

Tax Smart Strategies for Retirees Transcript

Hi, my name is McKenna. I'm an advisor here at Journey Financial.

I have been at Journey for a year and a half now, and I'm super excited to talk to you guys today about tax strategies for retirees.

So I wanted to break out of a little agenda of what we will be discussing today.

So we'll be discussing tax bracket management, the different types of taxation, top tax saving strategies for retirees, and some not all of the new big beautiful bill, um, regulations that took place this year.

So let's jump into it. So tax bracket management, um, I'm sure some of you know this, but there is some confusion around how we are taxed in general.

So we are actually on a progressive tax system, which means that whatever tax bracket you're in, so let's say you're in the 22% tax bracket, well let's say you make a hundred thousand dollars married filing jointly.

The first 10% of that amount that's in that tax bracket is going to be taxed at the 10%.

Then the next amount up until the limit on, we have this 2025 tax strategy summary, tax summary with all the numbers on it.

So anywhere between 23,851 and \$96,950 is going to be taxed at 12%.

And then anywhere above \$96,951 above up at 200,000 is taxed at 22%.

So now there's ways to manage your tax bracket.

First you wanna fill up your lower brackets, you wanna avoid jumping into higher brackets unless it's on purposely, which we can talk about later.

And then you want to smooth out income over time.

So for example, we have some clients who sell real estate and if they sell real estate, obviously that means that they're going to receive a huge capital gains portion that they have to report as income.

Well, in order to smooth out that income over time, you could set up a payment plan where they pay you in increments over the course of many years.

And that's so that way you don't receive a huge tax bill in year one and you can be able to smooth out income over time.

As financial planners, we tend to lean towards trying to save you taxes, not just in one lump sum, but overall, but over the course of year lifetime as well.

So that's kind of how our tax system works and that's how to manage your tax bracket.

And how we can manage it for you is by taking a look at the investments and the accounts that you have and comparing it to the income so that they all tie together.

The different types of taxation.

Um, there are three different types of taxation.

Well, there's ordinary income, earned income and capital gains.

Ordinary income would be any income off of social security, um, pensions, annuity payments, uh, things like that.

Any distribution from an IRA or 401k.

Earned income is pretty obvious.

It's earned income off of your wages and then capital gains.

So what capital gains is, is it is a taxation of 15% on capital gains.

So that means, let's say you invest \$10,000 into an account and it grows to be 15,000.

So 15,000 you have now in your account, well let's say you want to pull out the full 15 grand.

Well now you have to pay any capital gains from what you put into it and what you invested.

So you just basically have to pay capital gains on any capital gains that you have received, right?

So in that case, the \$5,000 would be taxed at 15%.

Now I wanted to discuss social security and how that is taxed because that is taxed in within its own realm.

So for example, let's say our client's modified adjusted gross income is still at the a hundred thousand.

Well, if someone has their modified adjusted gross income, let's say married filing jointly is below 32 grand overall, not just their social security, their all their total modified adjusted gross income is below 32,000.

Social security is not taxed at all.

Now let's say between 32,000 and 44,000 is where their modified adjusted gross income is.

50% of their social security is taxed, not their modified adjusted gross income only.

Their social security only 50% of that is then taxable.

Well, now that we've breached through both of those tiers with our example, their modified adjusted gross income is a hundred thousand.

Well, let's say that they're receiving 40 grand in social security.

Only 85% of that 40 grand is going to be reported as taxable income.

So I have an example here that I'm then gonna show you on a 10 40.

Um, but I first wanted to run through the scenarios.

So first of all, we have Mr. And Mrs. Retired.

They are receiving, this is together 'cause they're married filing jointly.

They are receiving \$50,000 in their pension amounts.

They are receiving 19,600 in annuity amounts.

Their social security together combined is 93,600.

They have two CDs at the bank that are generating \$700 in taxable income.

They have qualified dividends of 2000 and non-qualified dividends of 1000.

Their RMD amount is \$10,000.

Of that \$10,000, they did a \$2,000 qualified charitable distribution.

And then they have a joint account that generated \$5,000 in capital gains.

So just remember, these are the numbers that are going to be displayed on our example here.

So on a 10 40 I'm gonna walk you through kind of what that would look like.

Okay, so let's start with the \$50,000 in pensions.

