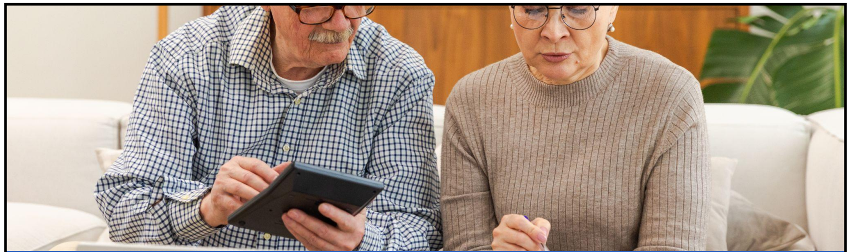

Taxes in Retirement

FEDIMPACT
Retirement Training by PROFEDS

Taxes in Retirement

Welcome

- » About today's topic
- » Our audience today
- » Q&A – the ProFeds Support Team standing by
- » Handouts – available for download
- » Recorded – how to get the replay
- » Stay until the end!

Taxes in Retirement

Your ProFeds Presenter

FEDIMPACT
Retirement Training by PROFEDS

Chris Kowalik

- » ProFeds Founder
- » Developer of the FedImpact Retirement Workshop
- » Host of the FedImpact Podcast

Support Team

- » Standing by for your questions

Taxes in Retirement

Taxes in Retirement

Understand the tax implications of retiring and what steps to take today to be ready when it happens

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Taxes in Retirement

Agenda

- **TAX BRACKETS:** How your tax bracket may or may not change when you retire
- **TAX TREATMENT:** What federal benefits will be taxed and how
- **TAX CHANGES:** When to expect significant changes to the taxability of federal benefits

Taxes in Retirement

What this webinar will NOT cover

Taxes in Retirement

What this Webinar Will NOT Cover

- We're not here to give tax advice (just tax awareness)
- We won't be able to cover every tax issue that you will experience in retirement (these are just the highlights on your federal benefits)
- We have no idea what your tax situation looks like, so seek professional help in executing a tax strategy that suits you
- We assume you have a basic understanding of benefits

Taxes in Retirement

TAXES IN GENERAL

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Taxes in General

- Taxes are a very real part of retirement and should be a very real part of financial planning
- Ignoring the tax monster doesn't make it go away
- Not all money is taxed in the same way or at the same time
- The most successful retirees have a solid tax strategy in place to ensure they don't pay more tax than absolutely necessary

Today's Session on Taxes Will Highlight

- CSRS/FERS Pension
- Survivor Benefit
- FERS Supplement
- Social Security
- Health Insurance (FEHB)
- Life Insurance (FEGLI)
- Long-Term Care (FLTCIP)
- Thrift Savings Plan (TSP)

TAX BRACKETS

How Tax Brackets Work

- We have a progressive tax system where the tax rate increases as the taxable amount increases
- The term "progressive" refers to the way tax progresses from low to high
- The result is that a taxpayer's average tax (amount they paid / amount they earned) is less than the person's tax bracket

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Taxes in Retirement

How Tax Brackets Work

- We currently have 7 tax brackets:
  - 10%, 12%, 22%, 24%, 32%, 35%, 37%
- Each bracket has 4 different filing statuses:
  - single,
  - married filing jointly,
  - married filing separately, and
  - head of household

Taxes in Retirement

How Tax Brackets Work

Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household
10%	$0 – $11,000	$0 – $22,000	$0 – $11,000	$0 – $15,700
12%	$11,001 – $44,725	$22,001 – $89,450	$11,001 – $44,725	$15,701 – $59,850
22%	$44,726 – $95,375	$89,451 – $190,750	$44,726 – $95,375	$59,851 – $95,350
24%	$95,376 – $182,100	$190,751 – $364,200	$95,376 – $182,100	$95,351 – $182,100
32%	$182,101 – $231,250	$364,201 – $462,500	$182,101 – $231,250	$182,101 – $231,250
35%	$231,251 – $578,125	$462,501 – $693,750	$231,251 – $346,875	$231,251 – $578,100
37%	$578,126+	$693,751+	$346,876+	$578,101+

Taxes in Retirement

An Example

- Let's see how the progressive tax is applied to a single person who has $100,000 of taxable income
  - What tax bracket are they in?
  - How much tax do they owe?
  - What is their average ("effective") tax rate?

