

# How Tax Planning Changes Through Four Stages of Retirement

People often pay more in taxes than expected because a confusing system treats various income types differently, and contains hidden taxes and penalties.



## FOUR STAGES OF RETIREMENT

Stage	Ages	Description
Pre-retirement	50–60	Work and save years
Early retirement	60–70	Go-go years
Middle retirement	70–80	Go-slow years
Late retirement	80+	No-go years

## RETIREMENT SURPRISES

- ✓ **Inflation:** People view their future costs in current dollars and don't anticipate how those costs will grow with inflation.
- ✓ **Longevity:** People may end up living longer than they expect, which requires more money.
- ✓ **Expenses:** People underestimate how much they need to maintain their pre-retirement standard of living.
- ✓ **Health care:** People don't realize how much of their savings will be spent on health costs.

## KEY #1:

You have to know what your after-tax retirement savings picture looks like **BEFORE** retiring.

- ✓ If you save \$500,000 in your 401(k)/IRA, it's not really \$500,000. Taxes must be paid.
- ✓ If you're already retired, you'll want to start evaluating next year's potential tax bill before you start tapping assets in the new year.

## KEY #2:

Social Security and Medicare have “tax traps” and you need to plan for them, too.

- ✓ IRA withdrawals can cause the taxation of Social Security benefits, and push taxpayers into a higher marginal tax rate.
- ✓ Higher income (i.e. withdrawing assets) can cause potentially hundreds of dollars a month extra in Medicare premiums.

## KEY #3:

**You must plan how and when you will use taxable, tax-deferred, and tax-free assets to manage your income and tax brackets efficiently.**

- ✓ Consider starting to draw down IRAs now, so that your required minimum distributions (RMDs) won't have as large an effect on Social Security taxation and Medicare premiums.
- ✓ Also consider "filling your tax bracket" in lower income years through Roth conversions or selling appreciated stock, to take advantage of a lower tax rate.
- ✓ Think about donating your RMDs directly to charity to avoid paying income tax on the distributions, through what is known as a qualified charitable distribution (QCD).

## KEY #4:

**Organize your assets for your family's benefit—estate planning still matters!**

- ✓ If you have a terminal illness, make sure to think about step-up basis strategies.
- ✓ There are multiple ways to leave IRAs as an inheritance; you need to make sure your heirs get the best and easiest transfer.
- ✓ Long-term care is a major concern for many people. You need to plan how you will fund this likely expense, and still leave an inheritance for your heirs.

**SOLUTION:** Because your tax exposure will change throughout retirement, you need a tax strategy that:

- ✓ Anticipates how and when you tap assets to cover your personal expenses.
- ✓ Understands the range of taxes you will face at various stages.
- ✓ Manages your actions so you pay as low a tax rate as possible.

**Jason Vitucci, CFP®, EA**  
**Financial Advisor**  
**Vitucci Integrated Planning**

2890 N. Main St., Suite 201  
Walnut Creek, CA 94597

(925) 370-3750

[jason@vitucciPlanning.com](mailto:jason@vitucciPlanning.com)  
[www.vitucciintegratedplanning.com](http://www.vitucciintegratedplanning.com)



