How Tax Planning Changes Through Four Stages of Retirement

People often pay more in taxes than expected because a confusing system treats various income types differently, and contains hidden taxes and penalties.

FOUR STAGES OF RETIREMENT

Stage	Ages	Description
Pre-retirement	50–60	Work and save years
Early retirement	60–70	Go-go years
Middle retirement	70–80	Go-slow years
Late retirement	80+	No-go years

RETIREMENT SURPRISES

- ✓ **Inflation:** People view their future costs in current dollars and don't anticipate how those costs will grow with inflation.
- ✓ **Longevity:** People may end up living longer than they expect, which requires more money.
- ✓ **Expenses:** People underestimate how much they need to maintain their pre-retirement standard of living.
- ✓ **Health care:** People don't realize how much of their savings will be spent on health costs.

KEY #1:

You have to know what your after-tax retirement savings picture looks like BEFORE retiring.

- ✓ If you save $500,000 in your 401(k)/IRA, it's not really $500,000. Taxes must be paid.
- ✓ If you're already retired, you'll want to start evaluating next year's potential tax bill before you start tapping assets in the new year.

KEY #2:

Social Security and Medicare have "tax traps" and you need to plan for them, too.

- ✓ IRA withdrawals can cause the taxation of Social Security benefits, and push taxpayers into a higher marginal tax rate.
- ✓ Higher income (i.e. withdrawing assets) can cause potentially hundreds of dollars a month extra in Medicare premiums.

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KEY #3:

You must plan how and when you will use taxable, tax-deferred, and tax-free assets to manage your income and tax brackets efficiently.

- ✓ Consider starting to draw down IRAs now, so that your required minimum distributions (RMDs) won't have as large an effect on Social Security taxation and Medicare premiums.
- ✓ Also consider "filling your tax bracket" in lower income years through Roth conversions or selling appreciated stock, to take advantage of a lower tax rate.
- ✓ Think about donating your RMDs directly to charity to avoid paying income tax on the distributions, through what is known as a qualified charitable distribution (QCD).

KEY #4:

Organize your assets for your family's benefit—estate planning still matters!

- ✓ If you have a terminal illness, make sure to think about step-up basis strategies.
- ✓ There are multiple ways to leave IRAs as an inheritance; you need to make sure your heirs get the best and easiest transfer.
- ✓ Long-term care is a major concern for many people. You need to plan how you will fund this likely expense, and still leave an inheritance for your heirs.

SOLUTION: Because your tax exposure will change throughout retirement, you need a tax strategy that:

- ✓ Anticipates how and when you tap assets to cover your personal expenses.
- ✓ Understands the range of taxes you will face at various stages.
- ✓ Manages your actions so you pay as a low a tax rate as possible.

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