How Tax Planning Changes Through Four Stages of Retirement

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

FOUR STAGES OF RETIREMENT

Stage	Ages	Description
Pre-retirement	50–60	Work and 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:** People view their future costs in current dollars and don't anticipate how those costs will grow with inflation.
- ✓ **Longevity:** People end up living longer than they expect, which requires more money.
- ✓ **Expenses:** People underestimate how much they need to maintain their pre-retirement standard of living.
- ✓ **Health care:** People don't realize how much of their savings will be spent on health costs.

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. Taxes must be paid.
- ✓ If you're already retired, you'll want to start evaluating next year's potential tax bill before you start tapping assets in the new year.

KEY #2:

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

- ✓ IRA withdrawals can cause the taxation of Social Security benefits, and push taxpayers into a higher marginal tax rate.
- ✓ Higher income (i.e. withdrawing assets) can cause potentially hundreds of dollars a month extra in Medicare premiums.

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KEY #3:

You must plan how and when you will use taxable, tax-deferred, and tax-free assets to manage your income and tax brackets efficiently.

- ✓ Consider starting to draw down IRAs now, or converting to Roth IRAs, so that your required minimum distributions (RMDs) won't have as large an effect on Social Security taxation and Medicare premiums.
- ✓ Also consider donating your RMDs directly to charity to avoid paying income tax on the distributions.

KEY #4:

Organize your assets for your family's benefit—estate planning still matters!

- ✓ If you have a terminal illness, make sure to think about step-up basis strategies.
- ✓ There are multiple ways to leave IRAs as an inheritance; you need to make sure your heirs get the best and easiest transfer.
- ✓ Long-term care is a major concern for many people. You need to plan how you will fund this likely expense, and still leave an inheritance for your heirs.

SOLUTION: Because your tax exposure will change throughout retirement, you need a tax strategy that:

- ✓ Anticipates how and when you tap assets to cover your personal expenses.
- ✓ Understands the range of taxes you will face at various stages.
- ✓ Manages your actions so you pay as a low a tax rate as possible.