Tax Efficiency of Retirement Accounts

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PASSIONATE ABOUT HELPING PEOPLE MAKE FINANCIAL DECISIONS WITH CONFIDENCE AND CLARITY.

LOVES TO EDUCATE ABOUT COMPLEX FINANCIAL TOPICS.

ADORES DOGS OF ALL KINDS (CRAZY DOG LADY).

Tax planning is individual!

Always speak to a tax professional to determine which strategies may be applicable to your personal situation.

We are not providing tax advice, only education on options that may be worth discussing.

3 Buckets for Retirement Savings

Taxable

- Investments
  (stocks, most bonds, CDs)
- Taxable portion of Social Security benefits
- Profit from selling a primary home

Tax-deferred

- Pension
- Retirement savings
  - 401(k)
  - 403(b) plan
  - 457(b) plan
  - Traditional IRA
- Certain annuities

Tax-free

- Retirement savings
  - Roth 401(k)
  - Roth 457(b)
  - Roth IRA
- Life insurance cash value
- Certain municipal bonds
- Health reimbursement arrangement (HRA)
- Health savings account (HSA)
- Nontaxable Social Security benefits

Tax Diversification

Choose ***when*** and ***how*** to take money from each bucket based on tax environment.

When taxes are ***low***, take $$$ from taxable account (Traditional)

When taxes are ***high***, take $$$ from tax-free account (Roth)

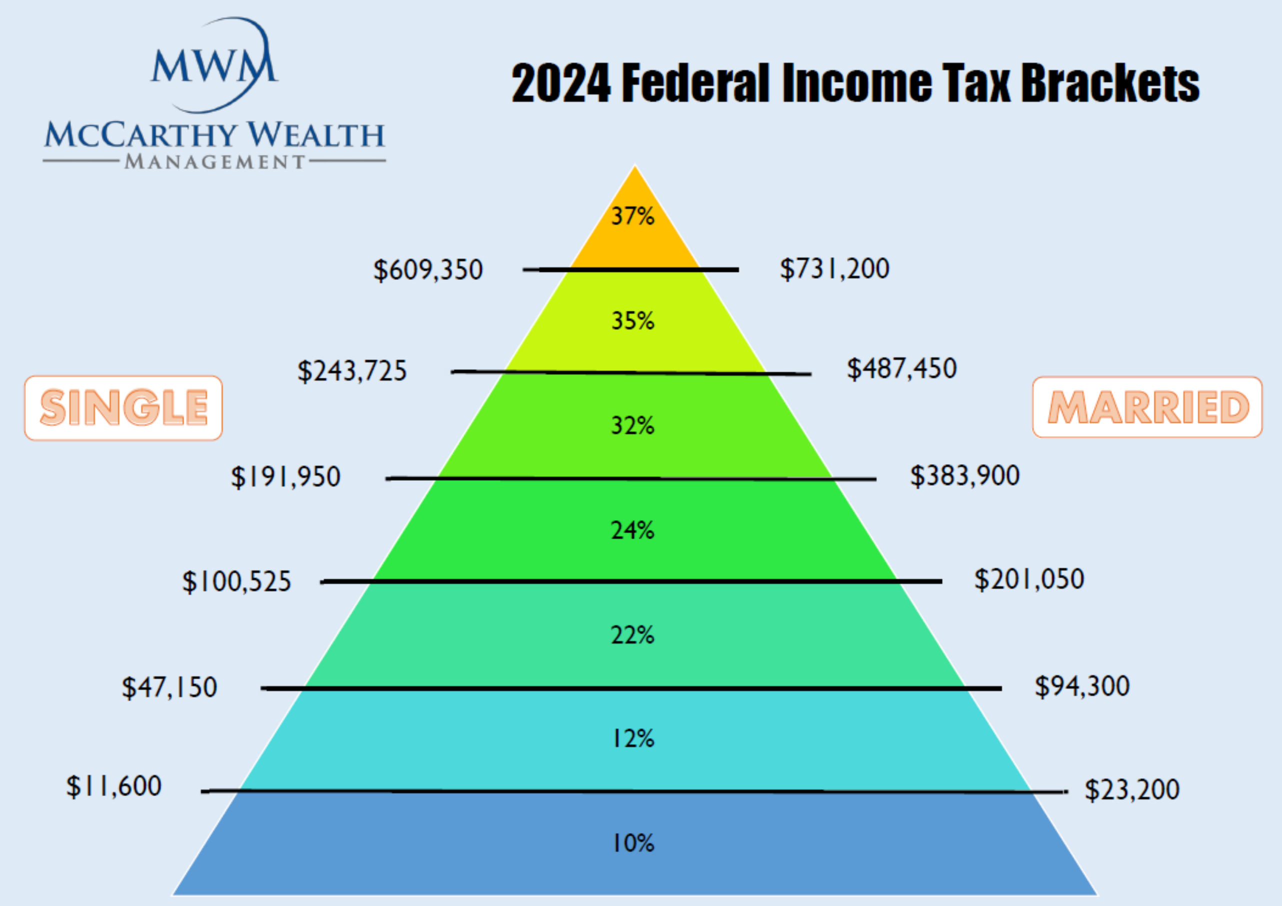
The more tax diversity you have in your portfolio, the more control you have over your tax liability each year.

