HOW TACKLING TAXES NOW CAN HELP AVOID A RETIREMENT INCOME SHORTFALL LATER

Will your income go as far as you think it will in retirement? If you're viewing your retirement income sources at face value—without factoring in taxes—you could come up short. Why? Because taxes can take a real bite out of your income. For example, a retiree in the 25% tax bracket would have to withdraw roughly $6,300 from a traditional 401(k) or IRA to generate $5,000 in income.[1] That's because contributions to traditional 401(k)s and IRAs are made on a pre-tax basis. When you withdraw money from those accounts in retirement the distributions are considered taxable income.

Gaining a clear understanding of the after-tax value of your various sources of income in retirement is a critical part of retirement income planning. Yet, doing so can be challenging since different types of income are treated differently for tax purposes. For example, unlike traditional 401(k) and IRA contributions, Roth 401(k) and Roth IRA contributions are made on an *after-tax* basis. Therefore, only distributions from account earnings (which compound on a tax-deferred basis) are taxed upon withdrawal. And what about income from investments held outside of qualified retirement plans? Typically, most interest is taxed at the same federal tax rate as your earned income,[2] while qualified dividends, such as most of those paid on corporate stocks, are taxed at long-term capital gains rates, which are lower than ordinary income tax rates. Nonqualified dividends, however, are taxed at the higher ordinary income tax rates.[3]

Another factor influencing taxes in retirement is the amount of income you receive. Typically, the higher your income in retirement, the greater your potential tax burden. Many retirees are surprised to learn that a portion of their Social Security retirement benefits may be taxable. While many retirees will pay no taxes on Social Security retirement income, up to 85% of Social Security income may be taxable for individuals reporting more than $34,000 in combined income (>$44,000 for couples).[4] Where you live in retirement can also make a difference. For example, some states tax pension distributions while others do not. However, states can't tax pension money you earned within their borders if you've moved your legal residence to another state. So, if you worked in Minnesota, but now live in Florida, which has no state income tax, you don't owe any Minnesota income tax on the pension you receive from your former employer.[5]

Any way you cut it, managing taxes in retirement can make a significant difference in how much of your income remains in your pocket. Fortunately, there are many strategies available to help retirees keep more of their income working for them in retirement, from Roth IRA conversions and Social Security claiming strategies, to tax-advantaged investments and more.

If you have questions about the impact of taxes on your retirement income, contact the office today to learn more about tax-advantaged strategies that may be appropriate for your situation.

[1] Example does not consider additional criteria used to determine an individual's overall tax obligation.
[2] https://www.fidelity.com/tax-information/tax-topics/interest-income
[3] https://turbotax.intuit.com/tax-tips/investments-and-taxes/guide-to-taxes-on-dividends/L1jBC5OvB
[4] https://www.ssa.gov/planners/taxes.html
[5] http://www.finra.org/investors/taxation-retirement-income

WHY MANY NEW RETIREES UNDERESTIMATE EXPENSES IN RETIREMENT

Conventional wisdom tells us that expenses go down in retirement. You're no longer commuting to work, may not need that second car and have paid down or paid off debt. While this "wisdom" may have described the typical retiree a generation ago, today's retirees paint a very different picture of life in retirement than past generations, which is reflected in their income needs and spending habits. For many retirees, money that was previously spent on work-related expenses such as commuting, clothing, and meals is often redirected—and in many cases increased—to support their more active lifestyles in the early years of retirement. In addition, instead of downsizing, many baby boomers are choosing to remain in their homes, with more than half carrying a mortgage in retirement.[1]

A study from the U.S. Bureau of Labor Statistics that examined the spending habits of Americans age 55 and older for the period 2014 – 2016, cited housing as the greatest expense as a share of household budgets, followed by healthcare costs, which increased with age.[2] Currently, 53% of U.S. owner-occupied houses are owned by people age 55 and older with baby boomers trailing prior generations in paying off their mortgages, a lag that has persisted even with an improving economy and a housing recovery.[3] And as retirees enjoy longer lifespans, on average, than previous generations,[4] healthcare costs can take an increasingly larger bite out of retirement savings. According to the latest retiree healthcare cost estimate from Fidelity Benefits Consulting, a 65-year-old couple retiring this year will need an average of $275,000 (in today's dollars) to cover medical expenses throughout retirement, up from $260,000 in 2016.[5]

While these and other factors challenge long-held assumptions about living expenses in retirement, a comprehensive approach to retirement income planning with a focus on your unique lifestyle needs and priorities can help you protect and pursue the quality of life you desire throughout retirement. Having a disciplined strategy in place for managing income, cash flow and investment risk that is consistently monitored and adjusted over time provides a framework for confident decision-making aligned with your unique lifestyle needs and goals. We are well-versed in the challenges today's retirees face can not only help you pursue a broader range of income needs for a potentially longer period in retirement, but help you embrace life in retirement on your terms.

If you're concerned about how long your income may last, or need help developing a budget or spending plan aligned with your income needs in retirement, contact the office to schedule a consultation.

1 https://www.reuters.com/article/us-usa-mortgages-babyboomers/u-s-baby-boomers-fall-behind-in-paying-off-mortgages-fannie-mae-idUSKBN1CA2GG
2 https://www.bls.gov/opub/btn/volume-5/spending-patterns-of-older-americans.htm
3 https://www.bloomberg.com/news/articles/2017-08-08/baby-boomers-who-won-t-sell-are-dominating-the-housing-market
4 http://www.businessinsider.com/people-are-living-longer-and-that-means-retirement-will-change-2017-6
5 https://www.fidelity.com/viewpoints/retirement/retiree-health-costs-rise

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