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Financial Briefs

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Tax Planning and Retirement

When people think about their retirement, the mental picture they summon tends to focus more on beaches and hobbies and less on income taxes. However, the taxes you'll have to pay on your retirement income will have a large impact on how much you'll really need in retirement. While your tax burden will most likely be lower in your retirement than in your highest-earning years, you'll still have to deal with income taxes. This means that a part of your retirement planning must include planning for taxes in retirement as well. The good news is that being smart about how you invest and making strategic decisions about where you draw your income in retirement will better prepare you for a secure future.

How Much of Your Benefit Is Yours to Keep?

One of the biggest surprises that retirees encounter is that Social Security, a cornerstone of retirement income for many, is taxable. However, the portion of your Social Security benefit that is subject to tax depends on your total income for the year. If you rely solely on income from Social Security, you will likely not have to pay taxes on those benefits. But many people use Social Security as a supplement to what they withdraw from their retirement accounts. For those people, if their adjusted gross income, nontaxable interest received, and half of their annual Social Security benefits add up to a number between $32,000 and $44,000 (and they are married), they may have to pay tax on up to half of their benefit. For single people, that amount would have to be between $25,000 and $34,000. If the amount is higher than those figures, up to 85% of the benefit could be taxable.

Downtown Living = Downtown Taxes

Another tax-related aspect of retirement many people don't realize has a large impact on their finances is where they plan to live. While it's tempting to move in down the street from the grandkids or downsize to a

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Using Portfolio Losses

Capital gains on investments held for one year or less are short-term capital gains taxed at ordinary income tax rates. For investments held over one year, the maximum long-term capital gains tax rate in 2019 is 20%. While the 20% rate is below the maximum ordinary income tax rate of 37%, it still takes a significant chunk out of your investment portfolio.

To help minimize your capital gains tax bill, you should actively harvest any losses in your portfolio. Some strategies to consider include:

Recognize losses to at least offset $3,000 of ordinary income. Keep in mind the tax rules regarding gains and losses — capital losses offset capital gains and an excess of $3,000 of capital losses can be offset against ordinary income. If you are holding stocks with losses in your portfolio, you should probably take advantage of this tax rule.

If you still want to own the stock with the loss, you can sell the stock, recognize the tax loss, and then repurchase the stock. You just have to make sure to avoid the wash-sale rules. These rules state that you must repurchase the shares at least 31 days before or after you sell your original shares to recognize the loss for tax purposes. That timing can be troublesome. If the stock's price rises substantially before you repurchase it, your tax savings from the loss deduction may not be worth as much as the investment gains during that time period. You can avoid that concern by purchasing the additional shares first and then selling your original shares 31 days later. Another strategy is to

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Tax Planning

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condo in a walkable city, it's important to make sure you understand the tax situation of the locale before you pack up and resettle. Some U.S. states, like Nevada and Florida, have no personal income tax. That, combined with the warm weather, makes both states popular landing spots for retirees. If you want to live a bit more adventurously, try Alaska, which has no income *or* sales tax. States like Georgia offer special perks to draw retirees, like not taxing Social Security income or up to $65,000 of retirement income for people over 65. Other states have higher tax burdens, which can have an outsized effect on your nest egg. You will need to carefully weigh the advantages and disadvantages of any new place to live and budget accordingly.

Mix It Up with Tax-Diversified Investments

It's common for people saving for retirement to place an emphasis on tax-deferred accounts like 401(k) plans. This way, they save on taxes now in their higher-earning years, and then pay taxes when they draw on the funds in retirement and in a potentially lower tax bracket. While there is nothing wrong with this strategy, it's also a good idea to have some accounts to draw on that will not incur any taxes, like a Roth IRA. This gives retirees more of a choice about what they will draw on and if they will have to pay taxes on those funds. You can also keep some of your investments in regular taxable accounts, which provide income that is taxed at a lower capital gains rate.

If you are not currently contributing to a Roth IRA, you may want to consider a rollover from a tax-deferred account into a tax-free account. Of course, you will have to pay any taxes owed when the rollover occurs, but you will also have more options for income to draw on in retirement. Because this is not a good choice for everyone, you should speak with a financial advisor to make sure it is appropriate for you.

Don't Forget about Required Minimum Distributions (RMDs)

Many people are not in the enviable position of being well-off enough to leave funds untouched through their 60s. But for those who are in that situation, they must keep in mind that by the time they turn age 70½, they are required to start making withdrawals from their 401(k), Roth 401(k), IRA, or other similar account. Whether they need the money or not, they have to start taking the RMDs…and that added income could bump them into a higher tax bracket. The best course of action is entirely dependent on your specific situation, but one strategy is to begin making withdrawals before 70½ as long as you remain in a lower tax bracket, and re-investing the unneeded amount elsewhere. There is also the option to rollover the funds into a Roth IRA, which is the only type of retirement account not subject to RMDs. Speaking with a financial advisor can give you a clear picture of what strategies work best for you — the most important step is to have a plan.

