VETSHUB
VETERAN WORK & ENTERPRISE CENTERS

RELIANCE
INSURANCE & ADVISORY

THIS WEBINAR SPONSORED BY

Marco Capaldi
Managing Director
Reliance Insurance & Advisory
117 Bellevue ave. ste. 200A Newport, RI 02840 (401) 206-4446

Tax Planning for Federal Retirees: It's What You Keep That Counts

Presented by Marco Capaldi
Federal Benefits Expert

Closed Captioning (CC) is available on the recorded version of this webinar.

Agenda

Income Tax Basics

How Federal Benefits Are Taxed

Stealth Taxes

Should You Delay TSP Withdrawals

Making the Most of Charitable Contributions

Isolating Basis

RELIANCE
INSURANCE & ADVISORY

Income Tax Basics

Income Tax Basics

US Tax System

- Progressive tax system
  - Tax rate increases as taxable income increases
- Seven tax brackets
  - Ranging from 10% to 37%
- Consists of a web of complex rules and regulations

Income Tax Basics

Marginal Tax Brackets

2022 Income Tax Brackets						
Marginal tax rate	Single			Married filing jointly		
10%	$0	to	$10,275	$0	to	$20,550
12%	$10,276	to	$41,775	$20,551	to	$83,550
22%	$41,776	to	$89,075	$83,551	to	$178,150
24%	$89,076	to	$170,050	$178,151	to	$340,100
32%	$170,051	to	$215,950	$340,101	to	$431,900
35%	$215,951	to	$539,900	$431,901	to	$647,850
37%	$539,901		or more	$647,851		or more

Income Tax Basics

Key Figures and Terms to Know

Total income

- Taxable money earned from all sources, including wages, retirement plan withdrawals, pension, rental income, etc.

Above-the-line deductions

- Deductions subtracted from total income to calculate AGI

Adjusted gross income

- Result after subtracting above the line deductions from Total Income

Below-the-line deductions

- Either the standard deduction or itemized deductions

Taxable income

- Money that is earned that is subject to taxation

Income Tax Basics

Income Isn’t Created Equal

Ordinary income is taxed at marginal tax rates

but

Not all income is ordinary

Income Tax Basics

Types of Investment Income

- Interest income
  - Ordinary income
- Dividends
  - Nonqualified – ordinary income
  - **Qualified – 0%, 15% or 20%**
- Capital gains
  - Short-term – ordinary income
  - **Long-term – 0%, 15% or 20%**

2022 Qualified Investment Income Tax Brackets		
Tax rate	Single	Married filing jointly
0%	$0 to $41,675	$0 to $83,350
15%	$41,676 to $459,750	$83,351 to $517,200
20%	$459,751 or more	$517,201 or more

How Federal Benefits Are Taxed

How Federal Benefits Are Taxed

How Retirement Income Is Taxed

- CSRS and FERS annuities
  - Taxed as ordinary income
  - Employee contributions are received tax-free

- Social Security benefits
  - Up to 85 percent of benefits are taxable as ordinary income

How Federal Benefits Are Taxed

How Retirement Income Is Taxed

- Traditional Thrift Savings Plan
  - Contributions made with pre-tax money*
  - Earnings grow tax-deferred
  - Withdrawals are fully taxable as ordinary income*

* State rules vary

How Federal Benefits Are Taxed

How Retirement Income Is Taxed

- Roth Thrift Savings Plan
  - Contributions made with after-tax money
  - Withdrawals of contributions are always tax-free
  - Withdrawals of earnings are tax-free only with a qualified withdrawal
  - Consist proportionately of contributions and earnings
- Qualified Roth withdrawal*
  - Older than 59 ½, and
  - Roth account open for five or more years

* May elect TSP withdrawal to come 100% from Traditional TSP to avoid non-qualified withdrawal

Stealth Taxes

Key Tax Rates to Understand

Marginal tax rate

The tax rate you pay on an additional dollar of income

Vs

Effective marginal tax rate

The true tax rate paid on an additional dollar of income

Income Tax Basics

Marginal Rate vs. Effective Marginal Rate

- Marginal rate = Tax rate paid on next dollar of income
- Effective marginal rate = True tax rate paid on next dollar of income
  - Additional income may trigger taxes on capital gains and dividends
  - Additional income may trigger stealth taxes
    - Loss of credits and/or deductions
    - Social Security tax torpedo
    - Income related monthly adjustment amount (IRMAA)
    - Net investment income tax

