Tax Explorer

For people who have more important things to do in retirement than worry about taxes.

Your Tax-Wise Retirement Guidebook

Paying taxes is painful — but not nearly as bad as not having the funds to enjoy retirement. It takes money to travel, indulge in hobbies and check off other items on your bucket list. But paying taxes in retirement can also be costly. The more you spend on taxes, the less you have for enjoyment.

This guide contains 10 strategies that could help minimize taxes on your retirement income.

With the help of this guide and your most recent 1040 tax return, you might uncover tax savings treasures that allow you to spend more of your retirement income on your dream retirement.

Tax Increases Are On the Horizon

Here's why: Unless Congress takes action, tax rates are scheduled to go up on Jan. 1, 2026, due to the expiration of the Tax Cuts and Jobs Act.[1]

For example:[2]

12% tax rate goes to 15%
22% tax rate goes to 25%
24% tax rate goes to 28%

If you're retired or planning to retire in 2026, you could end up paying more in taxes.

Best Time for Tax Planning

If you have income entered on line 1 of Form 1040, it means you are still working. If you plan to retire within the next few years or you're retired, now is the time to engage in tax planning. Here's why: After you stop working, wages and salary will no longer appear on line 1. Most people intend to replace this income with IRA distributions (line 4a), Social Security (line 6a) and other income sources.[3] One key to tax planning is to understand that you may have more control over the amount and timing of this income. This can mean you have more control over if and when income will appear on your Form 1040.

Reducing Current Taxes

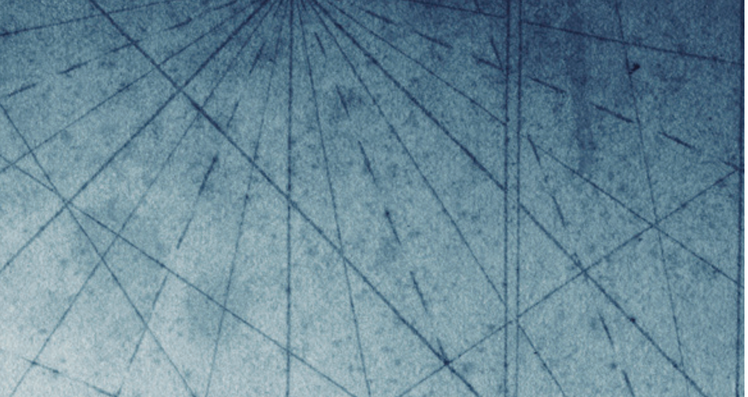
If an amount is entered on line 2b (taxable interest) of Form 1040, it may be important to decide if you currently need this interest to pay bills or fund your lifestyle. Here's why: Interest entered on line 2b is taxed at the same rate as ordinary income.[4] If this interest is not currently needed, by changing the financial instrument used, it may be possible to not only defer taxes on any earnings but also to reduce the tax rate applied to a lower capital gains rate when taxes become due.

Are You Paying Higher Taxes Because Dividends Are in the Wrong Account?

Some people are attracted to using dividend-producing investments for retirement income because of the potential for favorable tax treatment. But even qualified dividends will be taxed at higher rates if they are held in the wrong account. Here's why: Dividends appearing on line 3a of Form 1040 are taxed at rates between 0% and 20%.[5] However, if these same dividends are in an IRA, 401(k) or other tax-deferred retirement account, sooner or later, they will appear as withdrawals on line 4 of Form 1040 and be subject to higher income tax rates between 10% and 37%.[6]

Questions To Ask Your Advisor:

- Are these tax rate increases factored into my projected retirement income? If not, won't this mean I will have less money to spend after taxes have been paid?
- How can I be more proactive when it comes to tax planning and finding strategies that might minimize the taxes I pay in the future?
- Up to 85% of Social Security benefits may be subject to income tax.[7] How can I predict the taxes I might pay, and can these taxes be reduced?
- Should I convert my IRA, 401(k) or other tax-deferred account to a tax-free Roth IRA? If so, when will be the most tax-efficient time to convert?
- What is my plan for dealing with accrued capital gains in the most tax-efficient manner?
- How can I pass my assets to heirs in the most tax-efficient manner?
- What is the purpose of the account generating this interest? Is it for emergencies, current income, future income or something else? And is it invested in the best possible way for meeting that purpose?
- Is there a way for this money to earn a higher rate of return without increasing risk?
- What alternate financial instruments are available that can possibly generate the same or a higher return on a more tax-efficient basis?
- Given my level of risk tolerance, are dividends a good way for my portfolio to generate income?
- Do I currently have dividend-producing investments in my retirement accounts that will ultimately be subject to higher ordinary income tax rates? If so, would it be more tax efficient to have dividends come from a different account?



Questions To Ask Your Advisor:

- Should I convert my retirement accounts to a Roth IRA before tax rates go up?
- Should I realize any long-term capital gains now or wait until after tax rates go up?
- In what other ways can I generate low-tax or tax-free retirement income?
- Should I intentionally create a low-income year during retirement to harvest capital gains at a zero tax rate?
- Does my current “asset location” strategy ensure that my assets are held in the most tax-efficient accounts?
- Does my estate plan take full advantage of “step up” in basis so heirs avoid taxes?

Is Your 401(k) or IRA a Tax Strategy or Tax Trap?

It’s easy to forget that the money in your 401(k), IRA and other tax-deferred retirement accounts does not all belong to you. Because taxes will be due and payable in the years you take withdrawals, it might be better to think of these as joint accounts with a share belonging to the IRS. Now is the best time to think about how you will make your withdrawals as tax efficient as possible. The earlier you engage in tax planning, the more options you might have to reduce future taxes.

Capital Gains Taxes — Nothing Is Better Than a Zero Tax Rate!

The tax rate on most net capital gain is no higher than 15% for most individuals. And with proper planning, some or all net capital gain might instead be taxed at a 0% rate![8]

Here’s why:

If your taxable income is less than or equal to $44,625 for single filers and married filling separately or $89,250 for married filing jointly, some or all net capital gain may be taxed at 0%.[9] By tactically harvesting gains in years when taxable income is low, it may be possible to reduce your future tax liability and put more income in your pocket.

The Social Security Tax Torpedo

Even if there is nothing entered on line 6b of your Form 1040 (or if you aren't currently collecting Social Security benefits), planning today might help avoid future taxes.

Here's why:

Because the thresholds where those levies are applied have not been adjusted, more Social Security beneficiaries have become subject to those taxes over time. With proper planning, there might be several ways to manage the taxation of benefits.

Below is an illustration of potential results of one strategy using a Roth IRA.

Assumptions:

Married, filing jointly
Total income $67,000

- $22,000 Social Security benefit
- $20,000 of additional taxable income
- $25,000 withdrawals from a traditional IRA (or 401(k), 403(b) or other tax-deferred plan) vs. a Roth IRA withdrawal

Traditional IRA		Roth IRA
$25,000	Annual IRA withdrawals	$25,000
$25,000	Added to SS provisional income	$0
$56,000	Total provisional income	$31,000
85%	Taxable portion of SS benefit	0%
Social Security benefits added to the taxable income over 20 years **$374,000**		Social Security benefits added to the taxable income over 20 years **$0**