Why Tax Planning Matters

Generally attributed to Benjamin Franklin, one quote that still rings true today is that "…in this world nothing can be said to be certain except death and taxes." And perhaps because that thought is more than a little bit depressing, the certainty of having to pay taxes only seems relevant to most people when it's time to file. But when people neglect to plan for taxes over the course of their lifetimes, they end up facing another, also depressing certainty: paying more than necessary. Taking the time and effort to plan for taxes saves you money in the short term and long term, and can make all the difference for your retirement and legacy.

Short Term

Making a tax plan at the beginning of the year can help lower your tax bill by ensuring that you are taking advantage of as many tax strategies as possible. The best way to make sure you haven't missed anything is by going over your tax situation and strategies with an accountant or advisor.

Long Term

Most people do not make enough money in a single year to fund their long-term goals, like paying for their children's college, purchasing a house, or paying off all of their student loan debt. Therefore, some long-term tax planning is in order. For example, the money you put away in a tax-advantaged 529 account for college education grows tax free and can be withdrawn tax free when used to pay educational expenses. Overall, the more you save on taxes, the more you have to put toward your financial goals.

Retirement

As you plan for your retirement and continue to contribute to your 401(k) plan or IRA, it is helpful to know the amount you contribute can be deducted from your taxes. Even if you utilize a Roth IRA and cannot deduct the contributions today, you can access those funds tax free in retirement. It takes a lot of money and careful planning to retire comfortably, and a tax plan is an essential part of the process.

Legacy

When you think about what you hope to leave behind for your heirs or your favorite charity, you might not initially consider the tax ramifications. Consider setting up part of your estate plan in a Roth IRA so your children can draw tax-free income from the account. You can also take advantage of the annual gift tax exclusion by transferring funds to your heirs while you are still alive. Donor-advised funds, life insurance, and various types of trusts can all offer other solutions to the tax aspect of your legacy.

Using Portfolio Losses

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purchase a similar stock, perhaps of a competitor, to replace the stock you sold. Since it isn't the same stock, you don't have to wait 31 days to purchase it.

Consider recognizing all, or a substantial portion, of any losses in your portfolio. Realize that no one likes to sell investments at a loss. And since you can only offset an excess of $3,000 of capital losses against ordinary income, you might wonder why you should incur excess losses that can't be used currently, even though you can carry them forward to future years. There are a couple of advantages to this strategy.

First, it gives you an opportunity to totally reevaluate your portfolio. If you are convinced all your investments are good ones, you can sell them, recognize the tax loss, and then repurchase the stocks, being sure to avoid the wash-sale rules. But it's probably more likely that you own some investments you wish you didn't or you don't think will recover as quickly as other investments. This is your opportunity to reinvest in stocks you believe have better long-term potential.

Second, it gives you more flexibility when recognizing gains in the future. You may be a little more skittish about letting capital gains ride with the market. Until you use all your capital losses, you can recognize capital gains without worrying about paying taxes. Even if your losses are long term, you can use them to offset short-term capital gains that would be subject to ordinary income taxes.

Use stock losses to offset other capital gains. You don't have to match stock losses with stock gains. If you have capital gains from the sale of another type of asset, such as a business or real estate, stock losses can be used to offset those gains.

Don't gift stocks with losses. If you are planning a large charitable contribution, it makes sense to donate appreciated stock held for over a year. You deduct the fair market value as a charitable contribution, subject to limitations based on a percentage of your adjusted gross income, and avoid paying capital gains taxes on the gain. If the stock has a loss, however, you should first sell it and then send the cash to the charity. That way, you get the charitable deduction and recognize a tax loss on the sale.

If you have losses in your portfolio, you may be able to use them to help reduce your income tax bill. Please call if you'd like to discuss these strategies in more detail.

Taxes and Retirement Withdrawals

As you prepare for retirement, develop a retirement withdrawal strategy that provides you with the income you need, minimizes the impact of taxes, and keeps your investment mix focused on your goals and personal situation. Here are some strategies to consider:

Withdrawal Order Matters

The order in which you take assets can have an impact on what you pay in taxes. The sequence strategy follows this order:

- Required minimum distributions (RMDs) from retirement accounts
- Taxable accounts
- Tax-deferred retirement accounts, such as a traditional IRAs, 401(k), 403(b), or 457
- Tax-exempt retirement accounts, such as a Roth IRA or Roth 401(k)

RMDs should be taken first if you're older than 70½ because if you don't, in most cases, you will pay a penalty that is half the amount of what was not withdrawn.

After the RMDs or if you are not 70½, you should take income from your taxable accounts until you've used all of the funds. The reason for this is that tax-advantaged accounts still have the potential to grow on a tax-deferred basis.