Taxes in Retirement

Rate	Taxable Income	Calculation	Owed
10%	$0 – $11,000	10% of taxable income	**$1,100**
12%	$11,001 – $44,725	+ 12% of the amount over $11,000	**$4,047**
22%	$44,726 – $95,375	+ 22% of the amount over $44,725	**$11,143**
24%	$95,376 – $182,100	+ 24% of the amount over $95,375	**$1,100**

- What tax bracket are they in? **24%**
- How much tax do they owe? **$17,400**
- What is their average ("effective") tax rate? **17.4%**
  That is, $17,400 / $100,000 = 17.4%

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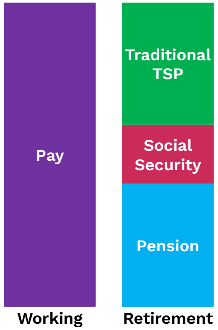
Taxes in Retirement

Why Retirement Rarely Means a Lower Tax Bracket

» Example of the general concept
- You have a final taxable pay of $100,000 right before you retire
- You start to receive your pension of $30,000
- You're missing $70,000 of lifestyle and need to pull in from other sources
- If the $70,000 is all taxable, you're right back in the same bracket!



Taxes in Retirement

How Can You Actually Be in a Lower Tax Bracket?

» There are only two reasons you end up in a lower tax bracket in retirement:
- You have less money (so you pay less tax), or
- You have taken steps NOW to give yourself access to money that is NOT TAXED when you receive it LATER
  - This takes a concerted effort to build a strategy
  - Why your CPA might be the wrong person to ask

Taxes in Retirement

FEDERAL PENSIONS (CSRS & FERS)

Taxes in Retirement

CSRS & FERS Pensions

» Your contributions to CSRS or FERS
- This is an involuntary contribution (a percentage of your pay) that you are required to make into your retirement system
  - CSRS (7.0%)
  - CSRS Offset (0.8%)
  - Blank
  - FERS / FERS Transfers (0.8%)
  - FERS – RAE hired in 2013 (3.1%)
  - FERS – FRAE hired after 2014 (4.4%)
- Law Enforcement Officers, Firefighters & Air Traffic Controllers pay an additional 0.5% amount to above percentages

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CSRS & FERS Pensions

- The contributions YOU made to the CSRS or FERS system were made with after-tax money (meaning, you paid tax on that money – you did not get a tax advantage in the year you contributed the money)
- Since you already paid the tax on the money when it went IN, you do NOT pay tax on that money when it comes OUT in the form of your pension

CSRS & FERS Pensions

- In addition to what YOU contribute to CSRS/FERS, there are two other parts that make up your pension:
  - The contributions YOUR AGENCY made to CSRS or FERS on your behalf
  - The GROWTH on both what YOU & YOUR AGENCY contributed
- ALL of this money IS taxable when it comes out in the form of your pension

CSRS & FERS Pensions

- Federal taxes
  - The vast majority of the CSRS/FERS pension is taxable as ordinary income
  - The small portion that is not taxable represents the money YOU contributed to the CSRS/FERS funds while working
  - The tax-free portion is calculated by OPM (1099-R)

CSRS & FERS Pensions

- State taxes
  - CSRS/FERS pensions are typically treated as ordinary income at the state level
  - Retiree-friendly states
    - Some states do not tax any income for any resident
    - Some states specifically do not tax CSRS/FERS pensions

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Taxes in Retirement

No income tax & (therefore no taxation of CSRS/FERS pensions)	
Alaska	Tennessee
Florida	Texas
Nevada	Washington
New Hampshire	Wyoming
South Dakota	

Source: State Tax Departments

Taxes in Retirement

With income tax, but specifically excludes taxation of the entire CSRS/FERS pensions	
Alabama	Louisiana
Hawaii	Massachusetts
Illinois	Mississippi
Iowa	New York
Kansas	Pennsylvania

Source: State Tax Departments; In addition, five states (Kentucky, Michigan, North Carolina, Oklahoma and Oregon) exempt certain federal pensions from taxation. Some exemptions depend on the taxpayer's age or dates of government service.

