

10 Proactive Tax Management Strategies for Retirement

Tax-efficient ways to
maximize your income and
minimize your liability



The CP Welde Group
Tax and Wealth Advisors

As you transition into retirement, your financial priorities and tax considerations often undergo significant changes. Working with an advisor who takes a proactive approach to tax planning and management can help optimize your income, preserve your wealth, reduce your lifetime taxes, and enhance your financial well-being during your retirement years.

Here are ten key strategies that retirees can employ to manage their taxes efficiently and make informed decisions to safeguard their financial future.

1. Tax-Efficient Withdrawal Strategies

Managing taxes in retirement is critical because they can significantly impact your income. To do this, you'll want to create a tax-efficient withdrawal plan for your retirement accounts like 401(k)s and IRAs. This involves strategically timing withdrawals, understanding required minimum distributions (RMDs), and recognizing how different account types are taxed.

In our Tax Management Journey®, we teach retirees the key idea that not all

"Not all money is taxed the same"

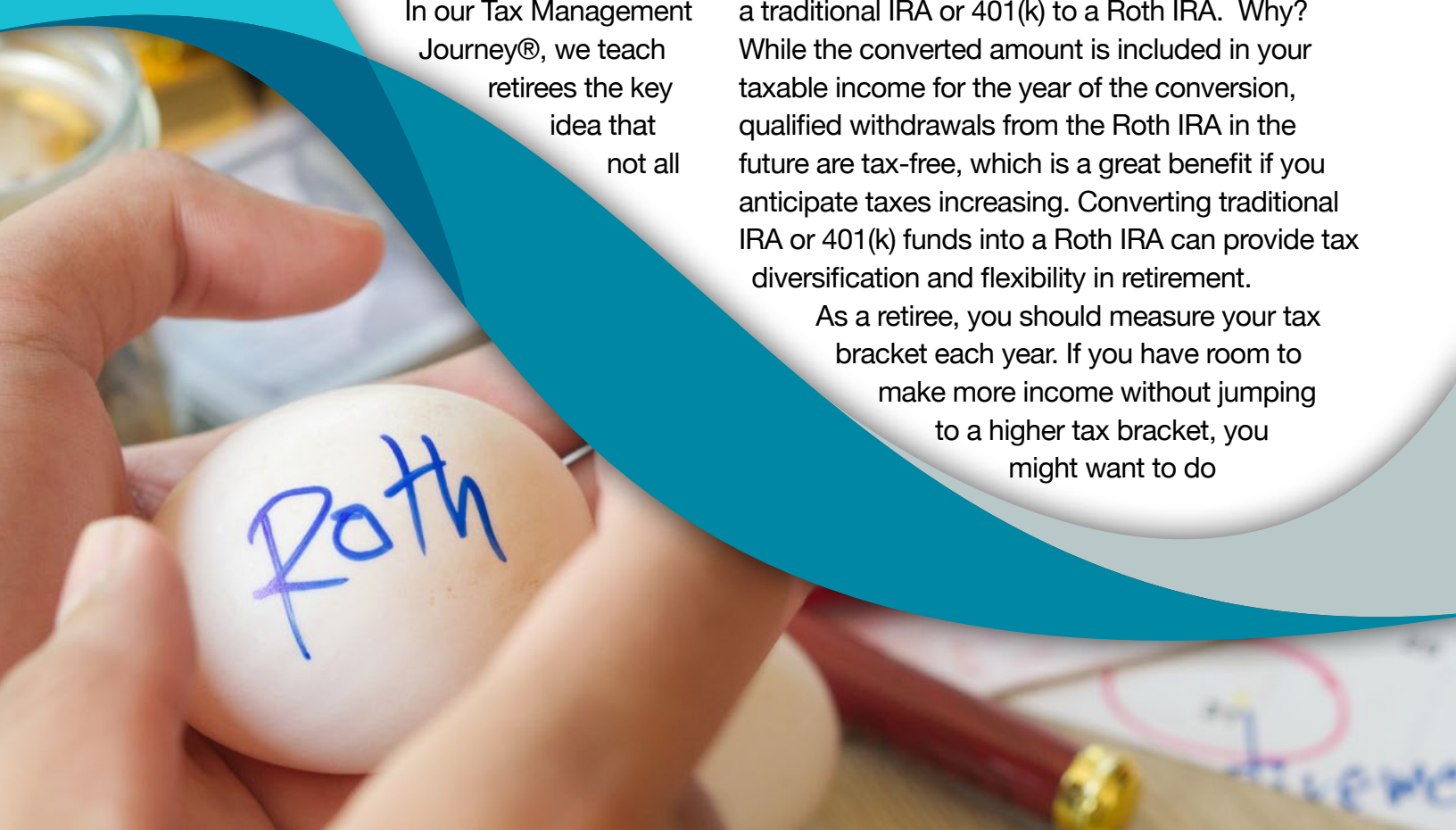
money is taxed the same. You can optimize your income and minimize taxes by withdrawing the right amount from each account type annually. For example, you might withdraw enough from your 401(k) or traditional IRA to match Social Security limits. Then, you can supplement income with sources like long-term capital gains or qualified dividends within the 15% tax bracket. If you need more income, consider tax-free sources like Roth IRAs or HSAs for medical expenses to avoid higher tax rates.

