

# A Complete Guide to Taxes in Retirement



Are you planning to retire or recently entered retirement and unsure how taxes will impact your income? We're here to help you understand how different sources of retirement income may be taxed and what to expect. From Social Security benefits to capital gains, knowing the tax implications can help you prepare and potentially reduce your tax liability.

Retirement doesn't mean the end of taxes. You may continue to pay taxes on income even after your working years are over, similar to how income tax is applied during employment. Taxes on retirement income vary by source, including Social Security benefits, pensions, and capital gains.

Understanding the tax rules for each income type can help you make informed decisions and minimize what you owe. For instance, Social Security income may be partially or entirely tax-free, depending on your total earnings. Pension income and withdrawals from retirement accounts like IRAs or 401(k)s are usually taxable. Each type of income is subject to specific tax regulations.

In this guide, we'll explore retirement earnings and how they are taxed. Our goal is to help you navigate tax season and plan effectively for your financial future. Keep reading to gain valuable insights into taxes in retirement and strategies for managing them.

## After Retirement Do You Pay Taxes?

Whether or not you pay taxes on Social Security income after retirement depends on your overall income. If Social Security is your only source of income, you may not owe taxes on it. However, if you have additional sources of income, a portion of your Social Security benefits could be taxable.

The IRS uses a formula to determine the taxable portion of your Social Security benefits, which can range from 0% to 85%, depending on your "combined income." Combined income includes your adjusted gross income, non-taxable interest, and half of your Social Security benefits. The taxable amount is calculated annually and will appear on your tax return.

For retirees with significant income from pensions, investments, or other sources, up to 85% of their Social Security benefits could be taxable. On the other hand, retirees with no additional income typically receive these benefits tax-free.

**Quick Tip:** If you anticipate taxable Social Security income, consider tax withholding or making quarterly estimated payments to avoid surprises during tax season.



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\*

Social Security income can either be tax-free or partially taxable, depending on your overall income in retirement. If Social Security is your sole income, you may not owe any taxes on it. However, if you have additional income sources, a portion of your Social Security benefits may be subject to taxation.

The IRS determines the taxable portion of your Social Security benefits using a formula that considers your “combined income.” Combined income includes:

- Adjusted gross income (AGI)
- Non-taxable interest
- Half of your Social Security benefits

Depending on your combined income, up to 85% of your Social Security benefits could be taxable. For instance:

- If your combined income exceeds certain thresholds, you may owe taxes on a portion of your benefits.
- Retirees with high pension or investment income typically pay taxes on the maximum 85% of their benefits.
- Those with no other income often receive Social Security benefits tax-free.

**Planning Tip:** Understanding how Social Security benefits are taxed can help you plan withdrawals from other income sources, potentially lowering your overall tax burden.



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

# Pension Income

Most pension income is fully taxable because contributions were made with pre-tax dollars. This means the entire amount of your pension payments will typically be included in your taxable income for the year.

To make tax planning easier, you can request that taxes be withheld directly from your pension payments. Doing so helps ensure you won't owe a large tax bill at the end of the year. Be sure to set the withholding rate appropriately to align with your expected tax liability.

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

Withdrawals from tax-deferred retirement accounts, such as traditional 401(k)s and IRAs, are taxed at regular income tax rates. Since these accounts were funded with pre-tax contributions, all withdrawals are considered taxable income.

**The amount you owe will depend on:**

- **Your Tax Bracket:** Withdrawals are taxed as ordinary income, so the rate depends on your overall income for the year.
- **Deductions:** If your deductions exceed your income, you may owe little or no taxes on the withdrawals.

**Note:** Withdrawals from Roth accounts, such as Roth IRAs or Roth 401(k)s, are tax-free if the account has been open for at least five years and you are age 59½ or older.

**Planning Tip:** If your income is lower in certain years (e.g., due to high medical expenses or other deductions), it may be an opportune time to make larger withdrawals to minimize your overall tax burden.

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

# Annuity Distributions

Annuities, when held in a tax-deferred account, are subject to specific tax rules. The tax treatment of annuity payments depends on whether the annuity was purchased with pre-tax or after-tax dollars:

- **Tax-Deferred Annuities:** Payments from tax-deferred annuities are taxed as ordinary income.
- **Immediate Annuities:** Payments are split into two parts—principal and interest. The principal portion is tax-free, while the interest portion is taxable.

If you withdraw more than the amount contributed, withdrawals are treated as income and taxed accordingly. For annuities purchased outside a retirement account, the exclusion ratio determines how much of each payment is taxable.

**Tip:** Contact your annuity provider to understand the exclusion ratio and calculate your taxable income accurately.

# Gains With the Selling of Your Home

For many retirees, selling a primary residence can provide significant financial benefits—and often, the gains are tax-free. The IRS offers an exclusion on capital gains from the sale of a primary home, subject to the following conditions:

- **Single Filers:** Gains up to \$250,000 are excluded.
- **Married Filing Jointly:** Gains up to \$500,000 are excluded.

To qualify for this exclusion, you must have lived in the home as your primary residence for at least two of the last five years. If you do not meet this requirement, or if your gains exceed the exclusion limit, you may owe taxes on the excess amount.

**Complex Situations:** If you've rented out your home or used it for business purposes, the rules for excluding gains become more complex. Consulting a tax professional is recommended.

**Planning Tip:** Keeping records of home improvements can increase your cost basis, potentially reducing the taxable portion of any gains.




