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THE COMPLEXITIES OF TAX PLANNING IN RETIREMENT

If you are like most people when you hear the phrase "tax planning," you immediately think it is for high net worth people with complicated finances and not important for you. However, tax planning is an important part of retirement planning, and retirement can create both tax complexity and opportunity.

During your working years, your taxes may be straightforward, but they can become complex in retirement. If you are like most people, your primary source of income during your working years comes from your salary, which receives one type of tax treatment. However, in retirement your income may come from several sources that receive different tax treatments. For example, you may have a 401(k), Roth IRA, brokerage account, Social Security, an annuity, and/or a pension. With all of these sources to coordinate, a plan for how your retirement savings will be used helps prevent mistakes that unnecessarily increase your tax bill. Further, how much income you realize can also influence how much you pay for Medicare Part B and how much of your Social Security benefits are taxable. A tax efficient plan that keeps all of these considerations in mind can help your retirement savings last longer by reducing the amount drawn out of your savings. After all, in retirement you have to cover both your living expenses and your taxes.

Without getting into a lot of technical jargon, let's consider some of the tax complexity retirees' face in more detail. Withdrawals from a 401(k) are taxed at ordinary income rates. On the other hand, withdrawals from a brokerage account are taxed at lower capital gains rates and only the growth on

these investments is subject to tax. The amount of the original investment is not subject to tax. For an annuity, the earnings are subject to ordinary income taxes, but the contributions are not subject to tax. Social Security may be partially taxed depending on your overall tax bracket. Confused yet?

To further complicate matters, in the early years of retirement, you may receive money in differing amounts from different sources and in different years. For example, if you plan to retire at age 65 but decide to wait until age 70 to collect Social Security, you may need to take money from your brokerage account, 401(k), or a combination of the two to cover your expenses for these years. If you take money from your brokerage account, you may pay less in taxes now, but you may pay more later when your 401(k) required minimum distributions begin. On the other hand, if you take money from your 401(k) now, you may pay more taxes now but less later, because taking money out of your 401(k) reduces the amount of your required minimum distributions in the future. Which option is best in your situation requires careful tax planning and comprehensive knowledge of your entire financial picture. A financial planner with tax expertise can help develop a plan tailored to your individual circumstances.

Although there can be a lot of complexity, there may also be a window of opportunity to improve your retirement savings' tax efficiency. Consider the timing of required minimum distributions and social security benefits. You are not required to take distributions from a traditional IRA or 401(k) until age 70 ½, and you can decide when to begin collecting Social Security. By deciding when to use certain income sources, this can work to your advantage. For example, you could convert part of your traditional IRA to a Roth. Alternatively, it may be beneficial to use inefficient assets that do not fit well with your financial plan (Such as a whole life policy or an annuity) before using other assets. Again, whether this is appropriate depends on individual circumstances and requires careful planning by someone knowledgeable about taxes and your complete financial picture.

Although retirement can make your taxes more complicated, careful planning will help to stretch your retirement savings by avoiding mistakes and taking advantage of opportunities.