

# Tax brain teaser

- Bill is retired and has taxable income of \$42,275 (22% bracket)
- Includes \$38,000 in IRA income
- Plus \$25,000 in Social Security benefits
- He taps his IRA for an extra \$1,000 for a concert road trip

**How much will he owe in taxes on that extra \$1,000?**

2021 IRS Single Filer Tax Brackets	
RATE	Income Over
10%	\$0
12%	\$9,950
22%	\$40,525
24%	\$86,375
32%	\$164,925
35%	\$209,425
37%	\$523,600

Source: IRS

**How much tax  
will he owe  
on the extra \$1,000?**

He pays \$.22 in federal income taxes for every additional dollar.

Therefore, if he took \$1,000, he should owe \$220, right?...

**Wrong!**

He owes \$407\* in tax—a 40.7% tax rate on that income!

\*Always consult a tax professional before taking action

# How Tax Planning Changes Through Four Stages of Retirement

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# Seek professional tax guidance!

You should always consult a qualified professional tax advisor to discuss your tax situation, especially about:

- ✓ **Traditional IRAs (tax-deferred):** You must pay taxes on distributions or conversions at ordinary federal and state rates.
- ✓ **Roth IRA (non-deductible):** Money grows tax-free and earnings may be withdrawn tax-free in accordance with IRS rules.
- ✓ **State taxes:** This presentation references federal taxes. You may still face state taxes. Check with your tax professional.

# A new, complex world

- Taxes in accumulation phase (saving) vs taxes in distribution phase (spending)
- No more: child tax credits, mortgage interest deduction, tax-free employer-paid medical insurance, contributions to 401(k) or similar
- New: Social Security, RMDs, paying for Medicare, long-term care

# Problem

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People often pay more taxes in retirement than expected because a confusing system treats various income types differently and contains hidden taxes and penalties.



# Developing a Solution

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Because your tax exposure will change throughout four stages of retirement, you'll need a strategy that anticipates both traditional taxes AND possible taxes, surcharges, and penalties related to Social Security, Medicare, and other income\*.

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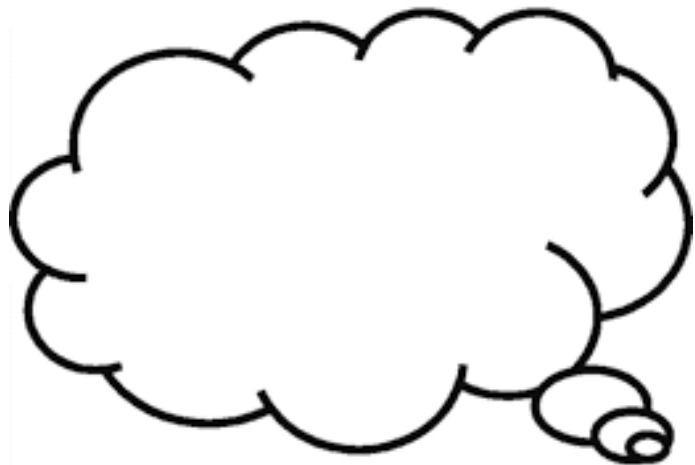


# Four stages of retirement

Stage	Ages	Description
Pre-retirement	50-60	Work & save years
Early retirement	60-70	Go-go years
Middle retirement	70-80	Go-slow years
Late retirement	80+	No-go years

# Retirement surprises

- Inflation
- Longevity
- Expenses
- Health care



*“Okay, so what’s  
the first thing I need  
to understand about  
retirement and taxes?”*

# KEY 1

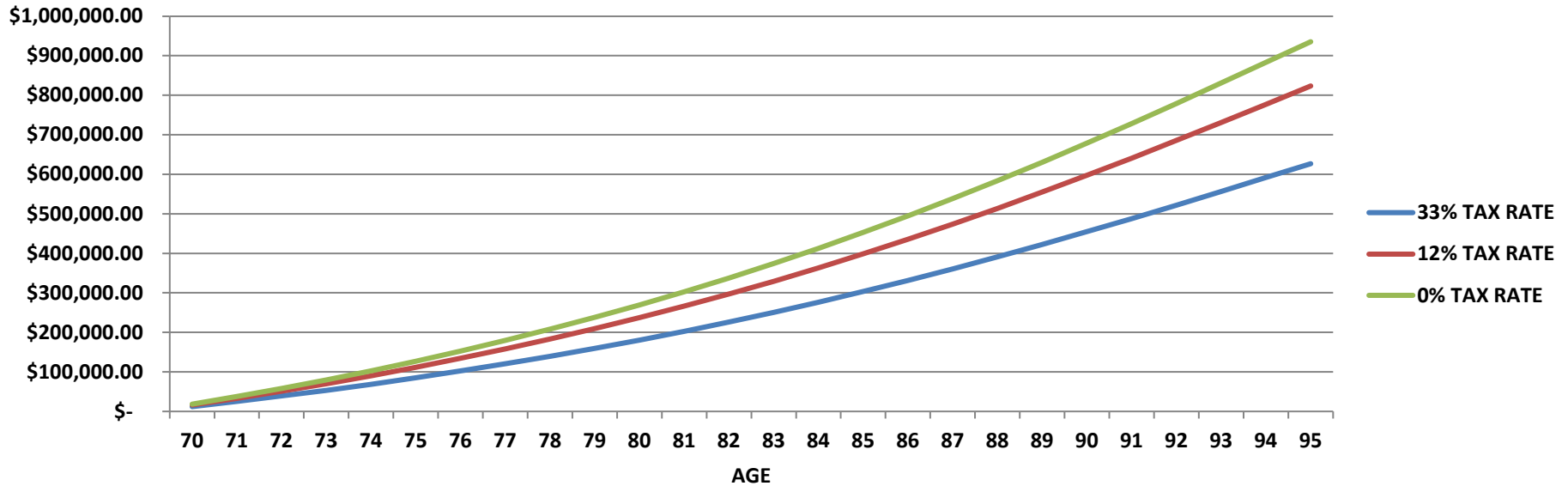
You have to know what your  
“after-tax” retirement savings  
picture looks like BEFORE retiring.

