As Seen In: Community Spirit

FINANCIAL

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Part 3: It's A Wonderful Life

Tax Free Retirement Income Strategies

The epic movie *It's A Wonderful Life* is a Christmas Tradition at the Cowell household during the holidays. With the help of Clarence, angel second class, George Baily slowly awakens to the realization that the future would be vastly different if he had never been born. Because of the love, compassion, and influence in his community, George realizes he truly influenced those he encountered, and that he did indeed have a wonderful life. To this day, when a small bell rings around the holidays, the thought that an angel is getting their wings makes me smile.

So, what does *It's a Wonderful Life* have to do with retiring in a zero-tax bracket? The answer, I believe, is with preparation. Just as George Bailey working at the Baily Savings and Loan to help his customers purchase their homes and make a great life for their families, we too must be consciously be preparing for our future. How you position your assets will determine whether you have a "just so" retirement or whether it will be a "Wonderful" retirement.

In the January and March issues of Community Spirit Magazine we discussed how and why you should start shifting assets from tax deferred investments to those that are truly tax free. If you haven't read those articles, I recommend you go to communityspiritmagazine.com. Throughout this article I will give you some previously discussed "planning nuggets" that you might want to consider as you plan your future.

There are four basic strategies to get to a lower tax rate at retirement:

1. Make contributions to your Roth IRA or Roth 401(k) now. If filing single, under age 50 and earn $6,000 you can fund a Roth. If age 50 or over, you can contribute an additional $1,000. If you are married and make at least $12,000 you and your spouse can make Roth contributions. Over age 50 you can catch up with an additional $1,000 each. Remember, only one spouse has to have earned income to contribute to both Roth IRA's. A minimum of $14,000 in needed to make the maximum contribution. There are adjusted gross income limitations for Roth contributions. If you file as an individual and your adjusted gross income (AGI) is more than $137,000 or if you file jointly and your income is more than $203,000 you can no longer contribute directly to a Roth.

You cannot get to tax-free with only one source of tax-free incomes.

2. Begin ***converting*** into tax-free Roth's. If you don't currently have a Roth account established, do it as soon as possible. It needs to be established at least five years to get the full tax-free income benefits. To convert your Traditional IRA to a Roth IRA you must pay taxes on the transfer. You can either pay from a nonqualified source such as a savings account or mutual fund at the time of transfer. Remember, if you utilize proceeds from

the sale of a mutual fund, stock or bond, you might incur a tax liability. Always consult your financial advisor or accountant before making any changes.

There are only two truly tax-free investments.
Roth IRA's and Specially designed life insurance.

A little-known provision in the IRS tax code Section 72(t) can also be used if you are under 59½ and want to avoid the 10% excise tax associated with early IRA withdrawals. Simply stated, you must withdraw substantial and equal payments for five years or 59½ whichever is **greater.** It is a great planning tool for offering a systematic and methodical way to move money from traditional to Roth IRA's. Remember, no matter your age, you have an opportunity to pay now at a lower rate or defer and pay at a higher marginal tax rate later. We know that barring any new tax legislation, marginal tax rates will be rising effective January 1, 2026.

If congress does nothing, tax rates will rise January 1, 2026. You have seven years to convert before tax rates go up.

3. Utilize a specially designed life policy specifically designed to provide death benefit in addition to tax-free income. While the primary purpose of life insurance is to provide a death benefit to the chosen beneficiary, there are other benefits afforded in correctly designed policies. Tax free income and long-term care benefits can add an additional layer of diversification and protection in retirement. Tom Henga writes in Pay Checks and Play Checks, you must "Understand the importance of tax diversification. Use Roth IRA's and permanent life insurance to diversify your ." retirement

Provisional income is calculated by adding all 1099 income, all ordinary income from your retirement accounts, one-half of your Social Security payments.

4. Reduce your provisional income. Unless you want up to 85% of your Social Security payments to be taxed at your highest marginal tax rate, you might want to bridle the growth of your IRA's and other qualified accounts. I know that sounds counterintuitive to intentionally slow down the growth of your retirement accounts, but hear me out. When you retire and you reach 70½, you will be required to withdraw money based on an IRS formula. If your account is allowed to grow "unbridled", this Required Minimum Distribution (RMD) from your IRA's alone could cause your Social Security income to be taxed in perpetuity.

Accessing cash values may result in surrender fees and charges, may require additional premium payments to maintain coverage, and will reduce the death benefit and policy values. A policy that lapses or is surrendered can potentially result in tax consequences. You should consult a qualified tax professional for tax advice on your own personal situation. All guarantees are based upon the claims-paying ability of the issuer.

According to CPA and previous Comptroller General, David Walker, – tax rates will have to double in the future. GAO office estimates 83% could be the highest tax bracket.

The national debt recently went over twenty-two trillion dollars.   In his recent book entitled Get Me to Zero, Mark J. Orr observes that as remarkable as that figure is, it becomes even more ominous knowing that EXCLUDES un-funded Social Security, Medicare, and Medicaid obligations. Those would add another fifty-four trillion dollars.

There are several other strategies available but they are beyond the scope of this article. If you are concerned about the inevitable rise in taxes and what actions you can take NOW to lessen your future tax burden and increase your chances of having a "Wonderful" retirement please contact us for a free no obligation strategy session.

Everyone should aspire to get the zero tax-rate if at all possible. Why? Because if the future tax rates double as predicted, two times zero is still zero.

We would love to help you chart a path to a tax-free retirement. Always seek competent financial advice before making changes to your plan. This information is intended for educational purposes only and is not intended as tax advice.