Taxes in Retirement

CSRS & FERS Pensions

- When thinking about where you will live in retirement
  - Carefully consider all of the factors before relocating to a particular state (state income tax is only one of many factors)
  - At the state level, you will be taxed in the state in which you reside when you receive the money (and has no bearing on the state you lived in when you retired)
  - Living overseas in retirement has its own tax complications, so consider that fully before moving

Taxes in Retirement

SURVIVOR BENEFIT PLAN (SBP)

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Taxes on Survivor Benefits

- This program allows roughly half of the pension to be protected for the spouse (upon the retiree's death) and costs the retiree roughly 10% of their pension
  - Taxes on premium you pay:
    - You will NOT pay tax on what you pay each month to have this benefit (it is simply not reported as income to you in retirement)
  - Taxes on benefit your spouse receives:
    - Your spouse WILL be taxed on all of the benefit that they receive from this program after you die

Taxes on Survivor Benefits

- Example of a FERS retiree with a $2,000/mo pension:
  - Taxes on premium you pay:
    - Protecting $1,000/mo for spouse (upon retiree's death)
    - Cost is $200/mo while federal retiree is living (10% of pension)
    - Retiree would be taxed on $1,800 of income (not $2,000)
  - Taxes on benefit your spouse receives:
    - When your spouse receives the $1,000/mo, it is fully-taxable

FERS SPECIAL RETIREMENT SUPPLEMENT (SRS)

FERS Special Retirement Supplement

- This program allows for most FERS employees who are retire under the age of 62 to receive a benefit "similar" to Social Security from when they retire until reaching age 62
- This benefit is taxed as ordinary income and treated just like the CSRS and FERS pension at the federal and state levels

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FERS Special Retirement Supplement

- You will not receive this benefit while OPM is processing your retirement claim, but you will receive retroactive payments
- Tax issues often arise with the delayed payment of the missed SRS payments (perhaps it is paid in the next tax year which may push you into a new tax bracket)

SOCIAL SECURITY (SS)

Paying into Social Security & Medicare (FICA taxes)

- While working
  - Most employees contribute 6.2% of their gross pay of “earned income” into Social Security & 1.45% into Medicare
- Upon retirement
  - FICA taxes are no longer paid into Social Security or Medicare (because you do not have new “earned” income as a retiree)

Taxes on Social Security Benefits

- Federal taxes
  - Generally, up to 85% of your SS benefits are taxable
  - Taxes are NOT automatically withheld, but you may request:
    - On your initial application for SS benefits, or
    - At a later point in time (you may only choose 7%, 10%, 12% or 22%)

Voluntary Withholding Request
W-4V

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Taxes on Social Security Benefits

- State taxes
  - States decide whether to tax SS benefits at the state level
  - The SSA does not have the authority to withhold state income tax from the SS benefit
  - If you are in a state that requires taxes to be paid on SS benefits, you must make payments directly to the state

Taxes on Social Security Benefits

States who tax some portion of Social Security benefits		
Colorado	Montana	Utah
Connecticut	Nebraska	Vermont
Kansas	New Mexico	West Virginia
Minnesota	North Dakota	
Missouri	Rhode Island	

Source: State Tax Departments

FEDERAL EMPLOYEE HEALTH BENEFITS (FEHB)

Taxes on FEHB Premiums

- Taxes vary on FEHB premiums
- How it works:
  - While working, you pay FEHB premiums with pre-tax dollars
  - In retirement, you pay FEHB premiums with after-tax dollars

Once retired, the premium is the same, but it sure FEELS more expensive!

Example:

If you're in a 24% tax bracket in the BCBS High Self Plus One (premium: $8,290/yr)

Pre-tax cost: **$8,290/yr**

After-tax cost: **$10,908/yr**

Your NEW tax burden as a retiree is $2,618!

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Taxes on Flexible Spending Accounts

» A Health Care Flexible Spending Account is a great way to set aside pre-tax money to be used exclusively for qualified medical expenses
  - FSAs are only available to you while you are working
  - FSAs are not available to retirees (any remaining funds are forfeited on your retirement date)

FEDERAL EMPLOYEE GROUP LIFE INSURANCE (FEGLI)

Taxes on FEGLI

» This program allows you to elect up to roughly 6x your salary to be paid out when you die:
  - Taxes on premium you pay:
    - You will pay tax on what you pay each month to have this benefit
  - Taxes on benefit your spouse receives:
    - Your beneficiaries WILL NOT be taxed on any of the benefit that they receive from this program after you die

FEDERAL LONG TERM CARE INSURANCE (FLTCIP)

