

# Taxes in

# Retirement

## Consider Paying it Forward!



What will be your **biggest expense in retirement**? Many would guess healthcare or housing. In fact, taxes tend to be the biggest expense that most middle class and affluent retirees face. The reason? With no kids at home, a mortgage paid down or paid off, and no longer funding tax deductible 401Ks and employment related expenses leaves less to write off. Your social security, pensions and distributions from retirement accounts (especially if you have been a good saver) might even put you at a higher income level and with it, a higher tax bracket. With a little forethought and planning, however, you could end up keeping more of your money in lieu of paying the tax man.

Wouldn't it be a lot easier to account for retirement taxation BEFORE you stop working? YES, of course! Better yet, wouldn't it be nice to retire comfortably on a tax-free retirement? Of course. For many savvy retirees it is indeed possible.

The phrase "tax free retirement" might sound too good to be true, but, if you plan strategically, it may be possible. By paying the majority of your taxes during your working years or the first few years into retirement (while presumably in a lower tax bracket), you could live out your retirement years without having to worry that Uncle Sam will come to drain your nest egg each year. You may have to pay taxes on pensions and some of your Social Security but with most of your living expenses coming from tax free sources, you probably won't be hitting the higher tax brackets like those who are cashing out IRAs, 401ks, stocks and bonds, and other deferred investment vehicles to finance their retirement.

### The 3 most common tax-free retirement strategies: Roth IRAs

Perhaps the most widely known way to reduce taxes in retirement is using the Roth IRA. Rather than paying taxes on the money when you withdraw it, you pay taxes on the principal amount when you make the contribution, or when you convert some traditional IRA funds to a Roth account. Not only do you avoid paying taxes on withdrawals later on, you won't be paying taxes on the growth of the account. You pay some tax now, but you may avoid paying a lot more tax later.

### Municipal Bonds

Another typical way retirees try to reduce taxes is buying Municipal Bonds (munis). You can buy them and earn around 2%-3% per year. Muni bonds are considered low risk, but they are not necessarily safe or "tax-free". Any income from these types of investments are not taxable directly, but still count toward your overall (provisional) income, which can lead to

your Social Security being taxed more, as well as your Medicare payments to be higher. So, while muni bonds may be "tax-free" they could still have an impact on your overall tax liability.

### Life Insurance Retirement Plan (LIRP)

Life Insurance products are often overlooked as tax planning tools, possibly because most people associate Life Insurance with death benefits and not tax efficient income. In fact, Life Insurance can provide many benefits that make them king when it comes to retirement and tax planning. Compared to the first two options, Life Insurance, when funded correctly, can provide a nice stream of tax-free income, with less overall risk than other popular fixed income investments. They can offer guarantees, provide extra benefits for Long Term Care and terminal illness, while leaving a tax-free benefit to your heirs.

The money placed into a Life Insurance Retirement Plan (we call them LIRPs) grows tax free, with a potential to earn much higher rates of return than muni bonds, CDs and other low risk investments. If you choose to take income from the cash value of your LIRP, it will not count as provisional or taxable income, which can help you reduce or avoid paying taxes on your Social Security, and reduce your chances of having higher Medicare payments.

The two potential drawbacks to using a LIRP, is that you have to be healthy enough to pass underwriting in order to be approved, and you must be able to afford an efficient amount of coverage for a LIRP to work optimally. More often than not, if you are looking for safe investments and guaranteed retirement income with built in tax breaks, you will find the LIRP will work for you.

All sound retirement plans should take into account your future tax liability because it's what you keep that really matters. If you are interested in a complimentary tax analysis and strategy session to learn more about Roths, Munis, or LIRPs, call us at 520-780-9059.

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Mr. Jeff Vogan Jeff P Vogan, RFC, CEP is a Registered Investment Adviser with Premiere Wealth Advisors, LLC. He can be reached at (520) 780-9059.

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