Think of this as your "order of money." During saving, there's an order to accumulate funds to maximize tax benefits. In retirement, there's an order to withdraw funds to boost income while minimizing taxes over your lifetime.

2. Roth IRA Conversions

A Roth conversion involves transferring funds from a traditional IRA or 401(k) to a Roth IRA. Why? While the converted amount is included in your taxable income for the year of the conversion, qualified withdrawals from the Roth IRA in the future are tax-free, which is a great benefit if you anticipate taxes increasing. Converting traditional IRA or 401(k) funds into a Roth IRA can provide tax diversification and flexibility in retirement.

As a retiree, you should measure your tax bracket each year. If you have room to make more income without jumping to a higher tax bracket, you might want to do



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a Roth conversion to “top off” a bracket, also known as “bracket-bumping” a Roth conversion. For example, if you’re retired and in the 12% tax bracket and have the capacity to create an additional \$12,000 of income that could be realized in the 12% bracket before you are pushed into the 22% marginal bracket, it might be prudent to convert up to \$12,000 from your IRA to the Roth IRA. This would create tax at the 12% rate and allow you to now have that \$12,000 in your Roth IRA growing tax-deferred and providing tax-free withdrawals in the future. We usually find it best if you can pay the tax for the Roth conversion from an outside account rather than having to take a withdrawal from the IRA itself to pay the tax.

3. Tax-Efficient Investment Strategies

As a retiree, you want to avoid any unforeseeable tax surprises that could push you into a higher tax bracket or cause taxation on your Social Security or Medicare benefits. Choosing tax-efficient investment vehicles and strategies can help minimize taxable gains and optimize after-tax returns.