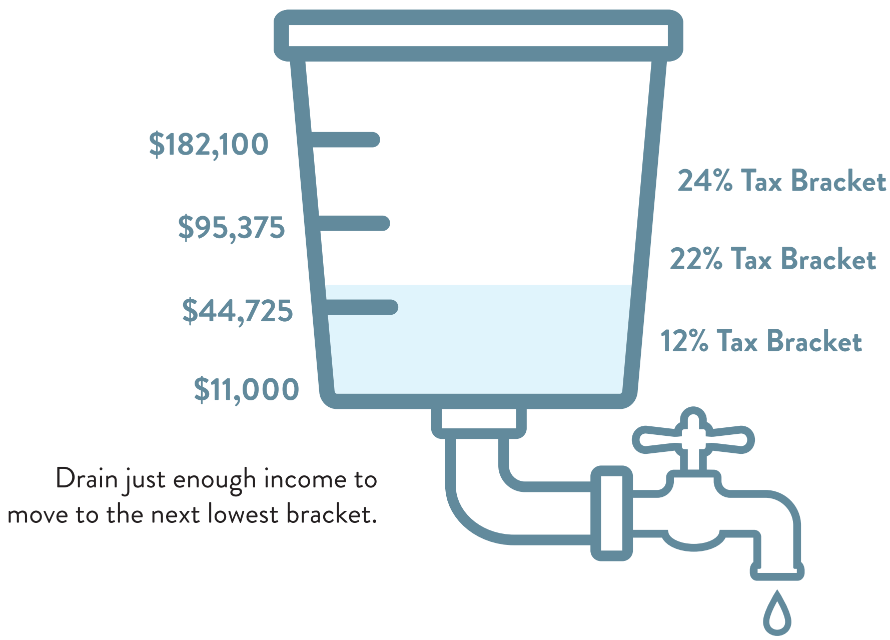
Social Security tax reduction questions to discuss with your advisor:

- Should you divert contributions from a traditional IRA or 401(k) to a Roth IRA?
- Should you consider doing a series of strategic Roth conversions?
- What other sources of income can allow you to stay below the taxable thresholds?

Drain Your Tax Bracket

If you are married and file jointly with taxable income (line 15 of Form 1040) greater than $89,450, you should consider using a bracket "drain" strategy to prevent income from being taxed at a higher rate. The same is true for single filers with taxable income greater than $44,725.[10] Here's why. By strategically draining taxable income from brackets with elevated tax rates, higher-income taxpayers can get an immediate tax savings.

Bracket "Draining" Strategy Example — Single Filer[1]



For example, if taxable income (line 15 on Form 1040) as a single filer totaled $49,725, your marginal tax rate would be 22%. By using a strategy to drain the top $5,000 of taxable income from the 22% bracket, it would save $1,100 in immediate taxes. (This concept works the same for married taxpayers, but different bracket income amounts apply.)

Questions To Ask Your Advisor:

- Could I drain income by increasing deductible retirement plan contributions?
- Could I drain income by using a donor-advised fund to increase deductible charitable giving?
- Could I drain income by strategically realizing capital losses?
- What other strategies could I use to drain income?

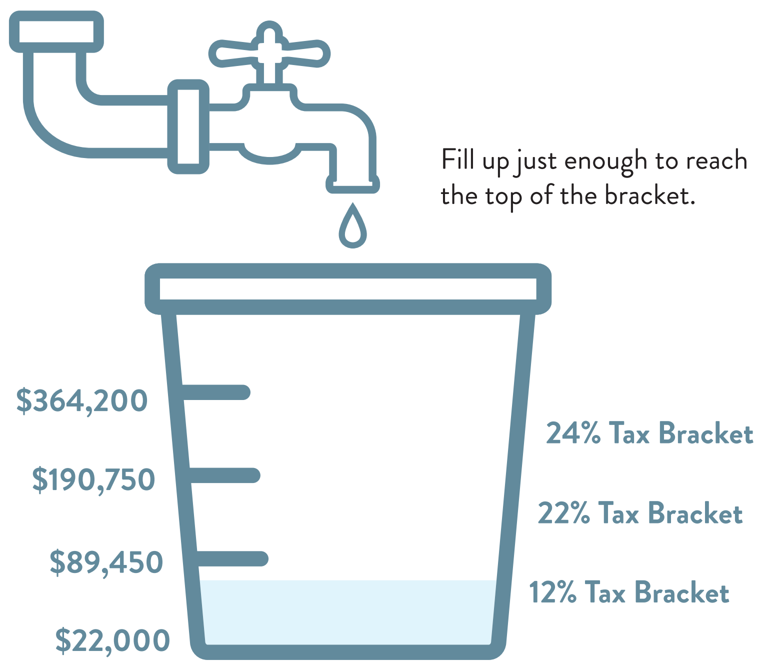
The Tax Sale Ends Soon

If you are married, file a joint return and your total taxable income as shown on line 15 of Form 1040 is less than $364,200, you should consider using a bracket "fill up" strategy to generate more taxable income. The same is true for single filers with taxable income less than $182,100.[12]

Here's why:

Unless Congress acts, tax rates are scheduled to go up on Jan. 1, 2026, due to the expiration of the Tax Cuts and Jobs Act.[13] Filling up your current bracket with additional income allows you to limit the tax rate applied. Doing this before tax rates go up could provide you with net tax savings.

