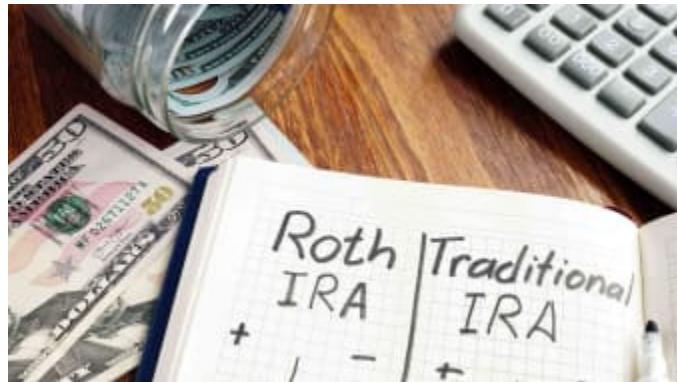
The [IRS has a handy calculator](#) that can help you determine whether your benefits are taxable. You should also check out [Calculating Taxes on Social Security Benefits](#).

And don't forget state taxes. In most states, Social Security benefits are tax-free. But there are still a handful of [states that tax Social Security benefits](#) at least to some extent.

## IRA Contributions

**Question:** Can you still contribute to an IRA after you retire?

**Answer:** Yes. All retirees can contribute to traditional or Roth IRAs if they earn a salary. In the past, the cutoff age was 70½ for contributing to traditional IRAs, but that age-based restriction was repealed a few years ago.



If you're younger than age 50, the maximum amount you can contribute to an IRA for 2022 is \$6,000. Anyone age 50 or over can add an extra \$1,000 per year as a "catch-up" contribution, bringing the maximum IRA contribution for 2022 to \$7,000. In order to contribute to an IRA, you must receive money from a job. Additionally, you can't put more into the account than what you have earned.

Your contributions to a traditional IRA may also be tax-deductible. If you or your spouse don't have a retirement plan at work, you can deduct the full contribution to your traditional IRA, no matter how much you earn.

For a Roth IRA, contributions aren't tax-deductible. Instead, money goes into a Roth IRA after taxes have been paid on it. You can then withdraw contributions free of taxes or penalties at any time. The earnings can also be withdrawn tax-free and without penalty once you've owned the account for five years and you're at least age 59½. Moreover, Roth IRAs don't have required minimum distributions, and the amount that can be contributed to a Roth IRA is subject to income limits.

## Withdrawals from Roth IRAs

**Question:** Are withdrawals from Roth IRAs tax-free once you retire?

**Answer:** Yes. [\*\*Roth IRAs\*\*](#) come with a big long-term tax advantage: Unlike their 401(k) and traditional IRA cousins — which are funded with pretax dollars — you pay the



taxes on your contributions to Roths up front, so your withdrawals are tax-free once you retire. One important caveat is that you must have held your account for at least five years before you can take tax-free withdrawals. And while you can withdraw the amount you contributed at any time tax-free, you must be at least age 59½ to be able to withdraw the gains without facing a 10% early-withdrawal penalty.

## Taxation of Rollovers From a 401(k) to an IRA

**Question:** Are post-retirement rollovers from a 401(k) plan to a traditional IRA tax-free?

**Answer:** Yes, if you do it properly. There are two ways to do a tax-free rollover from a [\*\*401\(k\) plan\*\*](#) to a [\*\*traditional IRA\*\*](#). First, you can withdraw the funds from the 401(k)



account and then deposit the money into the IRA yourself. Once you receive the funds from your 401(k), you have 60 days to complete the rollover to the traditional IRA. It's important not to miss this deadline. If you're late, the withdrawn funds will be treated as taxable income. In addition, exceeding this time limit could result in a 10% early withdrawal penalty if you're not at least 59½ years old (55 years old if you've left the company sponsoring the 401(k) plan).

There's also a 20% withholding requirement for 401(k) distributions paid to you, even if you intend to roll it over into another retirement account later.

The other way to transfer funds from a 401(k) plan to a traditional IRA without paying tax is to do a direct rollover. In a direct rollover, you instruct the 401(k) plan administrator to directly take the money from the 401(k) account and place it in the rollover IRA. The administrator can also send you a check made payable to the IRA account, which is acceptable. There's no withholding or early withdrawal penalty with a direct rollover.