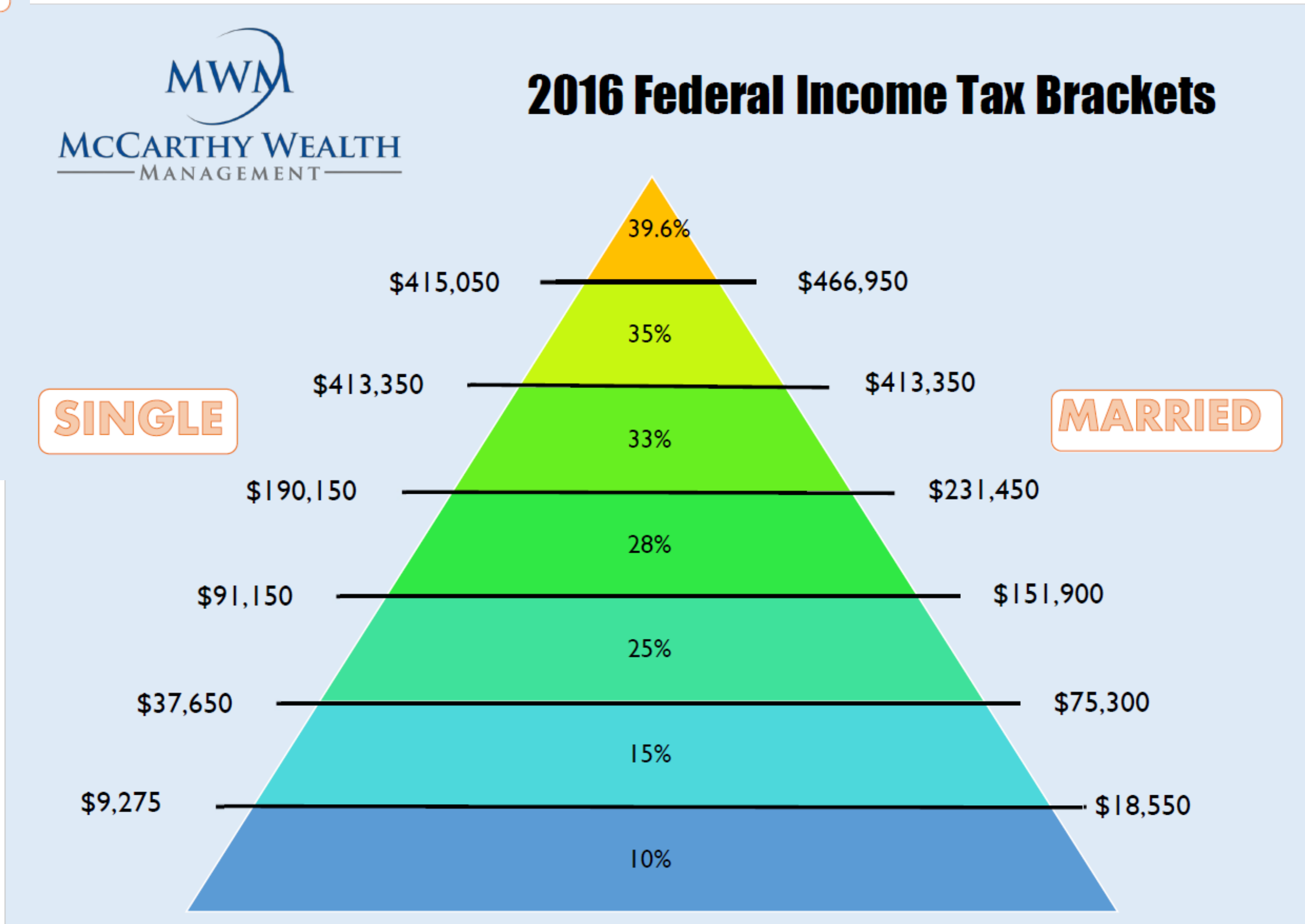
Concept

Have different buckets of money to choose from that are taxed differently in retirement.

Tax Predictions

- No one knows for sure
- "Tax Cuts and Jobs Act" sunsets on December 31st, 2025.
- If nothing is changed, tax brackets compress dramatically.
- What will YOUR tax obligations look like in the future?





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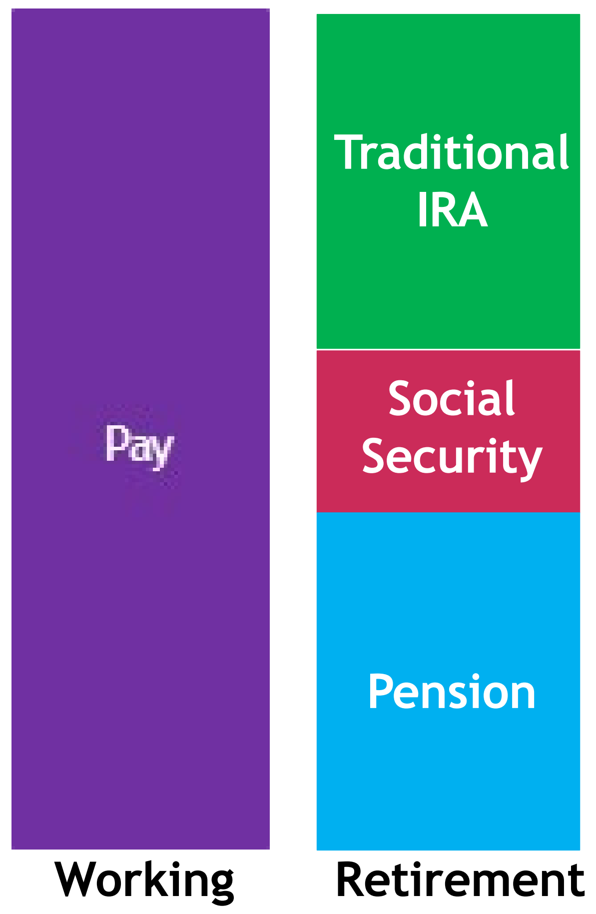


