Liberty National Wealth Management Newsletter

Tax Efficiency in Retirement

What role should taxes play in your investment decisions?

Provided by Liberty National Wealth Management

Will you pay higher taxes in retirement? Do you have a 401(k) or a traditional IRA? If so, you will receive income from both after age 72. However, if you have saved and invested much of your life, you may also end up retiring at a higher marginal tax rate than your current one. In fact, the income alone resulting from a Required Minimum Distribution could push you into a higher tax bracket.

While retirees with lower incomes may rely on Social Security as their prime income source, they may pay comparatively less income tax than you in retirement; some, or even all, of their Social Security benefits may not be counted as taxable income.[1]

What's a pre-tax investment? Traditional IRAs and 401(k)s are examples of pre-tax investments. You can put off paying taxes on the contributions you make to these accounts until you start to take distributions. When you take distributions from these accounts, you may owe taxes on the withdrawal. Pre-tax investments are also called tax-deferred investments, as the invested assets can benefit from tax-deferred growth.[2]

Under the SECURE Act, once you reach age 72, you must begin taking required minimum distributions from a traditional IRA, 401(k), and other defined contribution plans in most circumstances. Withdrawals are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty. Contributions to a traditional IRA may be fully or partially deductible, depending on your adjusted gross income.

What's an after-tax investment? A Roth IRA is a classic example. When you put money into a Roth IRA, the contribution is made with after-tax dollars. As a trade-off, you may not owe taxes on the withdrawals from that Roth IRA (so long as you have had your Roth IRA at least five years and you are at least 59½ years old). With distributions from a Roth IRA, your total taxable retirement income is not as high as it would be otherwise.[2]

Should you have both a traditional IRA and a Roth IRA? It may seem redundant, but it could help you manage your tax situation. Keep in mind that tax-free and penalty-free withdrawal from a Roth IRA also can be taken under certain other circumstances, such as the owner's death.

Smart moves can help you manage your taxable income and taxable estate. If you're making a charitable gift, giving appreciated securities that you have held for at least a year is one choice to consider. In addition to a potential tax deduction for the fair market value of the asset in the year of the donation, the charity may be able to sell the stock later without triggering capital gains.[3]

Remember, however, that this article is for informational purposes only and is not a replacement for real-life advice, so make sure to consult your tax, legal, and accounting professionals before modifying your charitable giving strategy.

The annual gift tax exclusion gives you a way to remove assets from your taxable estate. You may give up to $15,000 to as many individuals as you wish without paying federal gift tax, so long as your total gifts keep you within the lifetime estate and gift tax exemption of $11.58 million for the year 2020 and $11.7 million for 2021.[4]

Managing through the annual gift tax exclusion can involve a complex set of tax rules and regulations. Before adjusting your strategy, consider working with a professional who is familiar with the rules and regulations.

Are you striving for greater tax efficiency? In retirement, it is especially important – and worth a discussion. A few financial adjustments may help you manage your tax liabilities.

If you are interested in learning more about the services Liberty National Bank can provide please contact us for a free consultation at our wealth management locations in Downtown Sioux Falls or Dakota Dunes.

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Citations

1. SSA.gov, February 22, 2021

2. IRS.gov, November 16, 2020

3. IRS.gov, March 25, 2020

4. Policygenius.com, December 21, 2020