On your taxable accounts, you will most likely have to sell investments on which you will pay capital gains on any appreciation, which is from 0% to 20% depending on your tax bracket. The majority of taxpayers pay no more than 15%, since long-term capital gain rates are much lower than income tax rates.

Finally, you should use the assets in your tax-deferred accounts on which you will pay ordinary income tax. If you have Roth accounts, these funds will not be taxed.

Avoid Paying Taxes on Social Security

Up to 85% of your Social Security benefits are taxable if you make more than the income thresholds. If your adjusted gross income, nontaxable interest, and half of your Social Security reaches $25,000 for individuals and $32,000 for couples, you will pay income taxes on up to 50% of your Social Security benefits. Additionally, if your retirement income reaches $34,000 for individuals and $44,000 for couples, you will pay income taxes on up to 85% of your Social Security payments.

You want to manage your income to reduce the percentage of your Social Security benefits that are taxed. With this strategy, you'll want to make the income threshold the target instead of the income associated with a specific tax bracket.

Take Advantage of Lower Capital Gain Rates

If your taxable income falls into one of the two lowest tax brackets, you can sell stocks that were held longer than a year as a tax-efficient means to generating cash flow. In 2019, taxpayers in the 10% and 12% income brackets will realize long-term capital gains or receive qualified dividends without being taxed. This is a great strategy if you have a high proportion of assets in taxable accounts and a lower amount of recurring income.

News and Announcements

From the Thurman Household

Our son Levi has graduated with his Associate's degree and a 3.78 GPA. We are now awaiting to see if he gets into Physical Therapy Assistant school. It is quite competitive. He continues to work as an intern at PT Central and loves it. He has a great boss and enjoys the learning and the challenges.

Speaking of challenges, I'm having lots of fun lately. Mohs surgery for skin issues on my face and hand, pulled a calf muscle playing the rough and rugged sport of Pickleball, and threw out my back doing a very dangerous activity, putting on my shoe. I'm quite ready for this stuff to stop.

We have two new rescue kittens in our household, and you may not know this, but it is really challenging to read when they think your bare leg is a scratching post. They've been a lot of fun, most of the time.

My wife, Pati, is preparing for a run/walk up Pike's Peak. About 15 miles. Sounds a little crazy to me. A run down, I feel, would be much more fun, but that's me.

Have a great month!

Randy Thurman, CFP®, CPA/PFS

From the Flinton Household

"The real voyage of discovery consists not in seeking new landscapes, but in having new eyes."
~ Marcel Proust

I have continually been guided by those much wiser than myself to go and experience as much as we can stomach in the way of travel and creating memories with the family. With the school year far in the rearview mirror, we have our sights set on taking in some wonderful landscapes and enjoying some "lazy-hazy-crazy days of summer." Between staying at home and lounging by the pool, getting out of the state and seeing some new scenery, and a multitude of camps (cooking, science, horseback riding, soccer, basketball, and I'm sure I'm missing something) the girls are sure to be well worn and refreshed at the same time, before the next school year arrives.

We are also looking forward to spending some time this summer on the golf course as a family. Samantha and Emerson have always loved riding around in the golf cart; however, now they have their own golf clubs and are enjoying banging the ball around. I've always had a deep love of the game; however, it hasn't been anywhere near the top of my priority list over the last few years. To be able to get out to the course more than a handful of times in a year, let alone with two of my favorite people, will surely be an opportunity to create and capture some wonderful memories. As we do our best to cherish the moments of today, I would encourage you to do the same. It's rarely the grand events in our life that we remember the best, rather it's those still, quiet moments in which we are fully present, that tend to be the stories that we continue to recall and retell for years to come. Wishing you a summer of stories to be retold.

Andrew Flinton, CFP®

From the Bolander Household

The "Greatest Spectacle in Racing" is otherwise known as the Indy 500. I remember my dad watching the formula car race on TV, and the legendary names Unser and Foyt are somehow fixed in my memory. This year John and I are going to the race on Memorial Day weekend for the first time. My sister and her husband are die-hard fans and have had tickets to the event for many years. This will be the 103rd race on the Indianapolis Motor Speedway, nicknamed "The Brickyard" because the track was paved with bricks in 1909, and then eventually covered with asphalt except for a 36-inch strip on the front straight-away that marks the start and finish line. I'll be cheering for Hélio Castroneves. Although he's starting in seventh position, he won three times in the early 2000s, and mostly because he won ***Dancing with The Stars*** in season 5!

In other news, I recently had the great honor of being recognized as the 2019 Outstanding CPA in Business & Industry by the Oklahoma Society of CPAs Members in Industry Committee. I am grateful to Randy Ross, CPA, who nominated me and to all the wonderful mentors I have had through the years. Thank you, friends.

Have a great month!

Brenda C. Bolander,
CFP®, CPA/PFS