Well you can see here on five A that there is the line for pensions and annuities.

Well, if you take a look at that and then you kind of keep going, leaning over and following it over to five B, you'll notice that the amount is 69,600.

Well, what happened there is we took the amount of pensions and the amount of annuity payments that they're receiving and we totaled it together to reach \$69,600 and that is the full taxable amount.

So now let's move onto their social security.

Their social security, they were receiving 93,600 combined.

So their modified adjust gross income, which is down here on line 11 is above.

It breaches through that \$44,000 to where now 85% of their social security is taxed, which is the 79,560, which is 85% of 93,600.

So that is the taxable amount of their social security that they have to report as taxable income.

Well if we jump down to now that that is their income that they're receiving, let's now talk about their investment income that they have been receiving.

So they received \$700 in total from CDs at the bank.

When you have CDs at the bank, the interest that is generating off of them is a hundred percent taxable income.

So you will see here that \$700, that is the taxable income from the interest generated at the CDs at the bank.

And then I wanna also compare it with the \$5,000 that they generated in capital gains.

Well, as you can see there's a line right here, line seven for capital gains.

Well we reported 5,000 of it from their 10 99 that they receive from their custodian.

Um, if your clients of ours, you typically receive those at the beginning of the year before tax time for the 10 99.

That spits out to let you know how much was generated in dividends, how much was generated in capital gains and as well as interest and things like that.

Well now what will happen is they will take that \$5,000 and they will move it to a Schedule D because of that \$5,000 15% is now taxed, which means 15% of 5,000 is about \$750, which I wanted to point out because the CDs at the bank is generating interest, that's a hundred percent taxable.

But investments can do capital gains depending on the type of accounts and the type of investments.

But typically capital gains are generated often in an account and is only generating about the same as just two CDs at the bank.

Okay? So now they have qualified dividends and non-qualified dividends and qualified dividends.

They had \$2,000 which is reported right here.

But then in ordinary dividends they have 3000.

Well, the difference there is because 1000 of it is non-qualified dividends.

Non-qualified dividends can generate different types of income.

Um, that to where either 15% of it is taxed, sometimes it's from interest, sometimes it's from REITs.

So that's why they have to report it all together as 3000 and then it all evens out on the Schedule D.

Well now they have an IRA distribution of 'cause he has a required minimum distribution of \$10,000 right here, which is what he had to take.

But how come only 8,000 of it is taxable amount?

Well if you remember our scenario, Mr. Retired had to take 10,000 out of his IRA, however he used 2000 of it to go to charity.

Well that \$2,000 is now not reportable as taxable income because it went to a charity and that is called a qualified charitable distribution, which we will discuss later anyways.

So you total all of that together to then get your adjusted gross income and then you take the standard deduction, um, and so on from there.

But I just wanted to give you an example to see how it plays out on a 10 40.

Now let's jump into top tax saving strategies.

Our first one that we are going to discuss is the smart strategic withdrawal sequence.

So what that is is you can notice how I have two different withdrawal sequences here.

First taxable tax deferred and then tax free.

Taxable is all of your joint accounts, your brokerages accounts, things like that.

Tax deferred is your IRAs and your 401ks and your tax free is your Roth IRAs account retirement funds.

So the reason why I have both of 'em taxable tax deferred and tax-free or tax deferred taxable or tax-free is because it just depends on your certain scenario.

So when I was in school, when I went to college, um, for my personal financial planning degree, I had a tax planning professor who we would ask questions and he would always say, well, it depends because it depends on what you're trying to accomplish.

It depends on the account values, it depends on how much capital gains your account has generated.

It just depends on which strategic withdrawal sequence would be better for you, which is where we come in and we can be able to take all those considerations into play and see which would be more beneficial for you to take from first.

Now let's talk about Roth conversions.

What is a Roth conversion?

A Roth conversion is taking money out of your tax deferred account, which is typically an IRA and moving it to a tax free bucket.

So what you're doing is you're just moving it from one pocket to the other.

But now the new pocket is that if any distributions is now tax free.

So when you would want to do it, you can do it any point in time.

Um, just be aware that when you take a distribution, when you do Roth conversion, you're taking it as IRA distribution and then converting it over to a Roth.

So that amount that you are converting is uh, taxable income to you and that's how it affects your taxes.

