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Tax Considerations for Retirees

Rollovers

A rollover occurs when you get a distribution from one qualified retirement plan and you redeposit all (or part) of it into another qualified plan within 60 days. The part you redeposit is not taxed until you begin to withdraw from the new plan.

Be watchful for two problems that occur with rollovers:

1. The nontaxable part of a distribution, such as the after-tax contributions, may be rolled to another qualified plan (under strict procedures) or to a traditional IRA. If only part of a distribution that includes both taxable and nontaxable amounts is rolled over, the amount rolled over is treated as coming from the taxable part of the distribution. Before making this type of rollover, you should confer with your tax advisor.
2. Distributions made directly to you can be subject to income tax withholding (usually 20%). This means that the actual distribution received will be less than 100% of the taxable amount. Rolling over just the amount received often leads to an unwelcome surprise at tax preparation time – i.e., the withheld amount becomes taxable. If tax was withheld, you can still accomplish a tax-free rollover by making up the difference of the withholding with funds from other sources and then wait until you file your tax return to get the withholding back.

Sale of Home/Moving

Sale of Home:

You may choose to sell your home and move to some other area once you retire. Remember, however, if you

meet certain conditions, the law allows you to exclude all or part of your gain. Be sure to check before finalizing a sale to make sure you meet the necessary qualifications.

Moving:

Expenses for moving generally aren't deductible unless you plan to work full-time at your new location for at least one year after the move (two years if you're self-employed). Thus, if you plan full-time retirement in the new location, moving expense will usually be nondeductible.

Estimated Taxes

We have a "pay-as-you-go" tax system in the U.S. This means that the IRS requires you to pre-pay tax on income as you earn it; if you don't pre-pay enough, you could owe an underpayment penalty. Computing tax projections ahead of time can help you find ways to avoid the penalty.

Generally, you will have two options for meeting the pay-as-you-go requirement:

- If you get a pension, ask the payer to withhold income tax on your behalf (in the same manner an employer withholds for an employee); **or**
- Make estimated tax payments on a quarterly basis. Sometimes it is difficult to determine the correct amount of the estimated tax payments in order to avoid the underpayment penalty. The IRS generally requires safe harbor estimate amounts equal to 90% of the current years' tax liability or 100% of the prior year's tax. The 100% safe harbor increases to 110% for taxpayers with incomes in excess of \$150,000 (\$75,000 for married taxpayers filing separately).

Either of these methods is acceptable to the IRS.

Tax Planning

Because this brochure contains only a brief overview of retirement tax considerations and the rules are fairly complicated, you many want more in-depth planning based on your specific situation. This office would be pleased to assist you in any way possible. Please don't hesitate to call for an appointment and to find out more about the services available.

Client Information Series



The advice included in this brochure is not intended or written by this practitioner to be used, and it cannot be used by a practitioner or taxpayer, for the purpose of avoiding penalties that may be imposed on the practitioner or taxpayer.

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If you're retired or near retirement, you've probably already done the homework to ensure you're ready financially. But hopefully your research has not left out the tax ramifications that the transition to retirement usually brings. Every retiree needs an awareness of the possible tax traps they may encounter as their income shifts from reliance on wages or self-employment income to retirement-based pensions, investment income, etc. Lifestyle changes can also pose tax questions – e.g., a home sale and move to a new location. This brochure highlights tax pitfalls retirees should be on the lookout for and offers a few pointers for overcoming them.

Social Security Benefits

Pre-retirement:

If you haven't yet retired but are trying to predict your retirement cash flow, be sure to request an Earnings and Benefit Statement from the Social Security Administration (SSA). It's simple to do – just call the SSA at the number listed in your local telephone directory; ask for Form SSA-7004. Fill out the form, return it to the SSA, and they will send you a projection of the benefits you can expect to receive when you retire. You can also obtain this information online at www.ssa.gov.

Post-retirement:

If you're already receiving social security, try to avoid traps like these that could cause you to pay some of it back:

1. The SSA limits earnings (i.e., wages, commissions, etc.) of retirees who are under the age of 65. If you earn too much during this period, you may lose a portion (possibly all) of your social security. If you think you would like to continue working, it's wise to make a comparison of how loss of benefits in the short-run may affect possible increases in benefits in the future (i.e., because work continuation allows extra contributions to the social security system).

2. The amount of income tax you pay on your social security will depend on your filing status (married, single, etc.) and the level of your income. Be sure to take advantage of tax planning, particularly if you expect fluctuations in your income from year-to-year – planning ahead may help level the ups and downs and cut the amount of your social security that becomes taxable.

3. Watch your investment choices. Tax-free interest from investments like municipal bonds, for example, can increase the amount of your social security income that is taxable. Here again, tax planning is a key factor that can help keep a larger portion of the benefits in your pocket instead of Uncle Sam's.

IRA Accounts

Premature Distributions:

If you are under age 59 1/2, be extremely careful about drawing money from your IRA. A federal penalty of 10% applies to certain premature distributions; some states also assess a penalty. However, there are safe methods of withdrawing IRA funds before age 59 1/2. For example, withdrawals of substantially equal periodic payments based on your life expectancy (or the lives of you and a beneficiary) may prevent the IRS from assessing the penalty.

Minimum Distributions:

You will only be able to contribute to an IRA as long as you receive compensation and you are under age 70 1/2. At age 70 1/2, you must begin taking at least minimum distributions from your account*; otherwise the IRS can assess a penalty. Your minimum required distribution (MRD) is determined by using a factor based on your age from an IRS table called the "MDIB Annuity Table." If your spouse is your beneficiary and is at least 10 years younger, you may use the Joint Life & Last Survivor Table instead. To determine the minimum distribution amount, divide the balance of your IRA account on Dec. 31 of the prior year by the factor from the appropriate annuity table. If you have multiple IRA accounts, they are all treated as one for the purposes of this computation.

**Note: Required minimum distributions (RMD) are suspended for the 2009 tax year. However, this does not include RMD for 2008 that were deferred until 2009.*

Choosing A Beneficiary:

A beneficiary is someone you choose to receive your IRA in the event of your death. You may choose your spouse, your child(ren), a friend, etc. Choosing a beneficiary also plays a big part in how the IRA is distributed at your death. Be sure to consider the choice carefully before making a final decision.

Pension Plan Distributions

At retirement, you may be faced with many decisions about your pension plan (either employer-provided or your own self-employed plan). Any number of options are usually available for these payouts, among them:

An Annuity:

An annuity provides a regular income over a period of time; it is generally paid in monthly installments. However, the term over which an annuity is paid varies, depending on how you choose to have payments made. For example, your employer will probably ask if you want your pension paid over a 10-year period, over your lifetime, over the combined lives of you and your beneficiary, etc.

When you receive an annuity from a plan to which you made contributions that have already been taxed, a part of each annuity payment you receive is nontaxable. This is called your "investment in the contract." When you have an investment in the contract, special calculations are necessary to determine how much of your annuity will be taxable.

Lump Sum Distribution:

You may be eligible for a special tax computation called "averaging" if you were born before 1936 and receive the entire balance in your retirement plan within one tax year. Such payments are referred to as lump sum distributions and generally qualify for 10-year averaging. Consideration must be given to whether it is better to utilize this special averaging, which requires the tax to be paid up front, or to roll your distribution into an IRA.

Net Unrealized Appreciation:

Some retirees get pension distributions in the form of company stock that has appreciated in value while it remained in the pension plan – this is termed "net unrealized appreciation." Stock distributions can create special tax problems. If you receive one, it's a good idea to check with your tax advisor about the best way to handle it.