PARACLETE
WEALTH PARTNERS

TAX STRATEGIES FOR RETIREMENT

UNDERSTAND YOUR TAX CHOICES



This brochure is designed to provide valuable information and is not intended to offer specific tax advice. Your unique situation will dictate whether any financial product or strategy this article describes is right for you. We encourage you to consult with a qualified professional before making any decisions about your personal situation.

Taxes can affect retirees in a variety of ways, like state income taxes, estate taxes, and Social Security taxes, to name a few. The most common tax — the one that all retirees will deal with — is the federal income tax. For this reason, we'll focus primarily on the federal income tax's effect on individuals planning for retirement. Also, be aware that in order to have a financially comfortable retirement, you should understand and plan for all potential taxes.

THE IMPORTANCE OF TAX EFFICIENCY

A common way people save for retirement is to contribute pre-tax money into an IRA or a 401(k) plan (a qualified account). And if you're still working, contributing money into an employer-sponsored retirement plan can help you exclude contributions from your taxable income. Why? The growth in qualified retirement plan accounts is not subject to federal income taxes. However, you will start paying those taxes once you withdraw money from the account at the ordinary income tax rate.

For example: In retirement, your taxable income is **$40,000** and you withdraw **$4,000** from the qualified account. Your taxable income bumps up to **$44,000**. Preparing for these taxes will help you get ahead in your retirement planning so you retain as much income as possible.

TAKING REQUIRED MINIMUM DISTRIBUTIONS (RMDS)

The federal government requires that most people must start taking RMDs at a certain age — even if they already have enough income to live on.[1] If you must take an RMD while earning income from a job, you may move into a higher income tax bracket. So, you'll want your tax strategies to account for this additional money.

PAYING THE RMD PENALTY TAX

Choosing to not withdraw the RMD from your employer sponsored or other qualified retirement plan can create financial consequences. The IRS could require a 25% tax of the amount you don't withdraw. For example, if your RMD is $20,000 and you do not withdraw anything from your retirement plan, your assessed tax penalty could be $5,000 (25% of $20,000). And you will still owe regular income tax on the money when you take it out of the plan. You could lower this excise tax if you correct this distribution within two years (to as low as 10%).[2]



TAXING YOUR SOCIAL SECURITY BENEFITS

Whether your Social Security benefits are taxable depends on your total taxable income, Social Security benefits, and marital status. Generally, if your only retirement income is from Social Security, then your benefits will not be taxable. You also may not have to file a federal income tax return. However, if you receive income from other sources (creating combined income), your taxability changes.

To avoid paying federal income taxes on your Social Security benefits, your combined income must be below the base amount for your filing status.



BASE AMOUNTS [3]

TAXPAYER	INCOME LEVEL
Married filing jointly	Below $32,000
Individual	Below $25,000
Married filing separately (and lived together during tax year)	Probably pay some tax

To estimate if you'll need to pay taxes on your Social Security benefits, use the IRS online tool for taxpayers.

TAX STRATEGIES

REPOSITION ASSETS

The more wealth you have today, the more it may make sense to move some money from Buckets 1 and 2 to Buckets 3 and 4. Doing so could decrease the taxes you pay in the future.

DIVERSIFY TAXES

Tax diversification is a strategy that spreads your assets across a mix of taxable, tax-deferred, and tax-free accounts. The goal is to minimize the effect of taxes on your retirement funds.

FOUR BUCKETS:
THE TAX CONTINUUM

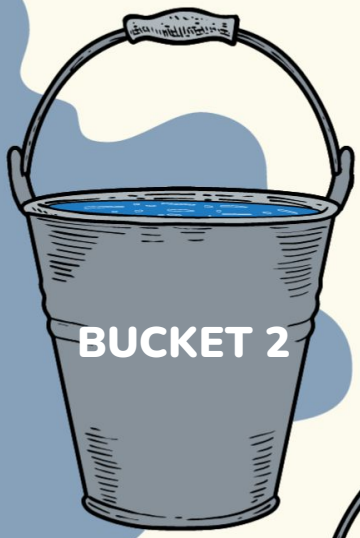
You can visualize the impact of taxes on your money by dividing your assets into four buckets.