Tax obligations

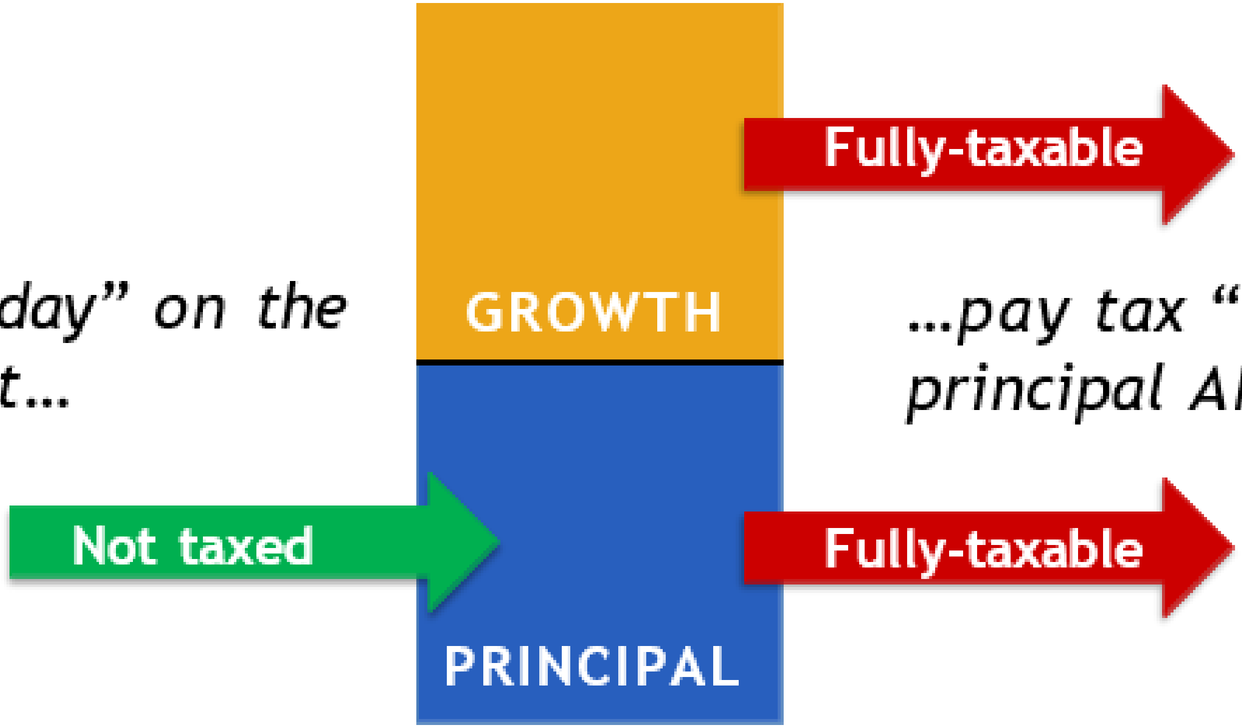
- Most people think they will be in a lower tax bracket when they retire (so they think they will owe less taxes in retirement).
- The reality is that if you intend to maintain your standard of living, (but all of the assets you have to pull from are taxable), you will likely be in the same bracket!