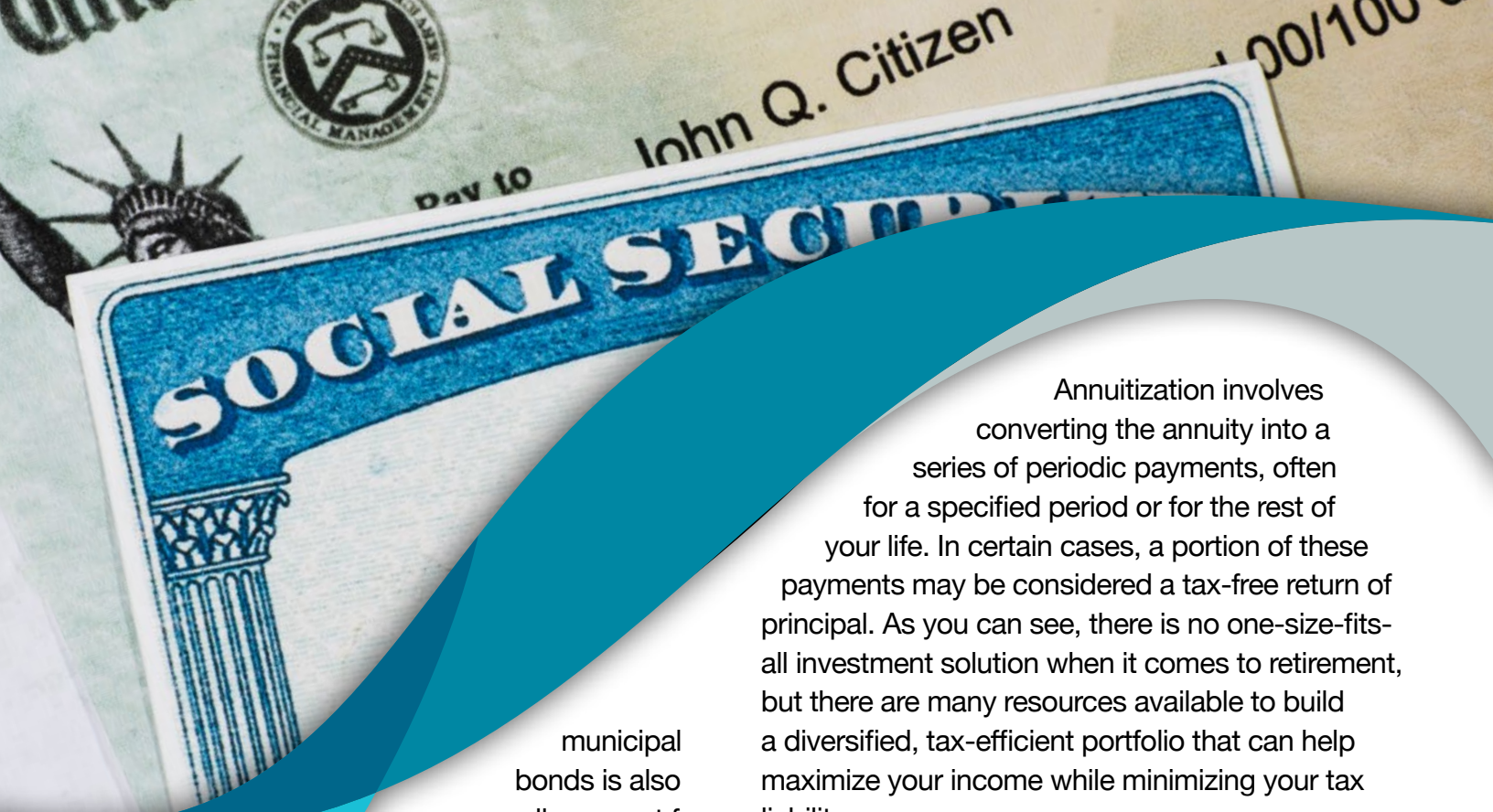
For your non-retirement accounts such as brokerage or revocable trust accounts, you may want to

consider a more tax-efficient exchange-traded fund (ETF) structure over actively managed mutual funds or investment strategies. Actively managed funds can generate capital gain distributions that you can’t control, potentially leading to unpleasant tax surprises.

If your accounts are large enough, you could even consider a large basket of diversified individual stocks or bonds, which would allow you to directly control the realization of capital gains in addition to providing annual tax deduction opportunities through tax loss harvesting.

For retirees looking for cash flow, explore investments like dividend-paying stocks and tax-efficient funds because they carry a more preferential tax rate than ordinary income (taxed at long-term capital gains). These options can help reduce your adjusted gross income (AGI) and the taxable portion of your Social Security benefits. REITs (Real Estate Investment Trusts) also often distribute a significant portion of their income as dividends, a portion of which may be classified as qualified dividends, subject to lower tax rates. Interest income from





municipal bonds is also generally exempt from federal income tax.

Non-qualified annuities can offer several tax benefits for retirement planning, too.

One of the primary tax benefits of non-qualified annuities is tax-deferred growth. Earnings within the annuity accumulate on a tax-deferred basis, meaning you won't pay taxes on the gains until you make withdrawals. This allows your investment to grow more efficiently over time. Non-qualified annuities typically offer various payout options, including systematic withdrawals. This allows you to receive a regular stream of income from the annuity, and you'll only pay taxes on the portion of the withdrawal that represents earnings.

Taxes on Social Security are added to your taxable income, so they affect your overall tax rate. Distributions from tax-deferred accounts like Traditional IRAs can increase your provisional income and thus the tax on your Social Security.

Annuitization involves converting the annuity into a series of periodic payments, often for a specified period or for the rest of your life. In certain cases, a portion of these payments may be considered a tax-free return of principal. As you can see, there is no one-size-fits-all investment solution when it comes to retirement, but there are many resources available to build a diversified, tax-efficient portfolio that can help maximize your income while minimizing your tax liability.

