Cape Gazette
Covering Delaware's Cape Region

Pay lower taxes in retirement with proper planning

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June 2, 2022

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Delawareans know the envy of neighbors over sales tax. Many retirees choose Delaware, in part, to enjoy its tax benefits, but taxes are still a fact of life. So, how can an individual determine when they're paying too much? While every person’s situation is different, here are some tips that any retiree looking to save should take time to consider.

First, make withdrawals strategically. Retirees often have income coming from many different accounts. Some of them will be tax-deferred accounts, and it may be advantageous to delay withdrawals from those as long as possible, thus limiting one's taxable income each year. Some people also have a non-taxable withdrawal account such as a Roth IRA and a taxable withdrawal account such as a 401K. In this case, it's helpful to defer making withdrawals from the 401K for as long as possible to keep from moving into a higher tax bracket and having a higher tax bill.

Next, max out the tax bracket. For example, if Paula Q. Retiree has a large IRA and still has some wiggle room before she maxes out a current tax bracket, she should consider withdrawing funds from that IRA in the current year. Yes, she will be taxed on the money she withdraws, but only at her current tax rate. For each year Paula can reduce the amount of an IRA, the less money she will have to pay in taxes in the future.

Moving on, consider how to reduce expenses. The less money a retiree must put out each month is less money he or she has to withdraw from retirement accounts. Pete J. Retiree can talk with his accountant to see what type of tax hit he might take if he paid off major expenses such as a car note, a mortgage – if he still has one – and other bills that aren't part of monthly living expenses. Pete may find taking one big tax hit to eliminate those bills means a much lower tax liability in the future, as he will need far less money to live on from month to month.

Deduction bunching is another way to minimize taxes. Try pulling some deductions into the current tax year to help minimize overall tax liability. An example would be bunching two years' worth of charitable giving into a single year to get over the itemized deduction threshold. Granted, this technique might put an undue strain on cash flow and savings, but it is an option for those who can afford it. With those extra charitable deductions, retirees can maximize their deductions for the current tax year.

Minimizing taxes on Social Security benefits can also be helpful. Social Security benefits are taxed based on a retiree's combined income. If Jane K. Retiree is married filing jointly and her income is below $32,000, she won't have to pay taxes on her Social Security benefits. If she's single and her income is below $25,000, she won't have to pay Social Security benefits taxes, either. As her taxable income increases, however, she will have to pay higher taxes on her Social Security benefits.

Some will benefit from considering moving to a Roth IRA to help reduce future tax liability. The move can also help shrink future minimum IRA distributions. To see if this strategy will work, individuals can mock up a tax return in the fourth quarter and see how much money they can remove before pushing into a higher tax bracket.

In tax planning, expertise makes all the difference. To minimize taxes and not pay more than is needed, it's important to get the advice of a good local advisor with a specialty in tax planning.

Len Hayduchok is the director and owner of Dedicated Financial Services. As a fiduciary and Certified Financial Planner, he offers his wealth of experience to guide others through the mire of financial and retirement planning. As a Certified Life Coach, he pairs his financial expertise with a heart to help others who want to make the most of their retirement plan. Investment Advisory services are offered through SGL Financial LLC.