Traditional IRA

<u>When $$$ goes in</u>

<u>When $$$ comes out</u>

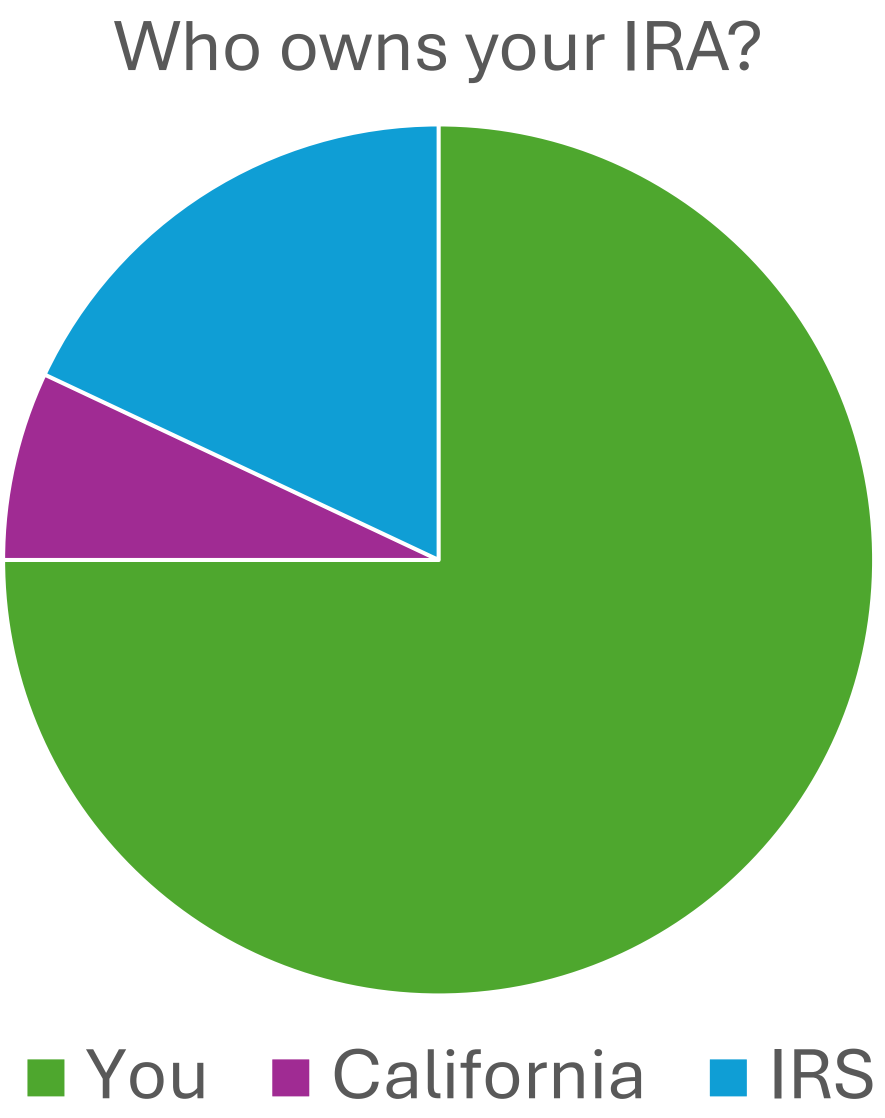
Save tax "today" on the principal, but…



…pay tax "later" on the principal AND growth!

Traditional IRA Withdrawals

- Taxation on 100% of withdrawals
- Required minimum distributions
- Create taxable income which affects Medicare premiums and taxation of Social Security



Individual Retirement Account (IRA) Options

	Traditional IRA	Roth IRA
Contribution Limits (All IRA accounts combined)	For 2024: $7,000/year (under age 50) or $8,000/year (age 50+) Must be EARNED income with spousal exception.	
Income limits	No income limit to contribute. Income limits apply for deductibility.	$161,000 (single) $240,000 (married filing jointly)
Tax on the way IN…	Not taxed not (assuming deductibility)	Taxable now
Tax on the way OUT…	Taxed later (all principal and earnings are taxed as ordinary income)	Tax-Free later
Restrictions (see IRS.gov for exceptions)	Must be age 59 ½ for penalty-free withdrawals with some exceptions.	Must be age 59 ½ and 5-year rule for penalty-free withdrawal of earnings. Each conversion has its own 5-year clock.

What is a "Roth" Anyway?

William Roth, Senator from Delaware from 1971-2001

- Senators Bob Packwood and William Roth
- Proposed in 1989
- Voted into law by the Taxpayer Relief Act of 1997
- Originally called "IRA Plus"
- Created an account for tax-free investing