4. Maximizing Your Social Security Benefit

Maximizing your Social Security benefits is a key part of retirement planning, but the tax rules around Social Security can be complex. What you pay in taxes on your benefits depends on factors like your income and filing status.

Your Full Retirement Age (FRA) matters. It's when you can get your full Social Security benefit without any reduction. For folks born between 1943 and 1954, it's 66, rising for later birth years. Delaying your claim past FRA earns you delayed retirement credits, boosting your benefit. Claiming earlier means a permanent reduction in your monthly payout. If you claim before FRA and keep working, an earnings test could lower your benefits if your income is high.

Understanding the tax implications of Social Security can help with retirement income planning. Delaying benefits until 70 can allow strategic Roth Conversions, but be aware, claiming Social Security can affect Roth Conversions. Your Social Security's taxation depends on provisional income, calculated from your adjusted gross income (AGI), non-taxable interest, and half your Social Security

benefits.

Individual taxpayers with provisional income between \$25,000 and \$34,000 might have 50% of benefits taxed, rising to 85% for those over \$34,000. For married joint filers, it's 50% between \$32,000 and \$44,000, and 85% over \$44,000.

Taxes on Social Security are added to your taxable income, so they affect your overall tax rate. Distributions from tax-deferred accounts like Traditional IRAs can increase your provisional income and thus the tax on your Social Security. Roth IRA distributions aren't included in this calculation, making them a tax-efficient income source. Keep in mind, these income thresholds don't adjust for inflation, so more people may face Social Security taxes over time due to income growth.

5. Legacy Planning for The Surviving Spouse

Many people believe Legacy planning is just for the children, grandchildren, and charities, but legacy planning is most important for the surviving spouse. In the year of a spouse's death, a surviving spouse can generally still file a joint return for that year. After the year of death, the surviving spouse may be eligible to use the "qualifying widow(er)" status for the next two years, which provides more favorable tax rates and a higher standard deduction compared to the "single" status. But after that two-year window, the surviving spouse must file a "single" tax return, which means their standard deduction gets cut in half, making more of their income taxable.

In addition, the brackets shrink for a single filer compared to the married filing jointly tax status, which means for the same amount of overall

income, the surviving spouse pays considerably more in income taxes. Not only do taxes go up, but income also generally goes down. When one spouse passes away, the surviving spouse doesn't get to keep both retirement paychecks. The lower of the two Social Security payments goes away. The impact of taxes going up and income going down is a double whammy on the surviving spouse, something we call the widow's penalty in retirement income planning.

To account for this, a married couple should consider how they can strategically reposition some of their funds while they are alive, healthy, and have the advantages of the large standard deduction as well as the wider tax brackets for a

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If you are a high-income retiree, a strategy called a back-door Roth IRA conversion can be useful. It lets you contribute to a Roth IRA even with income exceeding direct contribution limits.

married couple. This might mean using strategies like bracket bumping Roth conversions to create tax-free money for the surviving spouse, taking withdrawals from the IRA to purchase life insurance on each spouse, so that if one spouse does prematurely pass away, the life insurance provides tax-free money for the surviving spouse to supplement their income needs. Or just simply taking greater withdrawals out of the retirement accounts while they have the benefits of the wider brackets. And accumulating those savings in a post-tax brokerage account to be used by the surviving spouse to help maintain their net after-tax purchasing power in retirement.

6. IRA Contributions or Spousal IRA Contributions:

Retirees have options for IRA contributions, whether from their earned income or a spouse's. Earned income includes wages, self-employment earnings, and alimony, but not Social Security or investment income. Since the 2022 tax year, there's no age limit for traditional or Roth IRA contributions. People under age 50 can contribute up to \$6,000 annually, while those 50 and older get a \$1,000 "catch-up" allowance, making it \$7,000. One