**If you save  
\$500,000 in your  
401(k)/IRA, it's not  
really \$500,000**

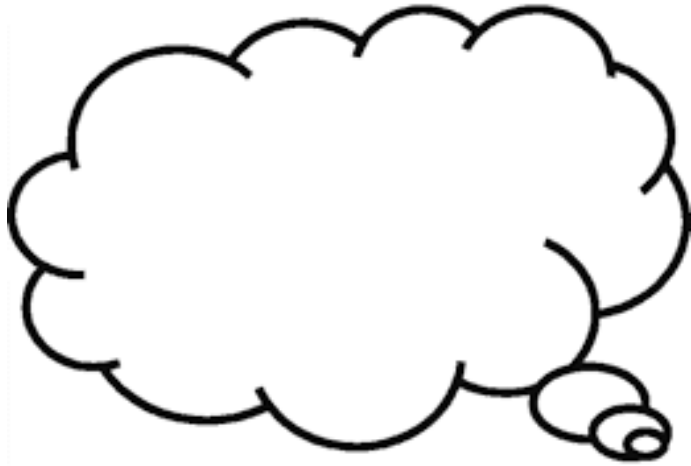
- If you are married filing jointly, your \$500,000 could actually be\* ...
  - \$325,000 (35% tax rate)
  - \$315,000 (37% tax rate)
- In addition, you will be required to withdraw a required minimum distribution (RMD) each year after you turn 72

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## CUMULATIVE AFTER-TAX DISTRIBUTIONS



\*Note: This illustration is hypothetical and assumes a 6% rate of return. This does not represent the performance of any investment product, and your results may vary. Ordinary income tax rates will apply to withdrawals from a tax-deferred investment. An investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision.



*“Ok, but at least I’ll still have Social Security to supplement my income and Medicare to pay my health costs.”*

## KEY 2

**Social Security and Medicare have their own "tax traps" and you need to plan for them, too.**



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# **SOCIAL SECURITY AND TAXES**

**EXAMPLE 1**  
**Remember**  
**Bill's 40.7%**  
**tax rate?**

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**Before concert trip:    After concert trip:**

- |                                       |                                       |
|---------------------------------------|---------------------------------------|
| • IRA income = \$38,000               | • IRA income = \$39,000               |
| • Social Security benefits = \$25,000 | • Social Security benefits = \$25,000 |
| • AGI = \$56,525                      | • AGI = \$58,375                      |
| • Taxable Income = \$42,275           | • Taxable Income = \$44,125           |
| • Income tax = \$5,049                | • Income tax = \$5,456                |

Actual increase in income from  
scenario #1 to scenario #2

**\$1,000**

\*Always consult a tax professional before taking action

# Bill got hit by the Social Security tax torpedo!\*

## Before concert trip:    After concert trip:

- IRA income = \$38,000
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  - AGI = \$56,525
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- IRA income = \$39,000
  - Social Security benefits = \$25,000
  - AGI = \$58,375
  - Taxable Income = \$44,125
  - Income tax = \$5,456

Increase in AGI/taxable income from scenario #1 to scenario #2

**\$1,850**

$$\$1,850 \div \$1,000 = \$1.85$$

For every additional dollar of income Bill received, an additional \$1.85 was added to his AGI and his taxable income!

