

Tax Arbitrage in Your Sixties

Your sixties are the very best time to defuse the tax time-bomb ticking away in your IRAs and 401(k)s.

If you're like many of our clients, you've diligently contributed to your IRA, 401(k) or other qualified retirement account for years. In most cases, those contributions were made on a tax-deferred basis. Money contributed to the plans did not have to be reported on your income tax return.

If you invested wisely, your account balance continued to grow and compound tax-deferred. And if you waited to age 59 ½ to tap your nest egg, you avoided the 10 percent penalty early withdrawals.

Tax-deferred does not mean tax-free. Sooner or later, Uncle Sam wants his money. Starting at age 73 (or age 75 if you were born in 1960 or later) the IRS mandates that you take Required Minimum Distributions (RMDs) from your IRAs and other qualified plans. For folks fortunate enough to have saved \$1 million in their retirement accounts, the first-year RMD is more than \$37,000 – all taxable. If you live in state with high income taxes, like Oregon or California, taxable IRA withdrawals become downright painful.

Your sixties provide a unique window to re-arrange your finances and reduce your long-term tax liability. Starting at age 59 ½, you can take distributions from your IRAs and 401(k)s without penalty. Starting at age 73 (or 75 if born in 1960 or later) you must take your RMDs. In between those two milestones you have total freedom to take as much, or as little, from your IRAs as you'd like. Coincidentally, these are also the years when your earned income usually drops. You retire, drop down to part-time work or start a new venture that doesn't make much money at all.

Here are a few ways that may help turn your sixties your Golden Years:

- Delay Social Security to age 70. There are lots of good reasons to delay Social Security. The most important is the survivor benefit for younger or lower earning spouses. Let's say Bob was the primary breadwinner while his wife, Sue, raised the family. Sue got a job outside the home after the kids left home but she never earned as much or paid into Social Security for as many years as Bob. Bob will have the higher Social Security benefit by far. If Bob delays Social Security to age 70 he'll claim his maximum benefit. And if



he dies before Sue, she'll get the higher of the two Social Security benefits. Because Bob delayed until age 70, Sue will get a much higher benefit as a widow in her late eighties.

- Convert all or a portion of your IRA to a Roth IRA during the low-income years between the day you retire and the day you start collecting Social Security. You might also be able to make Roth conversions up until you have to start taking RMDs. You'll pay income tax on the amount you convert, but you're likely to be in the lowest tax bracket of your retirement years. (Note: This doesn't work as well if you have to use IRA money to pay the taxes. It's better to pay the taxes from another source.) Some folks convert their IRA to a Roth all at once, but it may make more sense to do it over a period of years. You'll want to consult with your tax advisor before moving ahead.
- Alternatively, you can make heavier withdrawals from your IRAs in your sixties, knowing that the income will be replaced by Social Security when you turn 70.
- The whole point is to withdraw or convert IRA funds while you are in a lower tax bracket, and reduce the amount you'll be forced to take out once you hit RMD age. Limiting IRA withdrawals after you start Social Security may have the added benefit of making less of your Social Security income taxable. Double win!

To really explore the tax arbitrage opportunity in your sixties, it pays to sit down with a Certified Financial Planner™ who has access to sophisticated tax-planning software.

Wealth Enhancement does not provide legal advice or tax services. Please consult your legal advisor or tax advisor regarding your specific situation



Disclosures

Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual. Traditional IRA account owners have considerations to make before performing a Roth IRA conversion. These primarily include income tax consequences on the converted amount in the year of conversion, withdrawal limitations from a Roth IRA, and income limitations for future contributions to a Roth IRA. In addition, if you are required to take a required minimum distribution (RMD) in the year you convert, you must do so before converting to a Roth IRA.