

A Complete Guide to Taxes in Retirement

Written By Financial Educators



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Are you thinking of retiring or are a new retiree that isn't quite sure how taxes will work out for the following tax year? If so, we are here to help by looking at what income will be included on taxes when you're retired and how it will affect what you owe to the IRS.

From looking at what taxes you will have to pay on social security income to taxes you'll have to pay on capital gains, it's better to prepare and to know what to expect before doing your taxes. To learn more about taxes in retirement keep reading below.

After Retirement Do You Pay Taxes?

Once you retire from your job you will most likely be paying taxes long after your last day of work. These taxes work similarly to income tax. This means that taxes will go on what you earn during the year.

When it comes to your earnings you should be aware that there are taxes on things such as social security income and capital gains. Even that pension you've been paying into for years will have taxes.

You may be wondering how much you can be earning while you're in retirement. These taxes are most commonly taxes on retirement income.

But you should be aware that there are different tax rules for each income you receive in retirement. To help minimize how much you'll be paying in taxes in retirement you should be aware of how each income source will show up on your taxes.

To help you make the most out of your retirement taxes we will be looking closely at retirement earnings and how taxes are applied. Keep reading below to prepare for tax season and to estimate taxes in retirement.



37% of retirees admit they did not consider how taxes would impact their retirement income*

- Nationwide Retirement Institute

Social Security Income



Some of you may have to pay federal income taxes on your Social Security benefits. This usually happens only if you have other substantial income in addition to your benefits*

When it comes to social security income you will either have to pay taxes on it or you may not have to pay a penny. If social security income is your only income after retirement then you may not have to pay any taxes on it. If you have other sources of income at this time in your life then social security will have applicable taxes.

There is a specific formula used to help decide how much of your social security income is taxable. This formula may even include up to 85% of your benefits listed as taxable income on your tax return.

The taxable amount of social security taxes in retirement can fall anywhere from 0% to 85%. It depends on what your other income totals out to in addition to your social security income. The IRS will refer to this as "combined income" and can be entered into its own formula on your tax sheet. Your tax sheet will then help you to determine how much of your benefits are actually taxable.

If you're a retiree with a high amount of monthly pension income then you can plan to pay 85% on your social security income. This means that your overall tax rate may run as high as 37%. If you're a retiree with no other income than social security then you will more than likely receive these benefits tax-free and not have to pay anything during tax season.



* <https://www.ssa.gov/benefits/retirement/planner/taxes.html>

Pension Income

When it comes to pension income, most of it is taxable. If you withdraw the pre-tax money you contributed then it will be taxed come tax season.

Pension accounts are usually funded with pre-tax income. This means that the amount of your annual pension income will be included in your taxes as taxable income. This will happen each year.

If you'd like to get a head start on taxes while receiving your pension checks you can ask for taxes to be withheld. Just make sure you're having enough withheld from each check so you won't be owing a lot come tax time.

Roth 401(k) withdrawals are not taxable provided the account is five years old and the account owner is age 59½ or older.*



401(k) and IRA Withdrawals

Withdrawing money from a tax-deferred retirement account such as an IRA or 401(k) will be taxed at regular income rates. Since this is a long-term asset withdrawals won't be taxed at capital gains rates. Any withdrawal you make from a retirement account will 100% be listed on your taxes as a taxable income.

When it comes to how much your tax amount will be on these withdrawals it really depends on the overall amount of deductions and income you have for the year. Also what tax bracket you fall into affects this.

You may not pay taxes on withdrawals if you've had a tax year that has more deductions than income. This could be a year that has had a lot of medical expenses or itemized deductions.

*<https://www.investopedia.com/articles/personal-finance/061915/how-your-401k-taxed-when-you-retire.asp>

Annuity Distributions

Tax rules make no exceptions to any withdraws or annuity payments that you receive from an annuity owned within an IRA or another retirement account you may have. The specific tax rules that apply will depend on if your annuity was bought with after-tax dollars. Or in other words, it wasn't purchased with a retirement account.

Portions of each payment received from an immediate annuity are then considered a return of principal and interest. On your taxes, only the interest portion will appear.

If you call your annuity company they can then tell you what the exclusion ratio is each tax year. It will then help to show you how much of the annuity income you receive can be removed from your taxable income.

When it comes to tax rules on your withdraws from variable or fixed annuities they usually dictate that withdraws must be done first. This means that you'll be withdrawing your earnings or even the investment gain if your account is worth more than what you initially contributed to it.

This will all be taxable. From here you can begin to withdraw your initial contributions after withdrawing your earnings. These aren't included in your taxable income.

Gains With the Selling of Your Home

There's a good chance that you won't pay taxes on the gains from the selling of your home. This is mostly true if you've lived there for at least 2 years. If you have not lived in your home for 2 years but gains above \$250,000 (if single) or \$500,000 (if married) then you may not have to pay taxes either.

These rules become more complex if you've ever rented your home out. To see what your taxes will be it's best to meet up with a tax professional and discuss your options.



Investment Income


When it comes to investments you should know that you'll pay taxes on dividends. You will also be required to pay taxes on things such as capital gains and interest income just as you did before retiring.