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## 2021 Single Filer Tax Brackets

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Increase in income tax from scenario #1 to scenario #2

**\$407**

$$\$407 \div \$1,000 = 40.7\%$$

effective marginal tax rate of 40.7%

vs.

stated marginal tax rate of 22%

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## Different retirement approaches

- Retire completely
- Semi-retire with fewer hours in existing job
- Semi-retire to a passion-driven job
- Retire and volunteer



## Working and Social Security: the Good

- Social Security benefit is calculated using highest 35 years of earnings
- Earnings after 62 can still increase Social Security retirement benefit IF they replace \$0 or low-earnings years



## Working and Social Security: the Bad

- If you take Social Security “early” AND continue to work, your benefits COULD be reduced
- \$1 of benefits withheld for every \$2 earned over \$18,960 for 2021
- Withheld amounts added back to your benefit calculation at full retirement age



## Working and Social Security: the Ugly

- You still pay Social Security tax:
  - Even when you work in retirement
  - Even when you're receiving benefits and working
- It only increases your benefit if it is one of your top 35 years of earnings





# **MEDICARE AND TAXES**



## ***EXAMPLE 2*** **Watch out for the Medicare IRMAA cliff**

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George and Martha

- Have Medicare Parts B and D
- \$275,500 MAGI in 2019
- Sell stock for \$1,000 gain
- Owe \$188 tax (\$150 + \$38)

**They'll pay an 18.8% rate\*, right?**

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# Part B 2021 IRMAA charge: about \$180 monthly

MAGI Single Filers	MAGI Married-Joint	Total monthly premium amount	Monthly increase compared to lowest premium
≤ \$88,000	≤ \$176,000	\$148.50	N/A
\$88,001 - \$111,000	\$176,001 - \$222,000	\$207.90	\$59.40
\$111,001 - \$138,000	\$222,001 - \$276,000	\$297.00	\$148.50
\$138,001 - \$165,000	\$276,001 - \$330,000	\$386.10	\$237.60
\$165,001 - \$499,999	\$330,001 - \$749,999	\$475.20	\$326.70
≥ \$500,000	≥ \$750,000	\$504.90	\$356.40

**IRMAA: Income Related Monthly Adjustment Amount**

# Part D 2021 IRMAA charge: about \$39 monthly

MAGI Single Filers	MAGI Married-Joint	Total monthly premium amount
≤ \$88,000	≤ \$176,000	Plan Premium
\$88,001 - \$111,000	\$176,001 - \$222,000	Plan Premium + \$12.30
\$111,001 - \$138,000	\$222,001 - \$276,000	Plan Premium + \$31.80
\$138,001 - \$165,000	\$276,001 - \$330,000	Plan Premium + \$51.20
\$165,001 - \$499,999	\$330,001 - \$749,000	Plan Premium + \$70.70
≥ \$500,000	≥ \$750,000	Plan Premium + \$77.10

**IRMAA: Income Related Monthly Adjustment Amount**

# 1-Year IRMAA total charges: \$2,604

Monthly IRMMA surcharge		12-month total
<b>George</b>	Extra Part B \$89.10 per month Extra Part D \$19.40 per month	\$1,069.20 \$232.80
<b>Martha</b>	Extra Part B \$89.10 per month Extra Part D \$19.40 per month	\$1,069.20 \$232.80
<b>Combined</b>		\$2,604

**Stock sale tax  
+ IRMAA  
total damage:  
\$188  
+ \$2,604  
=\$2,792**

- ✓ Sold stock: \$1,000 income gain
- ✓ Stock sale tax: \$188 (18.8% rate)
- ✓ Stock sale triggers new IRMAA income tier
- ✓ Total IRMAA surcharges: \$2,604

**\$1,000 extra income triggers taxes of \$2,792—279% real tax rate!**



***EXAMPLE 3***  
**Medicare  
enrollment:  
Coverage gaps  
and late  
penalties**

- Jim and Ann are 68
- Jim retired at 65 and Ann, one year later, at 66
- They get coverage through Ann's employer, who offers retiree health insurance

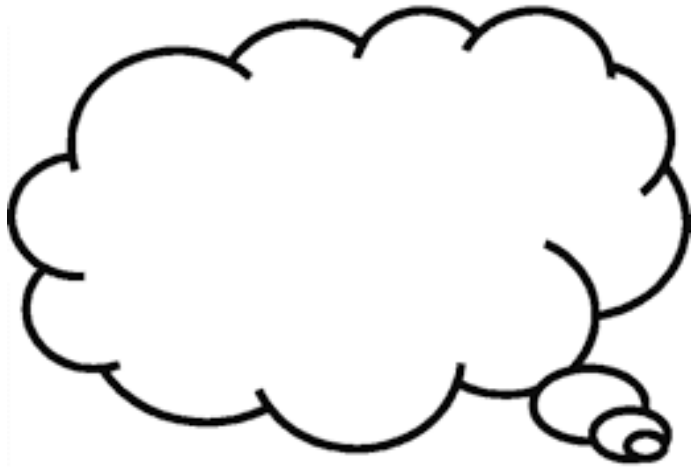
**When should they enroll in Medicare Part B?**

# Enroll in Part B as soon as they retire, but...

- You can't get Medicare coverage instantly
- Missed enrollment penalty: 10% of the base premium for LIFE
  - For 2021 =  $10\% \times \$148.50 = \$14.85 \times 12 = \$178.20 \times 2 =$   
**\$356** for the couple
  - Premiums tend to increase every year – so do the penalties!
  - Could translate to a lifetime \$10,000 mistake

**Watch for coverage gaps!**





*“Wow, are there other tax traps we will face in retirement?”*