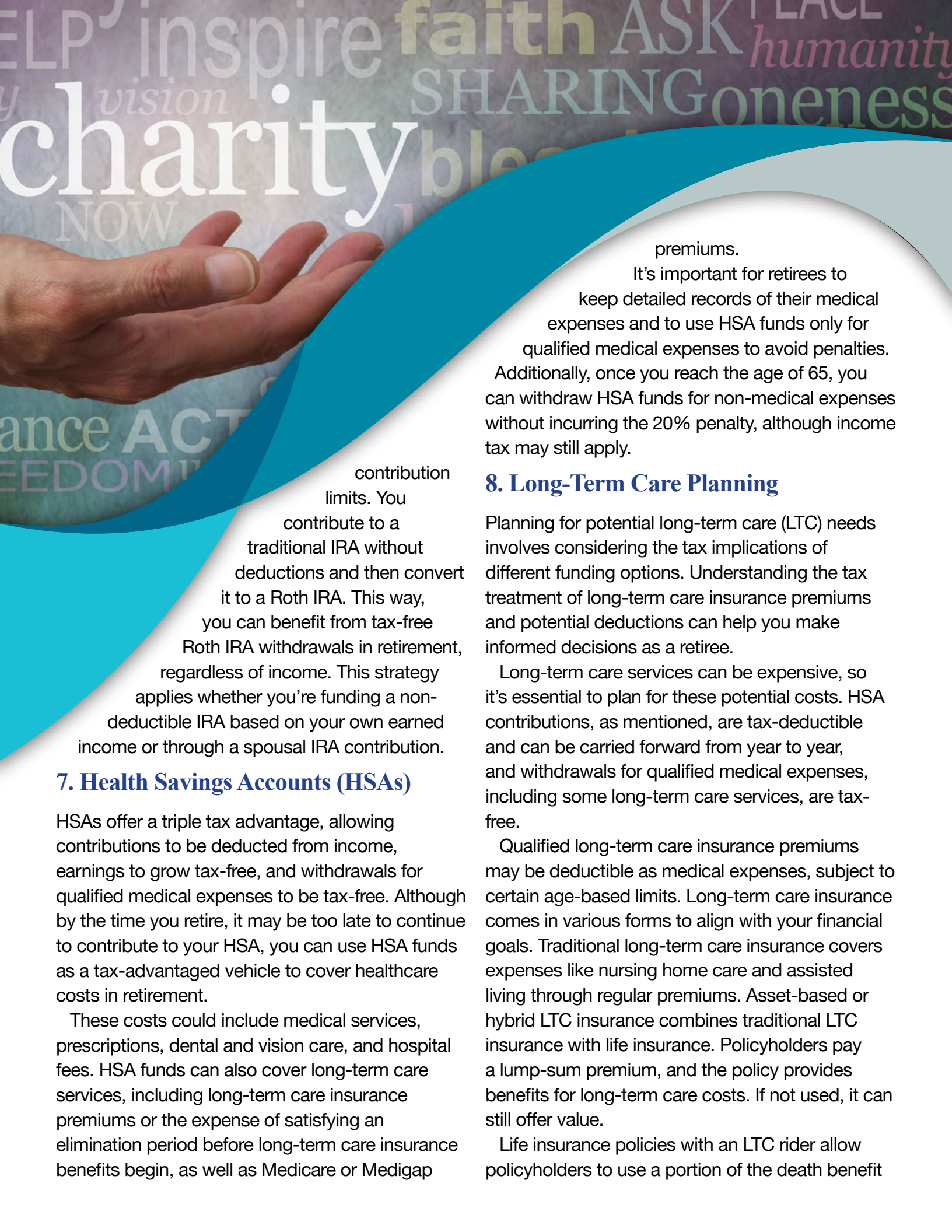
should note, Roth IRA contributions could have income limits.

If your modified adjusted gross income (MAGI) surpasses a threshold, Roth IRA contributions may be limited, but traditional IRA contributions are still allowed. The tax deductibility of traditional IRA contributions hinges on factors like income and retirement plan coverage. Contributions for a tax year can be made before the tax filing deadline, usually April 15 of the following year.

Even without earned income, if you are married to a working spouse, you can use spousal IRA contributions. To qualify, a couple must be married, file a joint tax return, and have enough earned income to cover both IRA contributions. The limits for spousal IRAs mirror those for individuals with earned income: \$6,000 annually, with a \$1,000 "catch-up" for those 50 and older. Tax deductibility for the non-working spouse's traditional IRA follows the same rules as earned income-based IRAs.

If you are a high-income retiree, a strategy called a back-door Roth IRA conversion can be useful. It lets you contribute to a Roth IRA even with income exceeding direct





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contribution limits. You contribute to a traditional IRA without deductions and then convert it to a Roth IRA. This way, you can benefit from tax-free Roth IRA withdrawals in retirement, regardless of income. This strategy applies whether you're funding a non-deductible IRA based on your own earned income or through a spousal IRA contribution.

