Rochester Wealth Strategies

439 S Main St, Suite 250
Rochester, MI 48307
(248) 434-6550

The Retirement Savings Time Bomb

By Dominic Garcia

This is the title of a great book written by Ed Slott, CPA, who is considered an expert on IRAs. Slott talks in extensive detail about how people may be surprised to realize the tax liability they may face later in life. Most of the population is under the impression that once they retire, their tax rate should decrease. While this is the case for some, it is not the case for many. Let's discuss a few factors that could lead to an increased tax liability.

The first reason for most people is required minimum distributions (RMDs). It is common that when someone retires, there may be a few years when their tax bracket goes down. However, when you begin taking RMDs, these distributions are counted as income, which in turn could bump you back into that higher tax bracket. Often, we see people jump from a 12% tax bracket to a 22% tax bracket because of this requirement. With the new RMD rules adjusting the required age to 73 (age 75 in 2033), your money can grow for longer. However, more time in the market could translate to a larger distribution and a higher tax rate. There are also new rules surrounding inherited IRAs. If you are receiving an inheritance from an IRA, this money may have to be distributed much faster than in years past.

Another factor is simply having more income in retirement. Much of the baby-boomer generation has been blessed with pensions from their previous employers. Some are lucky enough to have multiple pensions from both spouses. Now add this to social security, retirement account withdrawals, investment income, rental income, and potentially part-time work, a retiree may find themselves in a position with substantial income. Moreover, if you are a business owner, you may be one of the many who have no plans to sell their business but instead would prefer to live off the continued income as you slow down to enjoy life.

Imagine if one spouse passes away. The Widow(er)'s Tax Penalty is often overlooked but is sure to have a negative impact on retirement savings. The surviving spouse could be faced with a tax rate that is nearly double that of what it was when they were filing joint tax returns.

Although we expect to take level withdrawals over our lifetime, life rarely goes as planned. Based on our experience, you may need more money in one year than another. Whether this be for a home remodel, a gift to a family member, a memorable trip, or an unexpected purchase, there is always something that may compel you to take more out of your retirement accounts in any given year. Larger withdrawals usually mean larger tax bills.

The last factor relates to changes in the tax code. You may have heard that the Tax Cuts and Jobs Act will be expiring soon. This means that tax rates are set to go up in 2026. For example, someone who is in the 24% bracket can expect to jump up to a 28% bracket.

All of these factors must be considered when planning for taxes in retirement. Fortunately, there is much that can be done to navigate and help reduce your lifetime tax bill. We look forward to sharing more about these strategies in future articles.