But when you would wanna do it is typically the prime time is any time before you reach required minimum distribution age and after you retire.

And why you would do it is because well now you have moved money that is now taxable income whenever you take distributions off of it and now you've moved it to tax-free money.

So when you do a Roth conversion, you want to do it to move more money into the tax-free pocket, which overall saves you on the overall taxes over your course of lifetime.

So you're paying taxes now to save you even more taxes later when those required minimum distributions hit.

Because when those required minimum distributions hit, they grow larger every year.

They're a hundred percent taxable income.

And um, if you don't start doing Roth conversions, your IRA can then even grow larger to where your required minimum distributions grow larger, which means your taxes increase as well.

Next I wanted to talk about qualified charitable distributions.

What is a qualified charitable distribution?

Well qualified charitable distribution is taking money out of your IRA and donating it to a 5013C charity.

When you would wanna do it is, well, you can only do it after you turn the age of 70 and a half.

Once you are age 70 and a half, then you are able to use qualified charitable distributions, or what we call it is QCDs, we just abbreviate it.

Um, but the reason why you would wanna do this is, well if you think back to our Mr. and Mrs. retired scenario that he had to take a \$10,000 required minimum distribution, but he used 2000 of it to go to a charity and now only 8,000 of it was taxable income.

Because when you take money out of your IRA and donate it to a charity, however much you did is not taxable on your 10 40.

And why you would wanna do it, well, we have a lot of clients who have higher and higher required minimum distributions to where I don't want to report a full \$50,000 as taxable income because I'm also receiving pensions and I'm also receiving annuity payments and I also have social security.

And so they're not needing additional income that they don't wanna have to pay for.

Well, what you can do is maybe they want to write off 30,000 of it to a charity and keep 20 of it as taxable income.

Well now they do a \$30,000 qualified charitable distribution and now 30,000 of it is not taxable income of their required minimum distribution.

You can do this in general, if you're not RMD age, what you can do is after you turn 70 and a half, um, now you can use your IRA your retirement funds to now pay for charities that if you are paying directly out of your pocket, instead of paying out of your pocket, you're paying out of your retirement accounts.

And so, and it's not reported as income and that's how it affects your taxes as well.

Next, let's discuss donor advised fund account.

So a donor advised fund, again abbreviated is a DAF account.

What it is is it is an account that you can set up and, um, donate to.

So you donate to the account and you can invest within that account.

Well that account is specifically to donate to charities.

So when you would wanna do it is if you would want a huge tax write off, um, which I'll give you an example here in a little bit.

Or if you are just wanting to transfer assets, highly appreciated assets in a brokerage account and donate them over to a donor-advised fund and now you don't have to pay capital gains tax on those highly appreciated assets because you just now donated them to then use for charity later.

Um, so let's say we have a client who earns over \$500,000 in taxable income.

Well, he's not old enough to do a qualified charitable distribution.

So what he did is he took \$200,000 out of his savings and he donated it to a donor advised fund.

Well now that \$200,000 is now not reported as income because he was able to donate it to a donor-advised fund, which will then be used for charity later.

Why you would want to do it, well, one, you want a huge tax write off or two, you want to get rid of highly appreciated assets.

We also have another client who has a brokerage account and brokerages accounts are taxable accounts and those are the accounts that you have to pay capital gains on when you take a distribution out.

Well, this client had a lot of capital gains that they didn't wanna have to pay on come tax time.

So what they did is they took their very highly appreciated assets and they donated it to the donor advised fund to then decrease their capital gains.

And that's how it affects your tax bill as well is trying to save you taxes, uh, if you are charitable saving you taxes on creating these types of accounts for you and then we would invest it for you.

We also have it set up to where if you are ready to donate to a specific charity that we send out the funds from this account.

Now let's talk about tax loss harvesting.

Tax loss harvesting is basically taking, putting your losers against your winners.

So what it is, is we manage tax loss harvesting on people's accounts to see, okay, let's sell off the losers to offset the winners.

So we will sell off those that have not done well and we'll sell 'em at a loss to offset your gains.

So let's say we sell \$5,000 in losses and you have a \$20,000 gain in one account.

Well now that we've sold \$5,000 in losses, we can offset that against your \$20,000 gains to where now you're only having to report 15 rather than 20.

It's not a whole lot, but again, we're taking those little steps that save you little by little to then save you a lot more in taxes over the course of your lifetime.