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Taxes on FLTCIP

- This program allows you to elect coverage to be paid out if you need long-term care services:
  - Taxes on premium you pay:
    - You will pay tax on what you pay each month to have this benefit
  - Taxes on benefit you receive:
    - You WILL NOT be taxed on any of the benefit that you receive from this program when you need care
- NOTE: OPM has suspended the FLTCIP (no new applications allowed)

THRIFT SAVINGS PLAN (TSP)

Taxes on TSP

- There are several tax points in TSP that are worth covering today:
  - Taxes on contributions, distributions and loans
  - The concept of tax diversification
  - Taxes on "Required Minimum Distributions"
  - Taxes for your beneficiaries

Taxes on TSP Going IN & OUT

- Money going IN
  - How you are taxed "today" depends on which tax bucket you select for new contributions:
    - Traditional TSP and/or Roth TSP
- Money going OUT
  - How you are taxed "later" depends on which tax bucket you choose to pull from in retirement:
    - Traditional TSP and/or Roth TSP

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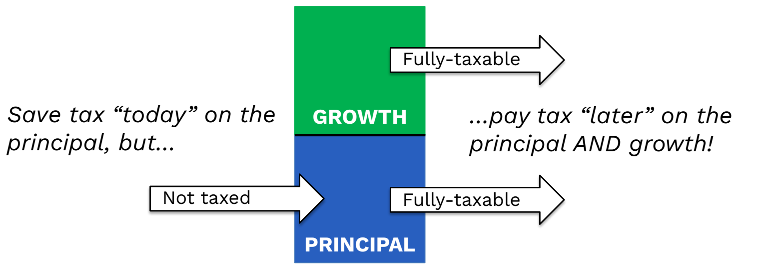
Taxes in Retirement

Tax-Advantaged Options in TSP (TRADITIONAL)

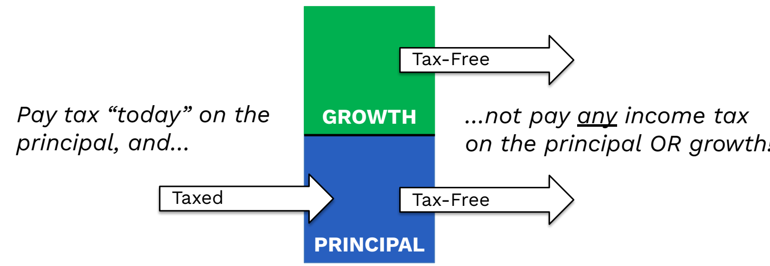
When $$$ goes in — When $$$ comes out



Taxes in Retirement

Tax-Advantaged Options in TSP (ROTH)

When $$$ goes in — When $$$ comes out



Taxes in Retirement

Taxes on TSP Withdrawals

States who do NOT tax TSP withdrawals		
Alaska	New Hampshire	Tennessee
Florida	Mississippi	Texas
Illinois	Pennsylvania	Washington
Nevada	South Dakota	Wyoming

Source: State Tax Departments

Taxes in Retirement

Taxes on TSP Loans

» While you are permitted to take loans against your TSP account, doing so is counterproductive given that this is a retirement asset and not a “now” asset

» If you’ve taken a TSP loan,
  - Once retired/separated, you may now continue paying it back or it will be declared taxable
  - Be prepared to be taxed TWICE! (“but Chris, are you sure?!”)

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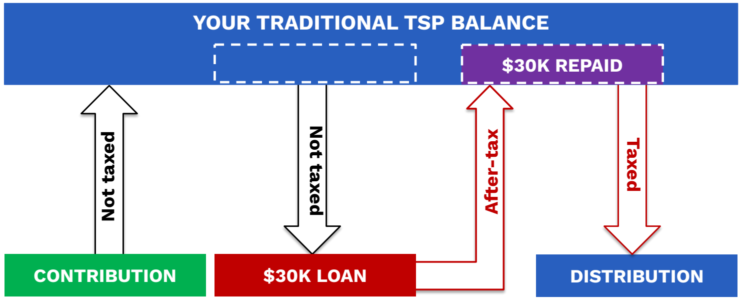
How You Are Taxed Twice on a TSP Loan



Tax Diversification

» Concept:

- Have different buckets of money to choose from that are taxed differently in retirement
- Choose <u>when</u> and <u>how</u> to take money from each bucket based on tax environment
  - When taxes are <u>low</u>, take $$$ from taxable account (Trad)
  - When taxes are <u>high</u>, take $$$ from tax-free account (Roth)

