What is the Retirement Planning Tax Window?

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Many investors tend to find themselves in a **lower tax bracket** following their retirement – sometimes substantially so. Oftentimes, an investor will begin retirement withdrawing from their taxable accounts to cover living expenses leading to a **significant drop-off in taxable income.**

This period typically lasts until a few events happen post-retirement:

- Social Security – Typically starting between 62-70, up to 85% of the income you get paid from social security will be included in your taxable income.
- Required Minimum Distributions (RMD's) – Beginning in the year you turn 73, you are required to withdraw a minimum amount from your 401(k) and pre-tax IRA accounts each year. For those with substantial account balances these required distributions can be substantial and push you into a higher tax bracket.
- Pensions – Depending on the rules of the pension, these payments can typically start at retirement or age 65 (although the plan may have other rules). These funds will be taxed as income in the year received.
- Annuity Payments – Depending on the annuity structure some or all of these payments can be taxed as income in the year received.

Roth Conversions

During this period of lower taxable income, converting funds to Roth IRA's can be a way to intentionally realize income at a low tax rate and also decrease your future RMD's. These low tax rates can be optimized by converting an amount that will take you up to the top of the appropriate bracket. The 2023 Tax Rate Schedules are as follows:

2023 TAX RATE SCHEDULES				
If Taxable Income Is		Then the Gross Tax Payable Is:		
Over	But Not Over	Amount	Plus (percent)	Of the Amount Over
SINGLE TAXPAYERS (other than surviving spouses and heads of households)				
$0	$11,000	10% of taxable income		
11,000	44,725	$1,100	12%	$11,000
44,725	95,375	5,147	22%	44,725
95,375	182,100	16,290	24%	95,375
182,100	231,250	37,104	32%	182,100
231,250	578,125	52,832	35%	231,250
578,125	--	174,238.25	37%	578,125
HEADS OF HOUSEHOLDS				
$0	$15,700	10% of taxable income		
15,700	59,850	$1,570	12%	$15,700
59,850	95,350	6,868	22%	59,850
95,350	182,100	14,678	24%	95,350
182,100	231,250	35,498	32%	182,100
231,250	578,100	51,226	35%	231,250
578,100	--	172,623.50	37%	578,100
MARRIED INDIVIDUALS (and surviving spouses) FILING JOINT RETURNS				
$0	$22,000	10% of taxable income		
22,000	89,450	$2,200	12%	$22,000
89,450	190,750	10,294	22%	89,450
190,750	364,200	32,580	24%	190,750
364,200	462,500	74,208	32%	364,200
462,500	693,750	105,664	35%	462,500
693,750	--	186,601.50	37%	693,750

Example: John and Jane Doe live off of $150k per year and recently retired at age 60. They have enough saved in their taxable investment account to cover their lifestyle expenses for the next seven years and are concerned about the substantial RMD's they will likely face in the future. After conferring with their financial planner and CPA, they determine they can convert $80,000 and stay within the 10% and 12% tax brackets.

Tax Gain Harvesting

For retirees whose income has dropped substantially, the ability to harvest capital gains at a 0% tax rate may open up. By falling below a certain threshold (see table on next page) based on your filing status, you can potentially sell investments that have gone up in value and not have to pay any taxes on the associated gains. One note for those looking to pursue this strategy in conjunction with a Roth conversion or realizing other income, capital gains taxes are added to taxable income and any amount that goes over the 0% threshold would then be taxed at 15%.

LTCG RATES BASED ON TAXABLE INCOME			
Filing Status	0% rate	15% rate	20% rate
Single	up to $44,625	$44,626-$492,300	over $492,300
Head of household	up to $59,750	$59,751-$523,050	over $523,050
Married filing jointly	up to $89,250	$89,251-$553,850	over $553,850
Married filing separately	up to $44,625	$44,626-$276,900	over $276,900
Estates and trusts	up to $3,000	$3,001-$14,650	over $14,650

Example: Ken and Barbie recently retired at the age of 65 and 15% of their portfolio is concentrated Barbie's former employer's stock. They would like to diversify out of the stock and currently find themselves with almost no income as they use their taxable investments to cover their lifestyle. The stock is worth $300,000 and has a cost basis of $200,000 – after conferring with their financial planner and CPA they decide they will sell half the stock this year and half next year and project to stay below $89,250 in taxable income both years meaning they will not owe any capital gains taxes on the sales.

Items to be aware of:

There are a few items to be aware of as you make decisions within this tax planning window. The first is related to the taxation of social security. Once you begin taking social security, the amount that is included in your taxable income will vary based on certain thresholds outlined below. If you will be converting or tax gain harvesting, you will want to incorporate the tax impact on your social security as part of the calculation.

Filing Status	Provisional Income	Amount of SS Subject to Taxation
Single, Head of Household, Qualifying Widower, Married Filing Separately	Under $25,000 $25,000-$34,000 Over $34,000	0 Up to 50% Up to 85%
Married Filing Jointly	Under $32,000 $32,000-$44,000 Over $44,000	0 Up to 50% Up to 85%

2023 MEDICARE PART B PREMIUM RATES:			
YOU PAY		If your 2021 income was:	
Premium	PART D Surcharge	SINGLE	MARRIED COUPLE
$164.90 not Hold Harmless		$97,000 or less	$194,000 or less
$230.80	$12.20	$97,001–$123,000	$194,001–$246,000
$329.70	$31.50	$123,001–$153,000	$246,001–$306,000
$428.60	$50.70	$153,001–$183,000	$306,001–$366,000
$527.50	$70.00	$183,001–$500,000	$366,001–$750,000
$560.50	$76.40	Above $500,000	Above $750,000

Once you reach age 63, your Medicare part B and D premiums can be impacted by additional realized income – this is called the Income-Related Monthly Adjustment Amount (IRMAA). Both conversions and capital gains will impact your modified adjusted gross income for IRMAA calculation purposes and you will want to be cognizant of these thresholds and factor in surcharges as eclipsing a threshold by just $1 means you will be subject to the surcharged rate. The IRMAA amount is determined by your modified adjusted gross income from two years prior, meaning 2023 surcharges would be determined from your 2021 tax filing.

Would you like to understand whether the content discussed in this post is appropriate for you and how it may fit in to your overall financial plan?

Schedule an introductory phone call with our team.

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Disclosure: Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount may be subject to its own five-year holding period. Converting a traditional IRA into a Roth IRA has tax implications. Investors should consult a tax advisor before deciding to do a conversion.

Please note, changes in tax laws may occur at any time and could have a substantial impact upon each person's situation. While we are familiar with the tax provisions of the issues presented herein, as Financial Advisors of RJFS, we are not qualified to render advice on tax or legal matters. You should discuss tax or legal matters with the appropriate professional.

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