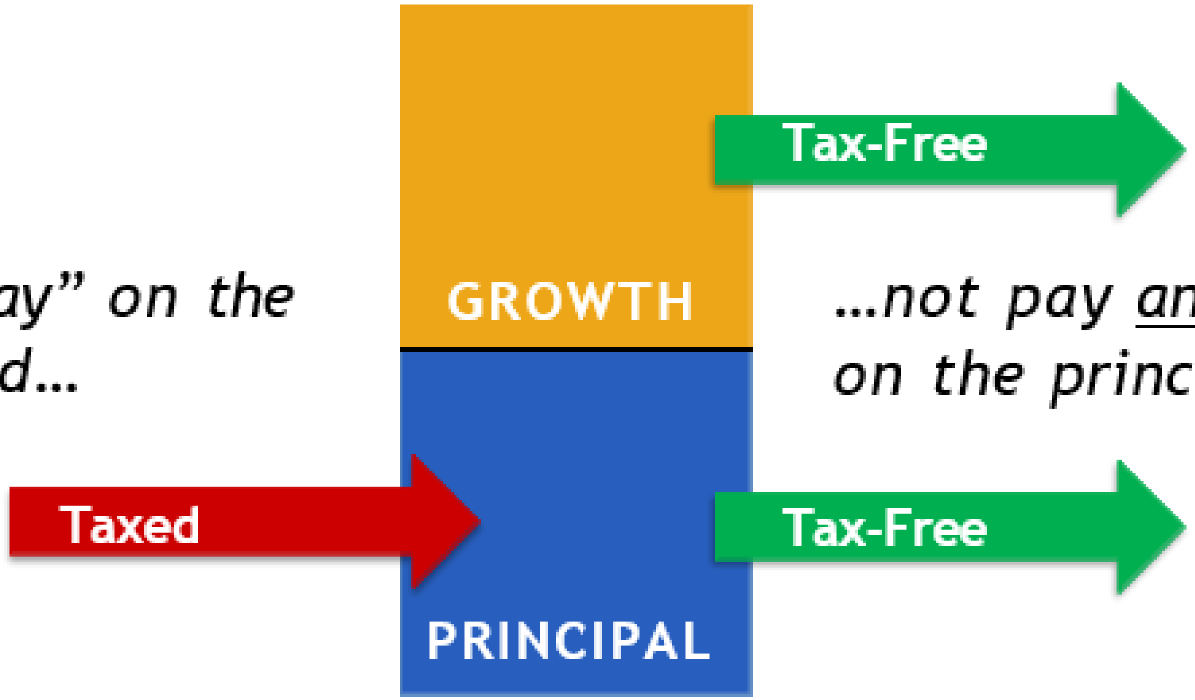
Roth IRA

When $$$ goes in

When $$$ comes out

Pay tax "today" on the principal, and…

…not pay <u>any</u> income tax on the principal OR growth!



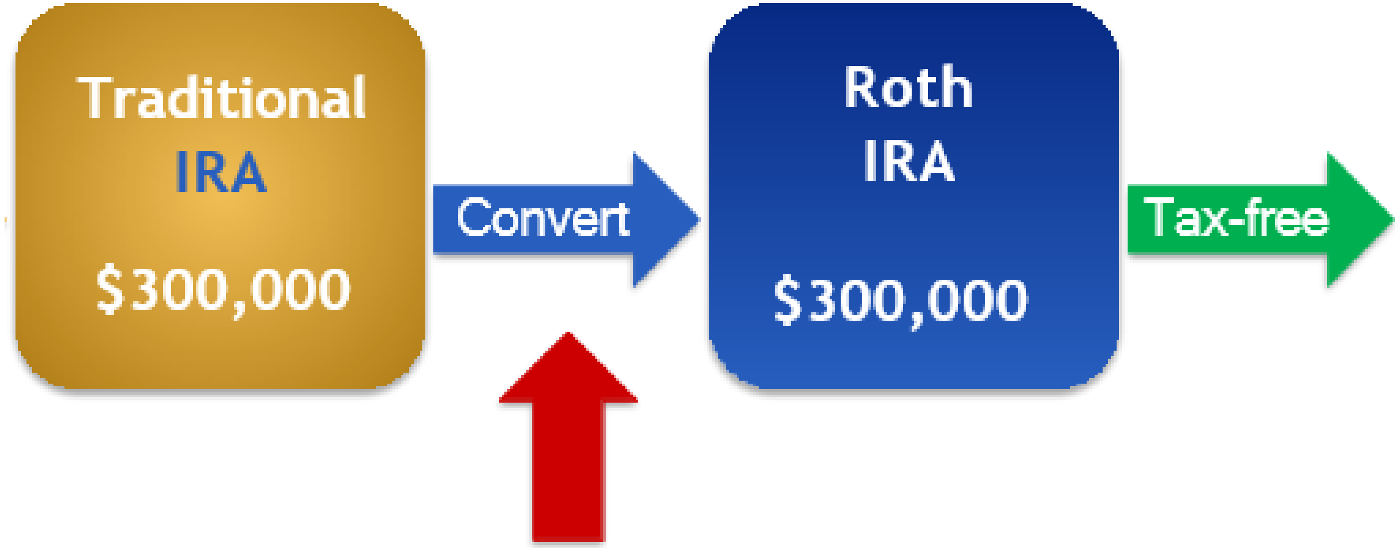
Roth IRA Withdrawals

- Tax-free!
- No required minimum distributions (RMDs)
- Create zero taxable income = less tax liability

Conversion vs. Contribution

- Contribution
  - Must be EARNED income.
  - Limited to $7000 per year (+$1000 catch up if over 50)
  - Limited based on income level.
- Conversion
  - Use IRA account to “convert” to Roth account.
  - Pay taxes on the conversion from outside funds (i.e. bank savings account).

Roth Conversion Strategy



Taxes get paid here…
and then never again!

Roth Conversion Strategy

- When does Roth conversion make sense?
  - Years with low income
  - When markets decline
  - If taxes are expected to increase
  - Outside funds exist to pay the taxes
  - To avoid the “Widow Tax” by converting while married
  - To create legacy wealth transfer of fast-growing assets
  - To avoid high income years in the future

Concept:

Pay taxes today to create tax-free withdrawals in the future.

