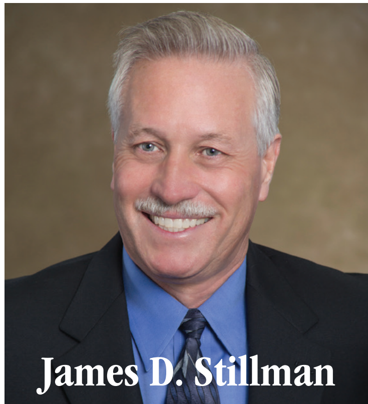
Between the Beacons

Charting Your Course to Retirement

Tax Planning in Retirement



This month I'd like to discuss the fourth of our five key areas of retirement planning included in our "Chart Your Course Retirement Plan". We previously touched on income, investment, and healthcare planning. Next up is everybody's favorite, TAXES! I want to make it clear that I am not a CPA or tax attorney, nor do I want to be. Any specific tax questions should always be directed to your personal CPA or qualified tax professional. That being said, I would like to address some basics on how taxes can play a part in your retirement plan, mainly when it comes to the issue of whether certain assets are taxable or non-taxable. We know this is something that confuses a lot of people, because we get questions about it on a near daily basis. So, we'll keep it simple on what's taxable and what's not. In the financial services industry you'll typically hear advisors reference two types of accounts - ***qualified & non-qualified***. Keep in mind that this is purely a tax designation and that these accounts can be invested in a whole variety of things from stocks, to annuities, to savings accounts, etc.

Qualified accounts (with the exception of Roth IRA/Roth 401k) are funded with pre-tax dollars, which means the contributions are tax deductible in the current tax year. The account will grow tax deferred, but is fully taxed as earned income when money is drawn out. These types of accounts come in many forms, such as Traditional IRA, 401k, 403b, 457 plans, Simple IRA, and SEP IRA. Contribution limits range from $5,500 up to $55,000 per year. In some cases, there are income phase out limits for tax deductions on high wage earners, but again I won't get into all that at this time. The basic concept with qualified accounts is that you get a tax break now, but the account is taxable later.

Another thing to remember is that qualified plans funded with pre-tax dollars require you to start taking Required Minimum Distributions in the year you turn 70½. Your RMD amount is calculated using a divisor based on your age and looks at the value of all qualified accounts as of the prior year's end. It's critical that you don't forget to take your RMDs, because the IRS will penalize you 50% of what you should have taken, in addition to making you take the required distribution. That can be a costly mistake! One of the most important things we do for our clients is to help determine the most strategic ways to take RMD distributions from year to year.

Non-qualified accounts are funds not designated as IRA/401k/etc. They are funded with regular old after-tax dollars. You do not get an upfront tax break on money you invest in non-qualified vehicles. Over time, you will pay capital gains taxes on any growth or interest earned on the account. Capital gains can be either short-term or long-term, depending on how long you held the investment position. Short-term gains are taxed as ordinary income, but long-term gains are taxed at a separate rate that currently ranges from 0-20% depending on your tax bracket. So, with non-qualified accounts, you're basically paying taxes on what you put in, as well as the growth over time.

Next we'll talk about Roth IRA and Roth 401k accounts, because those are somewhere in between qualified and non-qualified. They are technically considered qualified funds, but Roth IRAs are funded with after-tax dollars and then grow tax deferred. Once you reach age 59½ and you've held any Roth account for at least 5 years, then you can access the full value without paying further taxes. So, as long as you meet certain requirements, you are getting out of paying tax on the growth. There are limits on how much you can contribute to a Roth account each year, so it isn't a magic bullet to save you from all capital gains taxes. It can, however, be quite helpful to have access to Roth monies in retirement, because it gives you a place to draw tax-free income. There are other strategies that can be used to create tax-free income in retirement, but we don't have time to get into that in this article. If you'd like to learn more about creating a Tax Free Retirement, then you can contact us and we'd be happy to discuss the options. I might even cover it in a later article.

At JDS, everything we do is designed to take the worry out of your retirement. If you'd like to set up a visit to discuss your retirement and get your own ***Chart Your Course Retirement Plan***, then give us a call.

And remember: ***The purpose of the money dictates where you put it!***

Until Next Month,
James D. Stillman

Chart Your Course to Retirement

Thursday February 1st &
Tuesday February 6th

Chillfire Bar & Grill
6:30pm (doors open at 6:00pm)

REGISTRATION REQUIRED TO ATTEND
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