Money Matters

July 1, 2016

Skloff Financial Group Question of the Month:
Top 10 Tips to Reduce Taxes On Retirement Accounts
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Q: I am a recent retiree and my spouse is considering retirement. Can we avoid unnecessary taxes on our retirement accounts?

The Problem – Paying Unnecessary Taxes on Retirement Accounts
You have worked hard your whole life. You have also responsibly saved so you can enjoy your retirement and leave a financial legacy. Some of those savings are in tax advantaged retirement accounts. Now, the IRS wants you to take withdrawals from some of your retirement accounts so they can collect taxes and reduce the size of your financial legacy.

The Solution – Reduce Taxes on Retirement Accounts and Increase the Size of Your Financial Legacy
Fortunately, there are a number of ways to reduce taxes on retirement accounts. Let's review the top 10 tips below.

1. Avoid Taxes Completely with Roth IRAs. All withdrawals from Roth Individual Retirement Accounts (IRAs) are tax free for the original owner and their beneficiaries. If that not were not good enough, Required Minimum Distributions (RMDs) do not apply to the original owner of Roth IRAs or to spousal beneficiaries. But, RMDs apply to non-spousal beneficiaries. Avoiding or postponing RMDs can avoid or reduce your taxes and increase the size of your financial legacy.

2. Avoid Taxes Completely with Roth 401(k)s, Roth 403(b)s and Roth 457(b)s. All withdrawals from Roth 401(k)s, Roth 403(b)s and Roth 457(b)s are tax free for the original owner and their beneficiaries. But, RMDs apply to owners and beneficiaries. Fortunately, rolling over Roth 401(k)s, Roth 403(b)s and Roth 457(b)s to Roth IRAs avoids RMDs for the original owner of Roth IRAs and spousal beneficiaries. The RMD rules for Roth IRAs are the same as described in tip number one.

3. Avoid Taxes Completely by Converting After Tax 401(k) and 403(b) Contributions to Roth IRAs. Convert after tax 401(k) and 403(b) contributions before they have a chance to appreciate to tax free Roth IRAs. The RMD rules for Roth IRAs are the same as described in tip number one.

4. Avoid Taxes Completely by Working or Returning Back to Work and Leaving Money in Your 401(k), Roth 401(k), 403(b), Roth 403(b), 457(b) or Roth 457(b). If you are still working or return to work beyond the age of 70 ½ (when RMDs normally begin) and you participate in one of these plans, you are exempt from RMDs on those balances (as long as you do not own more than 5% of the employer sponsoring the retirement plan).

5. Rollover IRAs into Your 401(k), 403(b), and 457(b) Where You Work. Applying tip number four, you can also rollover IRAs into your employer plan and avoid RMDs.

6. Withdrawal Only RMDs on Retirement Accounts, Not More. Instead of withdrawing from retirement accounts that generate taxes and could bump you up to the next marginal income tax rate bracket, simply withdraw your RMDs and preserve your financial legacy.

7. Convert 401(k)s to Roth 401(k)s, 403(b)s to Roth 403(b)s and 457(b)s to Roth 457(b)s. Although converting pre-tax retirement account balances to their Roth counterparts is a taxable event, doing so in small increments could allow you to maintain your current income tax bracket. These conversions are ideal for taxpayers who can convert at a lower tax rate today compared to an estimated higher tax rate on withdrawals in the future. The RMD rules for Roth IRAs are the same as described in tip number one.

8. Convert Traditional IRAs, SEP IRAs and SIMPLE IRAs to Roth IRAs. Although converting pre-tax retirement account balances to Roth IRAs is a taxable event, doing so in small increments could allow you to maintain your current income tax bracket. These conversions are ideal for taxpayers who can convert at a lower tax rate today compared to an estimated higher tax rate on withdrawals in the future. The RMD rules for Roth IRAs are the same as described in tip number one. Evaluate a Backdoor Roth IRA.

9. Sell Your Losers in Your Taxable Investment Accounts. You can reduce your income and offset retirement account income by up to $3,000 per year if you have more capital losses that capital gains on your taxable investment portfolios. Take advantage of market dips to lock in your losses, but be mindful of wash sale rules on repurchasing the same investments. Your heirs generally won't have to worry about your reduced cost basis on the newer purchases since they receive a stepped-up basis when they inherit your portfolio when you pass away.

10. Donate to Charities. You can donate up $100,000 per year, including RMDs, to charities directly from your IRAs on a tax free basis.

Action Steps – Reduce Taxes on Your Retirement Accounts and Increase Your Financial Legacy
Work closely with your Registered Investment Adviser (RIA) to determine the best approaches to reduce taxes on your retirement accounts and increase your financial legacy.

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