Utilizing Low Income Years After Retirement

Planning options prior to Social Security and Required Minimum Distributions

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We often receive questions from clients concerning the decision to delay social security benefits until the maximum age of 70. This is a decision that requires consideration of your other assets and personal health situation. When we make the decision to delay receiving Social Security benefits, it often opens up the possibility of other planning opportunities. You may be able to consider delaying benefits if you have sizable non-qualified (non-tax advantaged) portfolios from which you can rely on to meet your lifestyle needs prior to supplementing this income with a Social Security benefit or distributions from tax advantaged assets. These lower income years may allow you to recognize capital gains on the investments in your non-qualified investment accounts and possibly convert traditional IRA assets to a Roth IRA.

If you are a client who will be relying primarily on the distribution of non-qualified assets to meet your lifestyle needs, you may be able to recognize long term capital gains on the sale at 0% long-term capital gains rates. Depending your your financial situation, we may recommend the recognition of gains above what is needed to fund your lifestyle in order to take advantage of the 0% capital gains rate offered by the current tax code. For clients who are married, long-term capital gains are taxed at 0% up to the top of the 15% federal tax bracket (taxable income of $74,900 in 2015). Utilizing this strategy allows for a free step-up in cost basis in the non-qualified account. However, once you begin receiving Social Security benefits and required minimum distributions, this strategy is usually not available given your higher level of federally taxable income.

Another strategy we can utilize during lower income years is to convert a portion of a traditional IRA to a Roth IRA thus converting taxable assets into tax-free assets. Again, depending your your situation, we may recommend this conversion to take advantage of the early retirement years where some additional income can be added to your federal tax return at potentially a 0% tax rate. If you are taking lifestyle distributions from non-qualified accounts and are recognizing minimal capital gains to do so, you may find that you are not taking full advantage of the standard deduction and personal exemption amounts. In 2015, a married couple has a standard deduction of $12,600 and personal exemptions of $4,000 each. This shelters the first $20,600 of income from taxation.

Retirees not currently receiving Social Security benefits or mandatory retirement distributions might find a small Roth IRA conversion advantageous if it can be done for no additional tax cost. Even small conversion amounts over a series of a few years can add up to a nice tax-free pool of assets. In addition, these assets are a great way to pass monies on to the next generation free of income tax liability.

Both of these strategies should be considered if you are a client who is temporarily in a low taxable income situation. By reviewing your tax returns, we can be sure to capitalize on these opportunities which will ultimately save you money, and allow us to provide greater value through proactive tax management.