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## Questions?



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## Tax Planning Now Can Pay Off Later in Retirement

For many people, retirement is not a time to slow down and stop. It's a time to explore the next great chapters of your life and build upon everything you've learned and experienced.

Another thing that doesn't slow down or stop, unfortunately, is taxes. Understanding how taxes could affect your future cash flow will help you create an effective retirement income strategy.

### Know how your retirement savings accounts are taxed

Withdrawals from traditional 401(k) plan accounts and certain other employer-sponsored plans, as well as traditional individual retirement accounts (IRAs), are generally subject to federal and state ordinary income taxes upon withdrawal.

On the other hand, contributions to a designated Roth 401(k) account or Roth IRA are federally tax free when you withdraw those funds, as are the earnings, assuming the withdrawal is a qualified distribution, which generally means it is made after a five-year waiting period and the account owner is at least 59½ years old.

As for nonretirement accounts, bond income and some of the dividends you receive from stocks and mutual funds may be taxed at your federal ordinary income rate, but qualified dividends and long-term investment gains are generally taxed at lower long-term capital gains rates. State and local tax treatment may vary.

### Develop a thoughtful distribution strategy

For some people, it will make sense to consider tapping taxable accounts first, then tax deferred. Depending on the circumstances, however, this order may not be right for everyone.

If most of your investment gains are from long-term assets held outside of traditional 401(k), IRA, or other similar tax-deferred accounts, you'll likely pay long-term capital gains taxes, which are generally lower than what you pay on distributions taxed as ordinary income from your tax-deferred retirement accounts.

You'll also need to consider the impact of your retirement savings on your taxes once you turn 73 (or 75 after 2032). That's when you must begin taking required minimum distributions (RMDs) from some of your retirement accounts, which is likely to boost your taxable income.

### **Avoid moves that could put you in a higher tax bracket**

RMDs and other changes that bump up your income can result in what's called "bracket creep," which is unintentionally slipping into a higher tax bracket. You might receive an inheritance or sell some real estate, for example. You might also slip into a higher tax bracket by taking selling appreciated stock in a taxable account to provide cash to renovate your home or buy a new car.

A higher income can also affect the taxability of your Social Security benefits and increase your Medicare premiums.

This is one reason to consider funding different kinds of retirement accounts during your working years. For example, you could split your retirement contributions between Roth and traditional (pretax) accounts.

During retirement, you can manage the amount of taxable income you receive and make adjustments when necessary.

You can also pay for qualified medical expenses during retirement with any health savings account (HSA) savings you may have. Those qualified withdrawals are tax free and won't affect your taxable income.

However, before you take any of these actions, you should consider consulting with an advisor or tax professional.

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advice. Please contact your legal or  
tax advisor for advice on your  
specific situation.

## Tricks for Paying Down Debt Faster

For many employees, a mountain of debt keeps them from contributing as much as they could to their retirement plans. Some of these obligations – mortgages and student loans, for example – are long-term obligations that may require years or decades to pay off. However, there are some strategies you can use to erase certain debts faster.

### Zeroing out credit card balances

Rather than try to make smaller payments to reduce several credit card balances, focus on making extra payments to zero one balance at a time – while continuing to make the minimum payment on all of your other debts. Two common strategies can help you achieve this goal.

- With the **avalanche method**, you tackle the loan with the highest interest rate first, which could save you more on interest.
- With the **snowball method**, you focus on zeroing out credit cards with the lowest balances, which could be emotionally satisfying as you clear away smaller, lingering debts first.

In either case, once you pay off a loan, take the amount you were putting into that payment and add it to your next loan in line. This keeps the total monthly payment amount the same but pays off subsequent loans more quickly.

### Reducing long-term loan payoff schedules

For long-term loans such as mortgages or car loans, consider making higher monthly payments or make more than one payment per month to accelerate their payoff schedule – for example, paying off a five-year auto loan in three years. Your goal with these payments is to reduce the amount of principal subject to interest rates. Since some lenders by default apply extra payments toward future interest, you may need to call your lender to specify that you want these extra payments to be used to reduce principal.

This material does not constitute either tax or legal advice. Although we go to great lengths to make sure our information is accurate and useful, we recommend you consult a tax professional before you implement any of these strategies.



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