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NEWSLETTER

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IRS WOES: Don't Let Taxes Derail Your Retirement Plans

By Eric Nager, CRPS®

All United States citizens are subject to income tax from the federal government, even those who are retired. Living on a fixed income in retirement can be difficult, so it's important to plan accordingly for how you will be taxed to get an accurate picture of your financial health.

Here's what you need to know about taxable income in retirement:

Social Security Benefits

One thing that many retirees may not realize is that they can be taxed on part of their social security benefits. If you have substantial income in addition to your social security benefits, you may need to pay taxes on up to 85% of your benefit amount. The amount of tax you pay depends on your combined income — your adjusted gross income (AGI) plus any non-taxable interest plus half of your Social Security benefits.

When you complete your federal tax return, you can use your annual Social Security Benefit Statement to figure out how much of your benefit payment will be taxable. There are a few ways to pay these taxes: Make quarterly estimated tax payments or choose to have them withheld from your benefit payments.

Retirement Savings Plans

The amount of taxes you pay on distributions from your retirement savings accounts depends on the type of plan. For example, your contributions to traditional IRAs and 401(k)s come from your pre-tax income. So, when taking distributions from these types of accounts, you will be taxed at your regular income tax rate.

Roth IRAs and Roth 401(k)s, however, are built up with funds after taxes. This means that distributions from these types of retirement savings accounts will not be taxed when withdrawn, provided they meet any withdrawal requirements or restrictions. Thus, your account grows tax free.

It's a good idea to think about the amount of money that you need to withdraw from your retirement savings accounts. As mentioned above, your combined income is what will determine your income tax rate, so the more you take out of your retirement accounts each year, the more you may owe in taxes.

To avoid unnecessary taxation, only take out the minimum distribution requirements or as much as you need above that amount in a given year.

Consulting a Professional

Figuring out how to pay your taxes, take distributions and live on a fixed income during retirement can be confusing. But a financial professional can help you navigate the waters of taxes in retirement and help you avoid pitfalls that may leave you in poor financial health.

Planning ahead of time means being prepared for whatever retirement might throw your way.

A Reminder About Required Minimum Distributions

By Eric Nager, CRPS®

Required Minimum Distributions (RMDs) were waived last year because of the pandemic. They must be taken this year, so we are calling all our clients who need to do so before the end of the year in order to avoid the harsh penalty if you do not take it. An RMD is money that must be taken out of a tax-deferred account, like a traditional IRA or 401k, so that the government can collect some taxes in return for allowing you to let your money grow tax-deferred over your working life. Some of the rules have changed because of recent changes in the law and we want to highlight a couple of them.

First, the age to start taking RMDs was raised from 70.5 to 72 as of 2020. We think this makes good sense because people are living longer lives. The longer you can wait to take money out of your account, the longer it has to grow and work for you.

Second, many people now have what are called beneficiary IRAs that they inherit from a non-spouse. The old rule was that the beneficiary could take RMDs out of these accounts over the course of his or her lifetime. But, for beneficiary accounts opened after January 1, 2020, the money must be taken out within 10 years.

An interesting aspect of this is that a surviving spouse can choose to inherit an IRA from the deceased spouse either as a beneficiary IRA or treat it as his or her own. Please contact us if you are facing this choice and we can help talk you through it. In the meantime, please let us know how you want to take your RMD. One option is to keep it invested in a non-tax qualified account, minus the taxes of course, if you don't immediately need the money.

DOW 36000

I read an interesting article this week in the *Wall Street Journal* by James Glassman. In 1999, he and Kevin Hassett published a book called *Dow 36,000: The New Strategy for Profiting from the Coming Rise in the Stock Market.* While it took much longer than they expected, the Dow Jones Industrial Average of 30 large company stocks did close above 36,000 for the first time ever earlier this month, an all-time high.

To put this in perspective, on November 2, 1971, the Dow closed at 825.86. The rise in value over the last 50 years represents an increase of more than 43 times! And, if the Dow continues that pace over the next 50 years, we could be looking at a Dow value of 1,573,865 in 2071! We are not saying that is likely and we are certainly not saying that it will happen any time soon. The larger point is that that market has been a tremendous engine for wealth *over time,* and we expect that it will continue to do so.

Glassman points out some other fascinating statistics. For example, the market roughly doubles every decade or so, and he quotes Jeremy Siegel, author of *Stocks for the Long Run*. Siegel calculated that since 1802, equities have returned between 6.5-7% after inflation. To be sure, there are always dips, sometimes severe one, but there are always recoveries. Glassman notes that over the last century, there has never been a 20-year period when the market had negative returns, and only twice has it returned less than 5% during that span.

We like to remember these facts for a couple of reasons. First, just because the market is at a high does not mean that it is poised for a tumble. It can grow steadily for prolonged periods. Second, we have enjoyed very strong markets over the past decade and the next period might not be as strong. That does not mean that there are not opportunities, though, and we watch economic and market conditions very closely. If you did not see Terry's newsletter last month with our quarterly market outlook, you can view it online at our website:
www.southerncapitalservices.com/newsletters *-Eric Nager*

Reminder

Please remember to notify us if you have had any material changes in your financial circumstances.