# Investment Income

Taxes on investment income in retirement work much like they did before. Here's what to keep in mind:

- **Dividends:** Taxable at either ordinary income rates or the lower long-term capital gains rate, depending on the type of dividend.
- **Capital Gains:** Long-term gains (assets held over a year) are taxed at 0%, 15%, or 20%, depending on your taxable income and filing status.
- **Interest Income:** Fully taxable at ordinary income rates.

Income from investments is reported annually via 1099 forms provided by your financial institution. Selling investments may trigger capital gains or losses, which must also be reported.

**Planning Tip:** If your income is below certain thresholds, you may qualify for a 0% long-term capital gains tax rate. Consider working with a tax advisor to strategically time investment sales.



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>

# Managing Taxable Accounts

Taxable investment accounts offer flexibility, but understanding their tax implications can help you optimize your retirement strategy. Here are key considerations:

## Tax on Earnings:

- Interest from taxable accounts is taxed at your ordinary income rate.
- Long-term capital gains and qualified dividends are taxed at a lower rate, ranging from 0% to 20%, depending on your tax bracket.

## Strategic Withdrawals:

- Unlike retirement accounts, taxable accounts don't have required minimum distributions (RMDs) before age 59½, allowing more control over your withdrawals.
- By carefully timing the sale of investments, you can manage the amount of taxable income reported each year.

## Offsetting Gains:

- Capital losses can be used to offset gains, reducing your taxable income. If losses exceed gains, up to \$3,000 per year can offset other income, with the remainder carried forward to future years.

**Tax Optimization Tip:** Consider working with a tax professional to explore methods like tax-loss harvesting, deferring income, and taking advantage of tax credits and deductions. These strategies can help minimize the taxes owed on investment earnings.

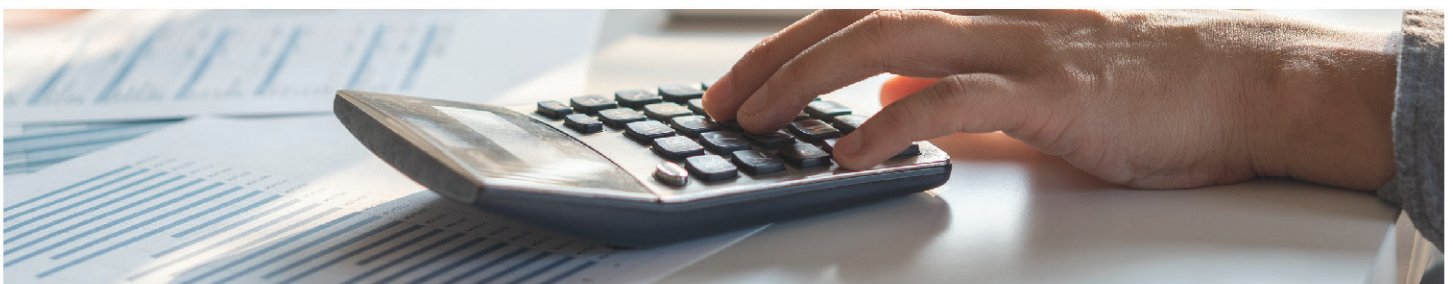
# Investment Strategies to Reduce Taxes

Beyond understanding tax rules, certain investment strategies can help reduce your taxable income:

**Index Funds and ETFs:** These tend to have lower turnover rates than actively managed funds, leading to fewer taxable events and lower capital gains distributions.

## Charitable Contributions:

- Donating appreciated assets, such as stocks, allows you to avoid capital gains taxes while receiving a charitable deduction for the asset's full value.
- Qualified charitable distributions (QCDs) from IRAs for individuals age 70½ or older can also reduce taxable income.



**Tax-Efficient Investments:** Investments like municipal bonds, which generate tax-free income, can be an excellent addition to a retirement portfolio.

**Bunching Deductions:** Grouping multiple years' worth of deductible expenses into a single tax year can increase the tax savings from itemized deductions.

**Smart Planning Tip:** Align your investment strategies with your tax bracket and retirement goals to maximize after-tax returns.



## How to Calculate Your Tax Rate

Your tax rate during retirement depends on the total amount of taxable income and deductions you have each year. To estimate your tax liability, follow these steps:

### **Add Up All Income Sources:**

Include Social Security (use 85% if taxable), pension payments, IRA or 401(k) withdrawals, and any other income such as dividends or capital gains.

### **Subtract Applicable Deductions:**

Use the standard deduction or itemize if it results in greater tax savings. Common deductions include medical expenses, mortgage interest, and charitable contributions.

### **Determine Your Tax Bracket:**

Use your taxable income to find which federal tax bracket you fall into. For example, income is taxed progressively, with higher rates applying only to amounts exceeding specific thresholds.

### **Example:**

Married filing jointly

- Social Security income: \$20,000
- Pension income: \$25,000
- IRA withdrawal: \$15,000
- Capital gains: \$5,000 (not included in regular income calculation)
- Total taxable income: \$57,000
- Subtract standard deduction: \$24,800
- Final taxable income: \$32,200 (12% tax bracket)

**Planning Tip:** Pay taxes quarterly or have taxes withheld from pension payments to avoid penalties and surprises at tax time.

# Now You Know All About Taxes in Retirement

Retirement brings exciting changes, but managing your taxes effectively is crucial to maximizing your income and maintaining financial stability. By understanding how different income sources are taxed and applying smart strategies, you can minimize your tax liability and keep more of your hard-earned money.

From Social Security benefits to investment income, tax planning in retirement requires knowledge and proactive decisions. Consider consulting a tax professional to tailor strategies to your unique situation, ensuring peace of mind during your retirement years.

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