Investment incomes are reported on a 1099 form. This will be done each year that you have income from your investments. You should receive this form directly from the financial institution that manages or holds your accounts.

The IRS will also receive a copy of this. Each sale of an investment will generate a long-term or short-term capital gain or loss. If you're selling investments regularly to help generate a steady flow of income this must be reported on your tax return.

At tax time you may find that you'll be required to pay little to no tax on a portion of all of your capital gains if your other income sources aren't too high. You may even qualify for the 0% long-term capital gains tax rate.

It's good to keep in mind that not every source of cash from investments is considered taxable income. For example, if you own a CD that gains the amount of \$15,000 then this money isn't additional taxable income that must be reported on your tax return. Only the interest that the CD earned will be reported.

An hourglass with white sand is positioned on the left side of a wooden surface. To its right are several stacks of silver coins of varying heights. In the background, a white teacup and saucer are visible, and a green plant is partially seen on the left. A semi-transparent grey box with white text is overlaid on the right side of the image.

The tax rate on long-term (more than one year) gains is 0%, 15%, or 20%, depending on taxable income and filing status.*

*<https://www.investopedia.com/articles/investing/072313/investment-tax-basics-all-investors.asp>

How to Manage Taxable Accounts

When interest is paid on investments of taxable accounts is always taxed at your regular rate. There are other sources of income such as qualifying dividends and capital gains that will be taxed at the long-term capital gains rate anywhere from 0-20%. This will depend on what your tax bracket is.

This is especially true when you have owned your investment for more than a year. Getting this lower tax rate on most of your earnings is just one of the advantages of your taxable accounts.

Before you turn 59 and a half there will be no required withdraws from your taxable accounts. This means that you have a high level of flexibility when it comes to deciding what investments you should tap into and which ones will need to be let go for needs in the future.

You can even manage your accounts to help minimize the amount of taxes you will owe at the end of the tax year. You can use capital losses to help offset capital gains on some of your investments. You can link up with a tax professional to help understand how you can defer or bunch income into a single tax year or even for help on how to take advantage of certain tax credits and deductions.

You may even discover that there are options that will help earn a large investment by paying little income. These include things such as index funds, real estate, managed accounts, individual securities, mutual funds, and exchange-traded funds.

Another way to avoid capital gains is to make charitable gifts of assets that have increased in their value. This will help you to avoid the capital gains tax while taking a tax deduction for the value of the asset.



Delaware has the highest average retirement savings, at \$286,277.

The tax benefits Delaware offers really shine through. This is the state with the highest average retirement savings in the country.

The fact that there's no state income tax, untaxed Social Security benefits, no personal property tax, and many more benefits have contributed to this status.*

*<https://whattobecome.com/blog/retirement-stats/>

How to Calculate Your Tax Rate

Your tax rate during retirement will depend on the overall amount of your income and deductions. To help determine what your tax rate will be you should make a list of each income you receive, add it up, and then subtract your deductions from the total.

For example, let's assumed you're married and filing joint taxes this year and have \$20,000 in social security income, \$25,000 in pension income, and you're going to be taking \$15,000 from your IRA. You will then have to estimate that you'll have \$5,000 a year in long-term capital gains. This will be from mutual fund distributions.

You will then add up your regular income. Make sure not to include your capital gains and to use 85% of your social security income. This will then come out to \$57,000.

Your standard deduction for the 2020 tax year will then be \$24,800 as a married couple filing together. Remember that you will be filing for the 2020 tax year at the beginning of 2021.

This will then put your income at \$32,200, hence placing you within the 12% tax bracket. You will then have to pay 10% on the first \$19,750 of taxable income you have. Then you will pay 12% for income that falls between \$19,750 and \$80,250.

This means that your estimated tax bill will be around \$3,469. Then your capital gains will qualify for the 0% rate. This means you won't be taxed for your capital gains because you're in the 0% for long-term capital gains on your income of \$32,200.

When it comes to paying this amount of taxes you do have options. You can choose to pay your taxes quarterly at payments of \$867.25 every quarter. If you'd like your pension to withhold taxes then you can ask them to tax it at a withholding rate of about 20%.



The more you can anticipate tax expenses in retirement, the more prepared you'll be.

Now You Know All About Taxes in Retirement

We have gone over what to expect when it comes to taxes in retirement. From looking at what income you'll be taxed on to figuring out what tax bracket you fall into to help determine how much you'll owe at tax season, you will be prepared. For more investing tips and information be sure to contact us.



Example Advisor Bio

John Smith is a Certified Financial Planner™ and has been in the financial services industry for over 15 years. He earned his bachelor's degree in finance from XYZ University and his MBA from ABC Business School. John's expertise includes retirement planning, investment management, estate planning, tax strategies, and risk management. He is dedicated to helping his clients achieve their financial goals by providing personalized advice and guidance. John takes a holistic approach to financial planning and considers his clients' overall financial picture to create a comprehensive plan tailored to their unique needs. He is committed to ongoing education and staying up-to-date on the latest industry trends and regulations. John's mission is to empower his clients to make informed financial decisions and achieve financial security."

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For more information, please contact your "YOUR PRACTICE GOES HERE" directly for a comprehensive overview and analysis of your specific situation using risk on or risk off asset classes in your retirement portfolio.