BUCKET 1: TAXABLE

The Taxable Bucket represents accounts you typically receive a Form 1099 for each year, such as:

- Interest from certificates of deposit (CDs)
- Dividends and taxable distributions from mutual funds held in nonqualified accounts
- Dividends and capital gains from stocks
- Interest and capital gains from bonds
- Reinvested dividends



BUCKET 2: TAX DEFERRED

The Tax-Deferred Bucket may include:

- Traditional IRA
- 401(k), 403(b), 457(b)
- Qualified and nonqualified annuities
- Appreciation of unsold mutual funds and securities
- Savings bonds



BUCKET 3: INCOME TAX FREE | ESTATE TAXABLE

The Income Tax Free / Estate Taxable Bucket includes:

- Roth IRA
- Municipal bonds
- Appreciation of capital assets held until death
- Life insurance (if properly structured)



BUCKET 4: INCOME TAX FREE | ESTATE TAX FREE

The Income Tax Free / Estate Tax Free Bucket includes items found in Bucket 3 used to fund:

- Irrevocable life insurance trusts (ILIT)
- Charitable trusts

CONVERTING TO A ROTH IRA

Will your income tax rates be higher in retirement than they are now? Then you may want to consider converting money from traditional IRA and qualified plan assets (Bucket 2 – Tax Deferred) to a Roth IRA (Bucket 3 – Tax Free). You can strategically convert limited amounts each year to control your income tax result.



Keep these notes in mind:

- You'll pay income taxes on the converted amount in the year you did so.
- Tax payments on Roth IRA conversions that you make from a qualified plan are considered additional distributions and will have taxes and penalties for distributing prematurely. So, you probably want to pay taxes from different sources, like income you receive from a job.
- Income limits exist that cap who's allowed to contribute to a Roth IRA, so conversions can help workaround these limits.

Because converting a traditional IRA or other qualified assets to a Roth IRA is a taxable event and could result in additional impact to your personal tax situation, including (but not limited to) a need for additional tax withholding or estimated tax payments, the loss of certain tax deductions and credits, higher taxes on Social Security benefits and higher Medicare premiums, you should be sure to consult with a qualified tax advisor before making any decisions regarding a potential Roth conversion.

ADVANTAGES OF A ROTH IRA

Here are some potential advantages of investing into Roth IRAs:

- Tax-free withdrawals don't impact the taxable status of your Social Security benefits.[4]
- You may have more investment options than an employer-sponsored retirement plan.[5]
- The investments have no RMD obligations during the taxpayer's lifetime.[6]

Any money in a Roth IRA will be considered part of your estate for estate tax purposes - placing it firmly in Bucket 3.

CREATING RELIABLE INCOME WITH PARTIAL TAXATION



Reliable lifetime income is becoming increasingly more important because retirees are living longer, and they need their retirement income streams to last. To this goal, another tax strategy is to reposition taxable assets from Bucket 1 (Taxable) to Bucket 2 for tax-deferred growth and partially taxable distributions.

For example, you could use a CD to purchase a nonqualified annuity. An annuity is a long-term retirement investment and a contract between you and an insurance company. You make a lump-sum or a series of deposits into the contract. In return, the insurer agrees to pay interest on the deposits and immediately make periodic payments to you or at some point in the future. Benefits include:

- Tax-deferred growth potential
- Death benefit during the accumulation phase
- Income-payout options (when you're ready) backed by the issuing insurance company's financial strength and claims-paying ability
- Possible help in reducing your overall market risk

ADDRESSING ESTATE PLANNING – BUCKET 4

FEDERAL GIFT TAXES AND ESTATE TAXES:
These are one unified tax credit, and the amounts change during tax years. Any gift tax exemptions you use during your lifetime will reduce your available estate tax exemption upon your death.

IRREVOCABLE LIFE INSURANCE TRUST (ILIT):
Your spouse and your children may be (and usually are) beneficiaries of an ILIT. You can reposition assets from Bucket 1 (Taxable) to Bucket 4 (Income and Estate Tax Free), and as part of your annual gift exclusion, transfer assets to the ILIT that you will use to pay life insurance policy premiums. Structured properly, life insurance death proceeds will be both income- and estate tax free. Limitations exist, so be sure to consult with a qualified estate planning attorney and insurance professional.



CONCLUSION

Your unique financial situation will determine which investments and tax strategies meet your specific retirement planning goals. Working with an experienced financial professional and your tax advisor can help you know what's right for you.

In general, the more taxes you pay in retirement, the more income you'll need to pay those taxes and live comfortably. By addressing your financial buckets, you can optimize tax results while you both save money and distribute that money in retirement. The goal is the help you pursue the retirement lifestyle you desire.



SOURCES

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* Annuities are long-term, tax-deferred insurance products intended for retirement purposes. Any withdrawals may be subject to income taxes and, prior to age 59 1/2, a 10-percent federal penalty tax and state penalty taxes may apply to the taxable amount. Withdrawals from annuities will affect both the cash value and the death benefit.

Investing involves risk, including the potential loss of principal. Any references to protection benefits or lifetime income generally refer to fixed insurance products, not securities or investment products. Insurance and annuity product guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company.

We are an independent financial services firm helping individuals create retirement strategies using a variety of investment and insurance products to custom suit their needs and objectives.



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CONTACT US

paracleteusa.com
(757) 238-5005 | 700 Tech Center Pkwy Suite 200-36 Newport News VA 23606

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