Required Minimum Distributions

» The IRS requirements

- The IRS mandates that by "April 1st of the year following the year you reach age 72 (or separate from government service, whichever is later)" you must begin taking money from tax-deferred accounts (like Traditional IRAs and TSP) and pay your taxes
- The percentage of your account that you must take each year <u>increases</u> based on your age (starting age 72 at 3.65%, age 73 at 3.77%, age 74 at 3.92%, and so on)

Required Minimum Distributions

» Traditional TSP

- RMDs are required to be taken each year

» Roth TSP

- Historically, RMDs were required on Roth TSP accounts
- Beginning January 2024, RMDs will no longer be required on Roth TSP accounts

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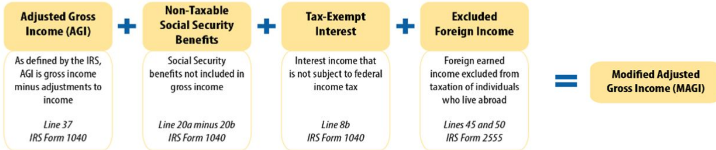
Taxes in Retirement

TSP's Effect on Medicare Costs

- » Medicare Part B premiums are based on your Modified Adjusted Gross Income (not just income earned in a given year)



- » Money you take from TSP is used to determine your MAGI!

Taxes in Retirement

TSP's Effect on Medicare Costs

Medicare Part B Premium Table (2023)

If your **2021** tax return was filed...			Your **2023** monthly premium is:
INDIVIDUAL	**JOINT**	**MARRIED & SEPARATE**	
$97,000 or less	$194,000 or less	$97,000 or less	**$164.90**
$97,001 - $123,000	$194,001 - $246,000	Not applicable	$230.80
$123,001 - $153,000	$246,001 - $306,000	Not applicable	$329.70
$153,001 - $183,000	$306,001 - $366,000	Not applicable	$428.60
$183,001 - $499,999	$366,001 - $749,999	$97,001 - $403,000	$527.50
$500,000+	$750,000+	$403,000+	$560.50

Taxes in Retirement

Taxes on TSP After You Die

- » If you name someone OTHER THAN your spouse as the beneficiary, when you die:
  - They are not permitted to keep money in the TSP
  - They can choose to:
    - Take all of the money in cash (and pay taxes "now"), and/or
    - Transfer the money to an "Inherited IRA" that allows them to take money out over the next 10 years (and pay taxes along the way)

Taxes in Retirement

Taxes on TSP After You Die

- » The most common beneficiary election: a spouse
- » Example of a common scenario:
  - Husband is the federal employee
  - Wife is the beneficiary of the TSP
  - He dies, the account is transferred to a "Beneficiary TSP Account" in wife's name (and defaults to the L Fund aligned with their age)
  - She names kids as beneficiaries, then she dies
  - Kids must take money lump-sum (and pay taxes "now")

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WRAP-UP & NEXT STEPS

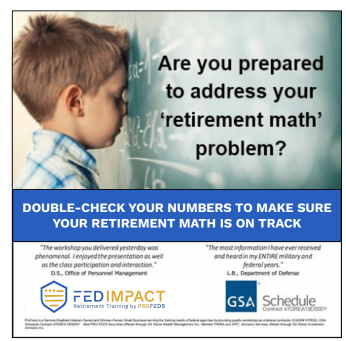
Wrap-Up

- Each of these tax scenarios that we've talked about today can affect one another and your overall tax obligation
- Without a tax strategy, you are likely to pay more taxes than necessary (and who wants that?!)

Wrap-Up

- Taxes are complicated, but we have more choices than we may think to control our tax situation in retirement
- There are LOTS of options to put yourself in a more favorable tax situation, so be proactive
- Remember, taxes are a very real part of retirement and should be a very real part of financial planning

How does this fit into the bigger picture?



- Attend a workshop:
  - In-person training
  - No cost to attend
  - Covers all of the federal benefit topics and decisions to be made
  - One-on-one help available
- See all the details at: FedImpact.com/Attend

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Handouts and Replay

» Handouts
  - Download
  - Emailed
» Replay
  - Link will be emailed to all registered participants

Taxes in Retirement

Next Webinar

» Next webinar topic!
  - **What are the Odds? Planning for Long Term Care**
    Exploring your options to weather the financial storm of needing extra care as you age – even in the absence of a government solution
» Sign-up at: FedImpact.com/Webinar

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