"Fill Up" Strategy Example — Married Couple Filing Jointly[14]



For example, if taxable income (line 15 on Form 1040) totaled $85,000, your marginal tax rate would be 12%. You might use a strategy to generate up to $4,450 of additional taxable income to fill up your 12% bracket before moving to the higher 22% tax bracket. (The concept works the same for single tax filers, but different bracket income amounts apply.)

Questions To Ask Your Advisor:

- Should I take a withdrawal from my IRA, 401(k) or other taxable accounts to "fill up" my current tax bracket?
- Should I do a partial Roth conversion limited to an amount that would "fill up" my current bracket or perhaps even the next higher bracket before tax rates go up?
- What other strategies should I consider implementing before tax rates go up?

Recapturing Lost Charitable Deductions

Tax deductions are not the primary reason people give to charities, but taxes can affect the amount and timing of those charitable gifts. As a result of the 2017 tax law, some high-income households give or give more using tax-saving techniques such as donor-advised funds.[15] Here's why: Donor-advised funds let people avoid capital gains taxes by donating stocks that have risen in value and potentially claiming charitable deductions on the value of the donations.[17]

Now Is the Time to Dig for Gold

If you're worried about having enough money to enjoy retirement, consider how much of your retirement nest egg will be used to pay taxes and whether you could minimize this amount.

Your financial advisor can explain tax-efficient tools and financial vehicles to help you reach your goals. They can also work with other qualified professionals — such as CPAs — to make your strategy work.

But don't wait! The Tax Cuts and Jobs Act will expire at the end of 2025, and this could be a wake-up call for even higher taxes in the future.

Now is the time to act and plan for the tax rates of tomorrow, not the rates of today.

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[2] Ben Geier. SmartAsset Advisors. March 8, 2023. “Trump Tax Brackets: Did Your Tax Rate Change?” https://smartasset.com/taxes/trump-tax-brackets. July 21, 2023.

[3] IRS. 2022. “Form 1040.” https://www.irs.gov/pub/irs-pdf/f1040.pdf. July 21, 2023.

[4] William Perez. The Balance. Jan. 17 2023. “How Is Interest Taxed and Reported?” https://www.thebalance.com/interest-income-3193087. Accessed Aug. 1, 2022.

[5] Greg Depersio. Investopedia. Dec. 18, 2022. “How Are Qualified and Ordinary Dividends Taxed?” https://www.investopedia.com/articles/taxes/090116/how-are-qualified-and-nonqualified-dividends-taxed.asp#. Accessed July 21, 2023.

[6] Claire Boyte-White. Investopedia. June 10, 2023. “How Retirement Account Withdrawals Affect Your Tax Bracket.” https://www.investopedia.com/ask/answers/030316/do-retirement-account-withdrawals-affect-tax-brackets.asp. Accessed July 21, 2023.

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[8, 9] IRS. April 4, 2023. “Topic No. 409 Capital Gains and Losses.” https://www.irs.gov/taxtopics/tc409. Accessed July 21, 2023.

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[14] IRS. “IRS provides tax inflation adjustments for tax year 2023.” https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2023. Accessed July 21, 2023.

[15, 16] Bob Carlson. Forbes. June 26, 2021. “Maximizing the Power Of Donor-Advised Funds.” https://www.forbes.com/sites/bobcarlson/2021/06/26/maximizing-the-power-of-donor-advised-funds/?sh=6056e7a95e85. Accessed Aug. 1, 2022.

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