## Taxation of Annuity Income

**Question:** Is the income you receive from an annuity you own taxable?

**Answer:** Probably (at least for some of it). If you purchased an annuity that provides income in retirement, the portion of the payment that represents your principal is tax-free; the rest is taxable. The insurance company that sold you the annuity is required to tell you what is taxable. Different rules apply if you bought the annuity with pretax funds (such as from a traditional IRA). In that case, 100% of your payment will be taxed as ordinary income. In addition, be aware that you'll have to pay any taxes that you owe on the annuity at your ordinary income-tax rate, not the preferable capital gains rate.



## Age for Starting RMDs

**Question:** At what age must holders of traditional IRAs and 401(k)s start taking required minimum distributions (RMDs)?

**Answer:** Age 72. It used to be 70½, but it was moved to 72 starting in 2020.



As for the amount that you are forced to withdraw: You'll start out at about 3.65%, and that percentage goes up every year. At age 80, it's 4.95%. At 90, it's 8.2%. Figuring out the percentages might not be as hard as you think if you try our [\*\*RMD calculator\*\*](#).

## RMDs From Multiple IRAs and 401(k)s

**Question:** Are RMDs calculated the same way for distributions from multiple IRAs and multiple 401(k) plans?

**Answer:** No. There's one important difference if you have multiple retirement accounts. If you have several traditional IRAs, the RMDs are calculated separately for each IRA but can be withdrawn from any of your accounts. On the other hand, if you have multiple 401(k) accounts, the amount must be calculated for each 401(k) and withdrawn separately from each account. For this reason, some 401(k) administrators calculate your required distribution and send it to you automatically if you haven't withdrawn the money by a



certain date, but IRA administrators may not automatically distribute the money from your IRAs.

## Due Date for Your First RMD

**Question:** Do you have to take your first RMD by December 31 of the year you turn 72?

**Answer:** No. Normally, you have to take RMDs for each year after you turn age 72 by the end of the year.

However, you don't have to take your *first* RMD until April 1 of the year after you turn 72. But be careful — if you delay the first withdrawal, you'll also have to take your second RMD by December 31 of the same year. Because you'll have to pay taxes on both RMDs (minus any portion from nondeductible contributions), taking two RMDs in one year could bump you into a higher [tax bracket](#).



It could also have other ripple effects, such as making you subject to the Medicare high-income surcharge if your adjusted gross income (plus tax-exempt interest income) rises above \$91,000 if you're single or \$182,000 if married filing jointly. (Note: Those are the income thresholds for determining 2022 surcharges.)

## Taxation of Life Insurance Proceeds

**Question:** If your spouse dies and you get a big life insurance payout, will you have to pay tax on the money?



**Answer:** No. You have enough to deal with during such a difficult time, so it's good to know that life insurance proceeds paid because of the insured person's death are not taxable.

## Estate Tax Threshold

**Question:** How valuable must an individual's estate be at death to be hit by federal estate taxes in 2021?

**Answer:** \$12.06 million (\$24.12 million or more for a married couple). If the value of an estate is less than the threshold amount, then no federal estate tax is due. As a result, federal estate taxes aren't a factor for very many people. However, that will change in the future. The 2017 tax reform law more than doubled the federal estate tax exemption threshold — but only temporarily. It's schedule to drop back down to \$5 million (plus adjustments for inflation) in 2026.



If your estate isn't subject to federal taxes, it still might owe state taxes. Twelve states and the District of Columbia charge a state estate tax, and their exclusion limits can be much lower than the federal limit. In addition, six states impose inheritance taxes, which are paid by your heirs. (See [18 States With Scary Death Taxes](#) for more details.)

## Standard Deduction Amounts

**Question:** If you're over 65, can you take a higher standard deduction than other folks are allowed?

**Answer:** Yes. For 2022, to the standard deduction for most people is \$12,950 if you're single and \$25,900 for married couples filing a joint tax return (\$12,550 and \$25,100, respectively, for 2021). However, those 65 and older get an extra \$1,750 in 2022 if they're filing as single or head of household (\$1,700 for 2021). Married filing jointly? If one spouse is 65 or older and the other isn't, the standard deduction increases by \$1,400 (\$1,350 for 2021). If both spouses are 65 or older, the increase for 2022 is \$2,800 (\$2,700 for 2021).



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