Taxation of Social Security

- * Your adjusted gross income
+ Nontaxable interest
+ ½ of your Social Security benefits
= Your "***combined income***"

% Taxed portion of Social Security	Single Combined Income*	Joint Combined Income*
0%	$0-$24,999	$0-$31,999
50%	$25,000-33,999	$32,000-43,999
85%	$34,000+	$44,000+

Medicare Income Tables (2024)

IRMAA – Income Related Monthly Adjustment Amount

Reminder: 2-year lookback

Medicare Part B monthly premium

If your yearly income in 2022 was:			
File individual tax return	File joint tax return	File married & separate tax return	You pay (in 2024):
$103,000 or less	$206,000 or less	$103,000 or less	$174.70
above $103,000 up to $129,000	above $206,000 up to $258,000	not applicable	$244.60
above $129,000 up to $161,000	above $258,000 up to $322,000	not applicable	$349.40
above $161,000 up to $193,000	above $322,000 up to $386,000	not applicable	$454.20
above $193,000 and less than $500,000	above $386,000 and less than $750,000	above $103,000 and less than $397,000	$559.00
$500,000 or above	$750,000 or above	$397,000 or above	$594.00

Medicare Part D monthly premium

If your yearly income in 2022 was:			
File individual tax return	File joint tax return	File married & separate tax return	You pay (in 2024):
$103,000 or less	$206,000 or less	$103,000 or less	Your plan premium
above $103,000 up to $129,000	above $206,000 up to $258,000	not applicable	$12.90 + your plan premium
above $129,000 up to $161,000	above $258,000 up to $322,000	not applicable	$33.30 + your plan premium
above $161,000 up to $193,000	above $322,000 up to $386,000	not applicable	$53.80 + your plan premium
above $193,000 and less than $500,000	above $386,000 and less than $750,000	above $103,000 and less than $397,000	$74.20 + your plan premium
$500,000 or above	$750,000 or above	$397,000 or above	$81.00 + your plan premium

Required Minimum Distributions

Why do we have RMD?

IRA is a tax-deferred account. The IRS wants to collect taxes.

- Start the year you turn 73.
- Calculated using "Uniform Lifetime Table."
- First year, you have until April 1st the following year.
- Every other year, must be taken by December 31st.
- 25% penalty if RMD is not taken.
- If corrected within 2 years, penalty drops to 10%.
- Must combine all IRA accounts for RMD. The amount can come out of any combination of the accounts.

IRS UNIFORM LIFETIME TABLE

To calculate RMDs, use the following formula for each account:

Account Balance as of December 31 last year*	÷	**Life Expectancy Factor** see the Uniform Lifetime Table** below to find the factor using the age you turn this year	=	**Your RMD**

Example

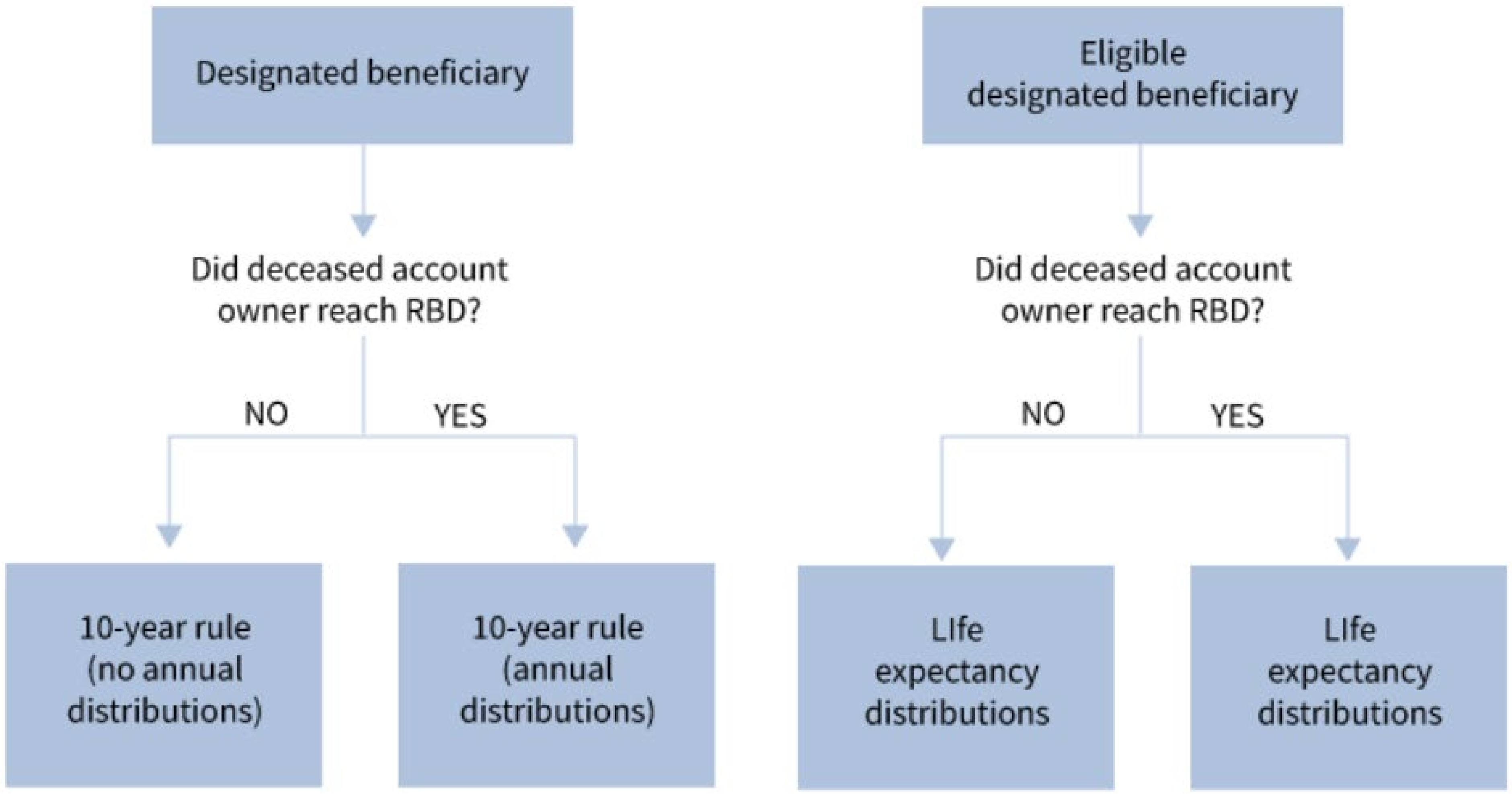
$100,000.00 Account Balance as of December 31 last year*	÷	**23.7** Divisor IRA owner turned 76 this year	=	**$4,219.41**

