



Obtaining Financial Freedom: Tax Strategies for Retirees

Now that you are either retired or close to retired, preserving your principal while taking a steady income from your investments could be more important than ever. But if you are in a high income tax bracket, the federal government could be waiting to take up to 35 percent of the income you receive from your investments (note: As federal and state tax rules are subject to frequent changes, you should consult with a qualified tax advisor prior to making any investment purchase decisions).

With respect to your IRA money, you could also be at the age (over 70 1/2) where you are required to take minimum distributions (RMD). But each year, do you find yourself sticking the money into a checking account or CD? Although there is something to be said about safety and the FDIC insurance afforded to these investments, it is important to also consider the effects of income taxes and cost of living. In years where inflation is on the rise, you could find that your “after-tax” return is not keeping up with the cost of living.

As a practical matter, municipal bonds could offer an alternative and some tax relief, since the interest is generally received free of federal, state and local income taxes. This could provide more income to help meet retirement needs. Of course, there are exceptions to the favorable income tax treatment for taxpayers that are subject to the Alternative Minimum Tax (AMT) or



who have invested in bonds outside of their state of residence. You should remember that these bonds are backed by the credit of the issuing local government, and the principal and yield on these bonds can fluctuate with market conditions.

On another note, if your beneficiaries receive your IRA money, they will have to pay income taxes on their distributions. Assuming that your IRA grows, this means that the potential income tax liability to your loved ones will also increase. On the other hand, beneficiaries who receive assets that are owned “outside” the IRA will receive them at the fair market value on your date of death. In other words, your beneficiaries receive a “stepped-up” cost basis on the inherited asset. To illustrate this principal, you could have mutual fund shares in your IRA that are worth \$100,000. When the funds are held inside an IRA or other qualified retirement plan, your beneficiaries will eventually pay income tax on the entire value of the shares at their respective tax rate. However, if you own the shares outside an IRA, your heirs could receive and sell the shares without owing any federal income taxes (although federal estate taxes could apply if the decedent’s estate exceeded \$2 million). This is something to consider if you are concerned about the end result of your estate plan.

Still Working and Over 70 1/2?

After you turn 70 1/2, the IRS specifies that you must begin taking Minimum Required Distributions (MRD) from your traditional IRAs. But what if you are still working or have other types of retirement accounts? Will you have to start removing money and



paying more taxes?

Anyone who is over the age of 70 1/2 is required to initiate the liquidation of their IRA, SEP-IRA, and Simple-IRA, regardless of employment status. Roth IRAs, on the other hand, are exempt from this rule and do not have any distribution requirement. The regulations on qualified retirement plans, though, are somewhat more involved.

Qualified plans are those offered through an employer. These can include 401(k)s, 403(b)s, profit sharing, and Keogh plans. If you are an employed participant in such a plan, and over the age of 70 1/2, you can delay the MRD until April 1 of the calendar year after you retire. That is, as long as you do not own 5 percent or more of the business.

There could possibly be more good news for employed seniors who also own IRAs—the government allows rollovers from IRAs to most employer-sponsored qualified plans. This means that if you are required to take MRD from your IRA and still work, you might be able to roll your account into your employer's plan. Then you could temporarily avoid taking distributions and paying the associated income tax.

Even though qualified plans are allowed to accept money from IRA rollovers, they are not required to. Therefore, you should check with your employer's benefit department before you undertake this tax-savings strategy. **HB**

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