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# Key Tax Changes

From the Tax Cuts and Jobs Act\*

**Jason Vitucci, CFP®, EA**  
Financial Advisor  
Vitucci Integrated Planning

2890 N. Main St., Suite 201  
Walnut Creek, CA 94597

(925) 370-3750

jason@vitucciPlanning.com  
www.vitucciintegratedPlanning.com



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TOPIC	NEW LAW	OLD LAW	COMMENTS
Tax deductions you counted on in the past may have been eliminated or changed			
<b>Income tax brackets</b>	7 brackets: 10–37%	7 brackets: 10–39.6%	Changes to paycheck withholding may need to be made
<b>Standard deduction</b>	\$12,200 (single) / \$24,400 (married filing jointly)	\$6,350 (single) / \$12,700 (married filing jointly)	Personal exemption is eliminated
<b>Alternative Minimum Tax</b>	\$71,700 (single) / \$111,700 (married filing jointly)	\$54,300 (single) / \$84,500 (married filing jointly)	Since most households will take the standard deduction, they will be less likely to pay the AMT
<b>Medical expenses</b>	Can deduct expenses that exceed 7.5% of Adjusted Gross Income (AGI)	Could deduct expenses that exceeded 10% of AGI	Originally the lower floor was for 2017 and 2018, but was extended permanently
<b>Miscellaneous itemized deductions</b>	Eliminated	Could deduct moving expenses, investment fees, tax prep fees, casualty loss, etc.	Deductions were only permitted if they were at least 2% of AGI
<b>Inflation measurement</b>	Cost of living calculated by the Chained Consumer Price Index	Cost of living calculated by the Consumer Price Index	Chained CPI rises more slowly, meaning credits and deductions will be less valuable over time
<b>Charitable giving</b>	Cash contributions can be deducted up to 60% of AGI	Could only be deducted up to 50% of AGI	Taxpayers may deduct qualified cash contributions up to 100% of AGI for 2020 and 2021
Where you live makes a big difference in how you are affected by the new rules on deducting state and local taxes (SALT)			
<b>SALT deduction</b>	Deduction is limited to \$10,000 for all state, local, property, and sales taxes. No inflation adjustment.	Unlimited ability to deduct SALT	High-tax states will feel the pinch. Some state governments are pursuing alternatives.
<b>Mortgage interest</b>	Can deduct interest on mortgage debt up to \$750,000; home equity loan interest is not deductible unless used in connection with home acquisition or improvement	Could deduct interest on mortgage debt up to \$1 million; could deduct the interest on up to \$100,000 of home equity loans	Increased homeownership costs need to be considered when buying a home

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TOPIC	NEW LAW	OLD LAW	COMMENTS
Family-related tax rule changes regarding children, education, high-earning couples, divorce, retirement, and estate planning may need your attention			
<b>Child tax credit</b>	Receive a credit of \$2,000 per child, \$1,400 is refundable; phases out at \$200,000 (single) / \$400,000 (married filing jointly)	Received a credit of \$1,000, only partially refundable; phased out at \$75,000 (single) / \$110,000 (married filing jointly)	This applies to children 17 or younger at the end of the year, \$500 credit for other dependents
<b>529 plans</b>	Can distribute \$10,000 per year for private K-12 education	Distributions only allowed for post-secondary education	You can also roll over a 529 plan to a 529 ABLE account
<b>Alimony</b>	Alimony is no longer deductible for the payer nor is it considered income for the payee	Alimony was tax deductible for the payer and taxed as income for the payee	This applies to agreements executed after 2018
<b>Roth IRAs</b>	Not allowed to recharacterize a Roth IRA conversion	Could reverse a Roth conversion by tax due date	Will need to plan conversions more carefully
<b>Retirement plans</b>	Participants in a 401(k) or 403(b) plan have until the tax due date to repay or roll over a plan loan upon leaving the firm	Participants in a 401(k) or 403(b) plan had 60 days to repay or roll over a plan loan upon leaving the firm	If the loan is not rolled over or repaid it can go into default, triggering penalties and taxes
<b>Estate tax exemptions</b>	Top rate of 40% on estates over \$12M for individuals and \$24M for married couples (with portability)	Top rate of 40% on estates over \$5.6M for individuals and \$11.2M for married couples (with portability)	Only 8 in 1,000 estates are expected to owe federal estate taxes
Businesses face new opportunities regarding how they pay taxes and what deductions and depreciation they can claim			
<b>Corporate tax rate</b>	Top rate of 21%	Top rate of 39%	Corporate AMT is eliminated
<b>Pass-through income</b>	Small business owners receive a 20% deduction for pass-through business income	Small business owners paid income taxes based on the rate for individuals, up to 39.6%	The deduction phases out beginning at \$170,050 (single) / \$340,100 (married filing jointly)
<b>Expensing business assets</b>	Can expense \$1 million on business assets	Could only expense \$500,000 of business assets	Changes to bonus depreciation and section 179 also give businesses more options for expensing property and equipment

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