And why we do it is to offset those gains and that's how it affects your tax bill is you're now not reporting \$20,000 in capital gains.

You're reporting \$15,000 in capital gains that you now don't have to pay taxes on that additional 5,000.

Now let's talk about asset location.

So asset location, what it is, is it's basically having the correct investments in the correct accounts.

Different types of investment generate different types of income.

That means capital gains, you generate different types of taxable income.

You have interest which generates taxable income.

You also have dividends and much more to where you would want to make sure.

And this is where we also, when we either are reviewing an account of yours or building someone new up from the ground, we look at what type of investments are in what type of accounts because we also would want to make sure, okay, are these type of investments that we would want to tax loss harvest?

And when we typically do it, um, again, is when we are reviewing or building a portfolio from the bottom.

And why we would do it is because we wanna make sure that they're in the right accounts because we would typically put more growth stocks and dividends in tax free accounts and those that generate a lot of income and a lot of interest in tax free accounts because then when you withdraw, you don't have to pay any taxes on it.

However, in those tax deferred and taxable, we want to make sure that those are being closely monitored and that they aren't pursuing so much in taxable gain for you to then have to pay on later.

Now let's discuss some of the new big beautiful bill uh, regulations that have come into play.

I only wanted to discuss a few, um, that affect this upcoming tax year.

So the first one is the standard deduction increase.

So in 2024 for those who are single, it was 15,000 and now it's been bumped up to 15,750.

And then same for married filing jointly it bumped up 1500 bucks.

It doesn't sound like a lot, but it's better than nothing, right?

It's just saving little by little each tax year to make sure that you can overly save over the course of your lifetime.

And then the next one is the senior bonus deduction.

So what that is, is those who are 65 and older, and this is only through 2026 and 2028, but those who are 65 and older get a \$6,000 deduction on top of their standard deduction.

So that 31,500 if you are married filing jointly plus 12,000.

Well now you just added \$12,000 to your standard deduction, which is 43,500.

If you're married filing jointly and you make more than \$150,000 modified adjusted gross income, it starts to phase out that six grand starts to decrease for 6% every \$1.

So for example, if we have a single person who's making \$80,000 a year, well they just breached through that \$75,000 limit of retaining that \$6,000 deduction.

Well, their \$5,000 over the limit means they get a 6% phase out for every \$1 that they're over.

So you take the 5,000 you times it by the 6%, well now it's \$300 that they don't get to receive as a senior bonus deduction.

So instead of \$6,000 they get to receive 5,700.

This is huge because now you get an additional deduction on top of the standard deduction.

Some final tips and takeaways.

First, you wanna manage and understand your tax bracket and that is something that we also do.

And so if we ever ask to see your 2024 tax returns, um, the reason behind that is because we want to understand where you're at income wise to see if you wanna take a distribution or if you have a large required minimum distribution coming up to see how that's going to affect you.

And then we also make sure that we are doing smart strategic withdrawal sequence for your certain scenario that you're in and you wanna make sure that those Roth conversions are timed.

The reason why I say timed is because typically when you're working, you don't wanna make a large Roth conversion of 60,000 to then add \$60,000 more to what you're already receiving in earned income and then pay charities out of the correct accounts.

So I was working, when I was working for a previous financial planning firm, there was a guy who came in who was donating every single year to this one charity.

Well, he was donating it out of his individual brokerage account, which is taxable, paying capital gains tax on it and then donating those funds to the charity.

Well now he still has to report the taxable income that he took as a distribution.

That is why paying charities out of IRA accounts, you receive that taxable favor in doing those types of qualified charitable distributions.

And then utilize and maximize your losses and gains.

The best time to do this also is to do it towards the end of the year so that way we can kind of see how much capital gains exposure you're in and seeing where we can utilize and maximize those losses and then purposely plan where your investments are held.

So we, again, we do this anytime we're reviewing your accounts.

We do this anytime when we're building a portfolio up from scratch to make sure that the right investments are in the right accounts.

And then if you have any questions whatsoever, go ahead and give us a call.

You can email us directly.

Um, we are more than happy to help you with any questions that you guys have.

Anyways, thank you guys for your time.

I appreciate it and this is our disclosures that we disclose for compliance reasons of the information that we have provided for you today.