Uniform Lifetime Table

Age	Life Expectancy Factor
72	27.4
73	26.5
74	25.5
75	24.6
76	23.7
77	22.9
78	22.0
79	21.1
80	20.2
81	19.4
82	18.5
83	17.7

Age	Life Expectancy Factor
84	16.8
85	16.0
86	15.2
87	14.4
88	13.7
89	12.9
90	12.2
91	11.5
92	10.8
93	10.1
94	9.5
95	8.9

Inherited IRA rules after SECURE Act of 2019



Break: 5 minutes

Charitable Options

- Donor Advised Fund (DAF)
  - Deductible on your taxes.
  - Cost can offset large income years such as Roth Conversion.
  - Group several years of giving.
- Qualified Charitable Distribution (QCD)
  - Come directly from your IRA account.
  - Can count toward your RMD.
  - Zero tax. The charity gets more money and you pay no tax on the amount.
  - Age 70 ½ minimum.

Why use QCDs?

Skip paying the IRS and directly fund the organizations you believe in (like OLLI)!

Qualified Charitable Distributions

- $100,000 limit per person per year.
- Must be distributed directly to the eligible charity.
- Can be used to satisfy RMD.
- You may not receive any goods or services in return. Get a receipt stating this.
- Always double check your tax return to make sure QCDs are accounted for.
- Lowers your taxable income for Medicare surcharges and Social Security taxation.

How a donor-advised fund works

GIVE

Make a tax-deductible donation

Establish a Giving Account and then donate cash, stocks, or non-publicly traded assets such as private business interests, cryptocurrency, and private company stock to be eligible for an immediate tax deduction.

GROW

Grow your donation, tax-free

While you're deciding which charities to support, your donation can potentially grow, making available even more money for charities.

GRANT

Support charities you love, now or over time

You advise us on granting the money to your favorite charities, now or over time, from your local food bank to your house of worship to organizations with international impact. Support charities you love at a pace that is comfortable for you.

Ideal Candidate

- Needs more tax diversification in portfolio
- Wants more control over tax liability
- Isn’t currently relying on distribution from retirement accounts for income
- Retired and not collecting Social Security benefits or paying Medicare
- Tax bracket will increase or remain the same
- Have heirs in higher tax brackets

Case Study 1

- Barb and Mike:
  - Married, both age 62 and retired
  - Social Security – collecting at age 67
  - Traditional IRA balance $350,000 for Barb and $150,000 for Mike
  - Roth IRA balance $0 for Barb and $10,000 for Mike
  - Assumption: 6% growth on all accounts

Doing the Math

- One-time Roth conversion
  - $50,000 each, $100,000 total Roth conversion in current year
  - Save $24K in taxes over their joint lifetime
  - $125K increase in portfolio assets to be passed onto heirs
- Repeat for 5 years:
  - $25,000 each, $50,000 Roth conversion each year for 5 years
  - Save $22K in taxes over their joint lifetime
  - $257K increase in portfolio assets to be passed onto heirs

Worth it?

- Benefits:
  - Partial Roth conversion can be done each year prior to taking Social Security (during lower income years)
  - Can reduce taxable Social Security once claiming
  - Creates tax diversification
  - Avoid "Widow tax" by converting while married
  - Increase tax-free accounts for beneficiaries, especially if heirs are in higher tax brackets

- Considerations:
  - May have reduced subsidies from Affordable Care Act

Case Study 2

- Sally:
  - Age 66 and retired, Single
  - Social Security – collecting at age 70
  - Traditional IRA balance $350,000
  - Roth IRA balance $0
  - Income - $5,000/year of interest
  - Assumption: 6% growth on all accounts

Doing the Math

- $25,000 Roth conversion for four years (total of $100,000)
  - Save $40K in taxes over her lifetime
  - $145K increase in portfolio assets to be passed onto heirs

Worth it?

- Benefits:
  - Partial Roth conversion can be done each year prior to taking Social Security (during lower income years)
  - Can reduce taxable Social Security once claiming
  - Greater overall net worth
  - Creates tax diversification
  - Maximize estate for beneficiaries, especially if they are in higher tax brackets

- Considerations:
  - IRMAA surcharges (begin at $103,000 for single taxpayer for 2024)

Case Study 3

- Julian:
  - Age 68, Single
  - Retiring this year with $100,000 income
  - Social Security - collecting $3,800/month
  - Traditional IRA balance $400,000
  - Roth IRA balance $15,000
  - No other income
  - Gives $11,000 to charity each year

  - Assumption: 6% growth of all accounts.