7. Health Savings Accounts (HSAs)

HSAs offer a triple tax advantage, allowing contributions to be deducted from income, earnings to grow tax-free, and withdrawals for qualified medical expenses to be tax-free. Although by the time you retire, it may be too late to continue to contribute to your HSA, you can use HSA funds as a tax-advantaged vehicle to cover healthcare costs in retirement.

These costs could include medical services, prescriptions, dental and vision care, and hospital fees. HSA funds can also cover long-term care services, including long-term care insurance premiums or the expense of satisfying an elimination period before long-term care insurance benefits begin, as well as Medicare or Medigap

premiums.

It's important for retirees to keep detailed records of their medical expenses and to use HSA funds only for qualified medical expenses to avoid penalties. Additionally, once you reach the age of 65, you can withdraw HSA funds for non-medical expenses without incurring the 20% penalty, although income tax may still apply.

8. Long-Term Care Planning

Planning for potential long-term care (LTC) needs involves considering the tax implications of different funding options. Understanding the tax treatment of long-term care insurance premiums and potential deductions can help you make informed decisions as a retiree.

Long-term care services can be expensive, so it's essential to plan for these potential costs. HSA contributions, as mentioned, are tax-deductible and can be carried forward from year to year, and withdrawals for qualified medical expenses, including some long-term care services, are tax-free.

Qualified long-term care insurance premiums may be deductible as medical expenses, subject to certain age-based limits. Long-term care insurance comes in various forms to align with your financial goals. Traditional long-term care insurance covers expenses like nursing home care and assisted living through regular premiums. Asset-based or hybrid LTC insurance combines traditional LTC insurance with life insurance. Policyholders pay a lump-sum premium, and the policy provides benefits for long-term care costs. If not used, it can still offer value.

Life insurance policies with an LTC rider allow policyholders to use a portion of the death benefit

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for long-term care costs while alive, functioning as an acceleration of the death benefit. Tax-qualified annuities can offer tax-free withdrawals for qualifying long-term care expenses or premiums.

Some states provide tax incentives for long-term care insurance, and certain long-term care expenses may be deductible on federal income tax returns.

Strategic gifting of assets, while considering gift tax implications, can be part of a long-term care plan to protect assets and potentially qualify for Medicaid after a waiting period.

9. Charitable Giving and Tax Deductions:

Retirees can make the most of their charitable giving through strategic planning, with two key methods standing out. Firstly, there's the Qualified Charitable Distribution (QCD), a tax-efficient approach for retirees over 70 ½ years old. By directing an IRA distribution directly to a qualified charity, you can still claim the standard deduction while avoiding taxation on the IRA distribution. You can distribute up to \$100,000 annually, or \$200,000 for married couples filing jointly. This not only helps

fulfill Required Minimum Distributions (RMDs) but also benefits those taking the standard deduction.

Another method is leveraging a Donor-Advised Fund (DAF), which allows you to make charitable contributions, get an immediate tax deduction, and then suggest grants to your chosen charitable organizations over time. When you fund your DAF with appreciated securities, you may receive a tax deduction for their fair market value, up to 30% of your adjusted gross income, while potentially avoiding capital gains taxes. This approach aligns with "deduction stacking," enabling retirees to optimize deductions by coordinating timing and sources, especially during high-income years.

By bunching contributions into a single year, retirees can maximize immediate tax benefits, while the flexibility to time grant distributions offers control over the charitable deduction's timing, further aiding tax planning, including offsetting Roth conversion taxes if necessary.

10. Estate & Transfer Tax Planning

The federal estate tax is a tax imposed on significant assets left behind after passing away. Currently, you can leave up to \$12.92 million (\$25.84 million for couples) without this tax. However, this exemption is set to decrease by half

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at the start of 2026.

Your taxable estate is calculated by adding up the value of all the decedent's assets, including real estate, cash, investments, business interests, life insurance death benefit and other personal property. If your estate exceeds this limit, a 40% tax applies to the excess. For example, if your estate is \$11 million with a \$10 million exemption, you'd owe \$400,000.

Leveraging the marital deduction of the federal tax code, which allows the unlimited transfer of assets to a surviving spouse without incurring estate tax, is a tax efficient strategy for estate planning.

