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The Retirement Savings Sweet Spot

by Dominic Garcia

There is much talk about taxes going up. With the nation's deficit rising and the endless amount of stimulus being pumped into our economy, it is safe to say that the government will eventually have to take measures to either slow down or, ideally, pay down its responsibilities. In recent proposals, politicians have made it clear that they are going to target the wealthy. Whether it be increasing tax brackets, raising the capital gains rate, or reducing the estate tax exemption, there is a lot of speculation on the table that could soon become reality.

So, what can you do and when is the best time to do it? The most optimal time is usually between when you retire and before you start taking RMDs. When you first retire, there is a good chance that you may be in a lower tax bracket. That said, when you turn 72, you will be forced to take distributions from your IRA/401(k). Depending on the size of your assets, those distributions may once again increase your tax bracket. Another factor to consider is when you should start receiving Social Security. If you are able to hold off on collecting Social Security early in retirement, you will have more freedom to take advantage of the following strategies.

Start thinking about Roth conversions or in-plan conversions. The more money you can get into Roth accounts, the less at risk your assets will be to government intervention. Regardless of what the naysayers believe, it would be very difficult for new laws to affect dollars that have already been taxed, let alone go back on promises that have already been made. It is important to understand that when doing Roth conversions, you should use your savings or taxable accounts to cover the tax liability. It would not make sense to pay these taxes with money from your retirement account.

What if you have plenty of money, but decide to work part-time as a means to stay active? You may now have a unique opportunity to make the most of a lower tax bracket by contributing the bulk of your paycheck into a Roth 401k and/or Roth IRA(s). The goal is to get as much money in those tax-free buckets as possible. Remember that you can always draw from the accounts, as needed, after age 59½.

Why not consider paying capital gains tax? Not only are rates historically low, but if you are married filing jointly and have taxable income of under $80,800, your federal tax on long-term capital gains could be 0%. House democrats are now proposing a top federal rate of 25% on long-term capital gains. When combined with a 3.8% Medicare surtax and a Michigan state tax of 4.25%, married couples making over $450,000 could eventually pay over 33% on the sale of appreciated assets. Be careful, as the proposal also suggests that the new rate would apply to any gains realized after September 13th, 2021.

Proper planning during this period could significantly reduce the tax liability not only for your retirement, but for your beneficiaries as well.

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