Doing the Math

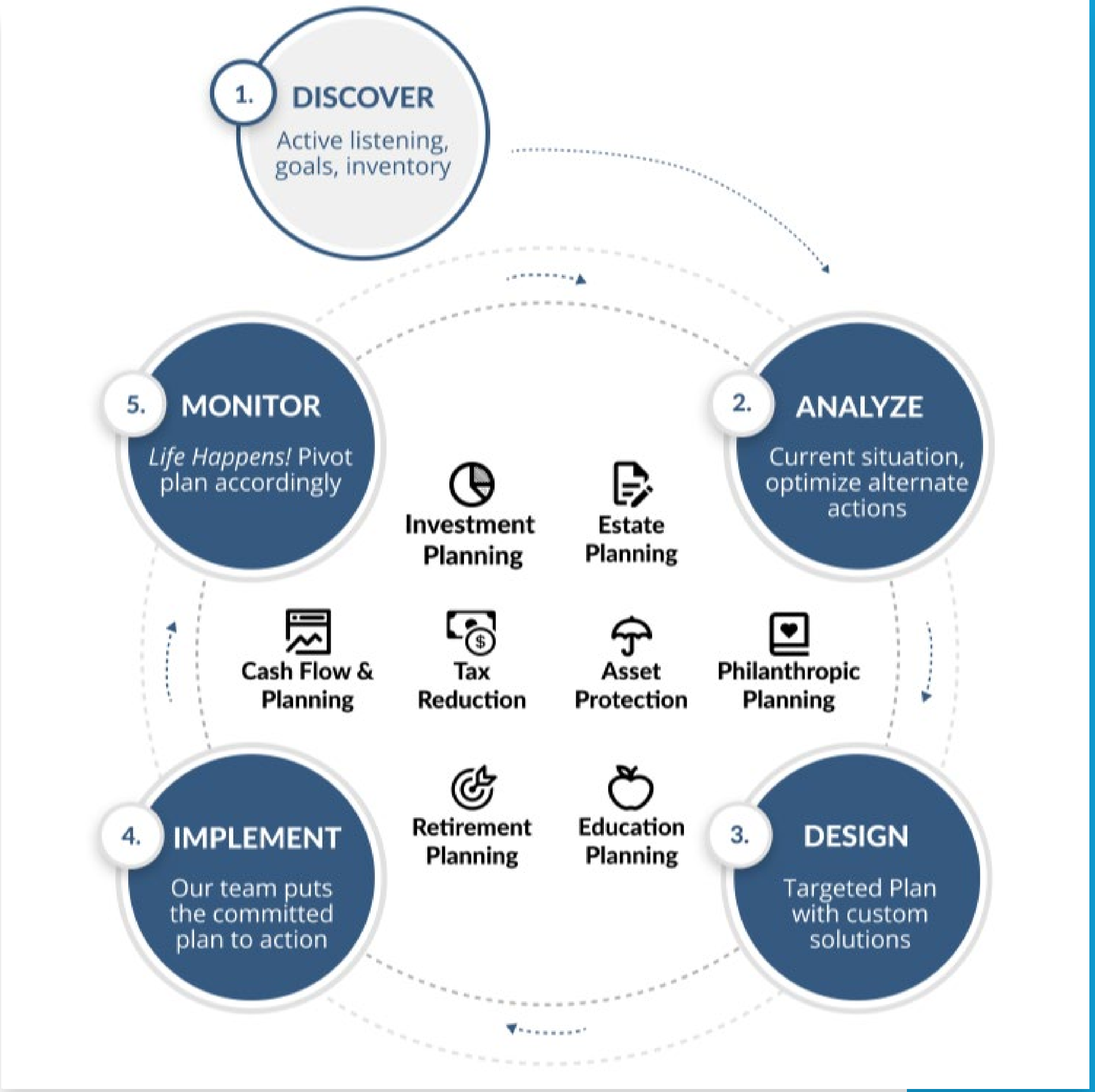
- $100,000 Roth conversion
  - Open DAF and forward fund for 5 years = $55,000 to DAF
  - After 5 years, use $11K QCD direct to charity out of IRA to satisfy partial RMD
  - Save $79K in taxes over his lifetime
  - $128K increase in portfolio assets to be passed onto heirs
  - At age 75, $88K in DAF for charity (growth rate of 6%)

Worth it?

- Benefits:
  - Less taxes owed over lifetime
  - Greater overall net worth
  - Donate to charity while creating future tax-free growth
  - Create tax diversification
  - Maximize estate for beneficiaries, especially if they are in higher tax brackets
  - Use DAF funds to contribute to charity flexibly over lifetime.

- Considerations:
  - May increase Social Security taxation in year of conversion
  - Potential IRMAA (Medicare) surcharges (begin at $103,000 for single taxpayer for 2024)

Holistic Financial Planning: Achieving your financial goals



Thank you!

Questions?

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