Additionally, the concept of portability allows a surviving spouse to use any unused portion of their deceased spouse's estate tax exemption, but this must be elected on a federal estate tax return (Form 706), which is commonly missed when settling an estate. The federal gift tax and estate tax are unified, meaning that there is a combined lifetime gift and estate tax exemption. This unified credit creates unique planning opportunities by allowing you to make lifetime gifts up to a certain amount without incurring gift tax.

However, gifts made during your lifetime reduce the available estate tax exemption at death. You can make annual gifts up to \$17,000 in 2023 and \$18,000 in 2024 per recipient without using any of your lifetime gift and estate tax exemption. This means that, for example, a married couple could give \$34,000 to a child in a tax year without having to file a gift tax return.

Efficient estate tax planning involves understanding the current estate tax laws and utilizing strategies to minimize the tax impact on heirs. Techniques like gifting, the use

of trusts, and other estate planning tools can be employed to protect and transfer wealth tax-efficiently. While many retirees don't have a taxable estate that exceeds the current exemption amount of \$12.92M, many more unsuspecting retirees will have estate tax exposure once the 2017 Tax Cuts & Jobs Act sunsets and the estate and gift exemption gets cut by half. This creates a unique opportunity to consider strategic estate planning between now and the end of tax year 2025 while the gift exemptions are so high.

For example, if you are on the fringe of having a taxable estate, it may be prudent to gift certain assets that you will not need in your lifetime, such as the death benefit of a life insurance policy, to a vehicle such as an irrevocable trust for your beneficiaries. While this could use up part of your lifetime gift exemption now, it could save significant transfer or estate tax to your beneficiaries in the future. Even if your estate value is not above the estate exemption threshold, your beneficiaries could face an income tax on the transfer of your retirement accounts to them. IRD stands for "Income in Respect of a Decedent," and it is term for certain types of income that a



deceased person had a right to receive at the time of death. When someone passes away and leaves an IRA to their heirs, the heirs may be subject to income tax on distributions from the inherited IRA. The income that the deceased individual would have received (but for their death) is considered Income in Respect of a Decedent. The beneficiaries of an inherited IRA are generally required to take distributions from the IRA, and these distributions are generally subject to income tax.

The taxation is based on the income tax rates that apply to the beneficiaries. Unlike some other inherited assets, such as real estate, there is no step-up in basis for the assets held within an IRA. This means that when beneficiaries sell assets within the IRA, they may owe capital gains tax on any appreciation that occurred before the original owner's death.

The Income in Respect of a Decedent is reported on the income tax return of the individual who inherits the IRA. The IRS typically provides specific forms and instructions for reporting inherited IRA distributions. Both traditional and Roth IRAs can be

subject to IRD rules, though the taxation and rules may vary. Traditional IRA distributions are generally subject to ordinary income tax, while qualified Roth IRA distributions are tax-free. If the decedent's estate is subject to federal estate tax, there may be an estate tax deduction for the portion of the IRA included in the gross estate. This is intended to prevent double taxation on the same assets, but the net effect is that if your net worth and IRA value is large enough, you could lose a substantial amount of the value of your account to income and estate tax without proper planning.

A Dollar Saved in Taxes is a Dollar You Can Enjoy in Retirement

The more you can engage in proactive tax management, the more we can help you keep what took a lifetime to build by again, maximizing your net worth and income and minimizing your taxes. To learn more about these tax management strategies and how we factor that into the goals of your retirement, schedule a call with us today!



Charles Welde, CPA, CFP
Founder and Owner,
The CP Welde Group

We understand that finding the time for financial planning can be a challenge, that's why we're here.

In the words of Charles Welde, CPA, CFP® who specializes in creating tax-efficient retirement plans, "Nearly everyone has a portfolio but very few have a plan," — which as you may have read by now, is **essential to retiring with confidence.**

At The CP Welde Group, we provide personalized Bucket Plans that include tax planning and ongoing management, to preserve and protect your assets and offer peace of mind. A tax-efficient and customized Bucket Plan is designed to safeguard your wealth, even in a volatile market environment.

Whether you prefer a quick phone conversation or a traditional in-person consultation, we're flexible and can meet you wherever you are in life.

You can trust our team at The CP Welde Group to answer your questions and help you plan now, so you can focus on enjoying your retirement to the fullest.

Schedule your **complimentary consultation** today for a plan and partner you can rely on in retirement.

Schedule a Consultation

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