Income Related Monthly Adjustment Amount

IRMAA

- Medicare Part B premium adjustment
- Based on modified adjusted gross income (MAGI)
  - Includes tax-free interest
  - Does not include tax-free Roth withdrawals
- Based on MAGI from two years prior
- 2022 premium based on 2020 MAGI
- Recalculated each year*

2022 Part B Premium (Based on 2020 MAGI)

Individual	Married filing joint	Married filing separate	2021 premium
$91,000 or less	$182,000 or less	$91,000 or less	$170.10
$91,001 to $114,000	$182,001 to $228,000	Not applicable	$238.10
$114,001 to $142,000	$228,001 to $284,000	Not applicable	$340.20
$142,001 to $170,000	$284,001 to $340,000	Not applicable	$442.30
$170,001 to $499,000	$340,001 to $749,999	$91,001 to $408,999	$544.30
$500,000 or above	$750,000 and above	$409,000 and above	$578.30

* Can be appealed

Income Related Monthly Adjustment Amount

Married couple, age 66, filing jointly

	No TSP Withdrawal	With TSP Withdrawal	Difference
TSP Withdrawal	$0	$50,000	$50,000
Pensions and Annuities	$128,750	$128,750	-
Social Security (Gross $25K)	$21,250	$21,250	-
Adjusted Gross Income	$150,000	$200,000	$50,000
- Standard Deduction	- $27,800	- $27,800	-
= Taxable Income	$122,200	$172,200	$50,000
Federal Tax Liability	$18,381	$29,381	$11,000
IRMAA		$1,426	$1,426
Marginal Rate	22.0%	22.0%	
Effective Marginal Rate			24.9%

Social Security Tax Torpedo

Impact of the Social Security Tax Torpedo

Year 2025 Projection: Married couple, age 66, filing jointly

	No TSP RMD	With TSP RMD	Difference
Interest income	$18,951	$18,951	-
TSP Required Minimum Distribution	$0	$19,928	$19,928
Pensions and annuities	$29,891	$29,891	-
Social Security (gross $74,179)	$41,642	$58,581	$16,939
Adjusted gross income	$90,484	$127,351	$36,867
- Standard deduction	- $30,285	- $30,285	-
= Taxable income	$60,198	$97,065	$36,867
Federal tax liability	$6,788	$12,052	$5,264
Marginal rate	12.0%	22.0%	
Effective marginal rate			26.4%

Stealth Taxes

Net Investment Income Tax

- Additional 3.8% tax on investment income
- Interest, dividends, capital gains*
- Tax is based on the lessor of
  - Amount AGI exceeds $250,000 ($200,000 for single tax filers)
  - Net investment income

* Not an exhaustive list. See www.irs.gov for additional details

Stealth Taxes

Net Investment Income Tax Examples

- Married filing jointly
  - AGI = $260,000
  - Investment Income = $20,000
  - Tax = 3.8% x $10,000 = $380
- Single
  - AGI = $260,000
  - Investment Income = $20,000
  - Tax = 3.8% x $20,000 = $760

Should You Delay TSP Withdrawals Until Required Minimum Distributions?

Required Minimum Distributions

Impact of Required Minimum Distributions (RMDs)

Begin the year participant turns 72, or

- The year participant separates from service, if later

RMDs apply to both traditional TSP <u>and</u> Roth TSP

- May take RMD attributed to Roth balance from traditional balance

Required beginning date (RBD)

- Deadline for taking first RMD
- <u>April 1 following the year participant turns 72</u>
- Exception if still working
  - BD is April 1 following year of retirement
  - Applies only to current employer's retirement plan

<u>RMDs due by December 31 every year thereafter</u>

Required Minimum Distributions

Impact of Required Minimum Distributions (RMDs) (cont.)

SECURE ACT 2.0

- Increased RMD age from 72 to 73, beginning 2023
- RMD age increases to 75 in 2033
- Beginning 2024, Roth TSP no longer subject to RMDs

Required beginning date (RBD)

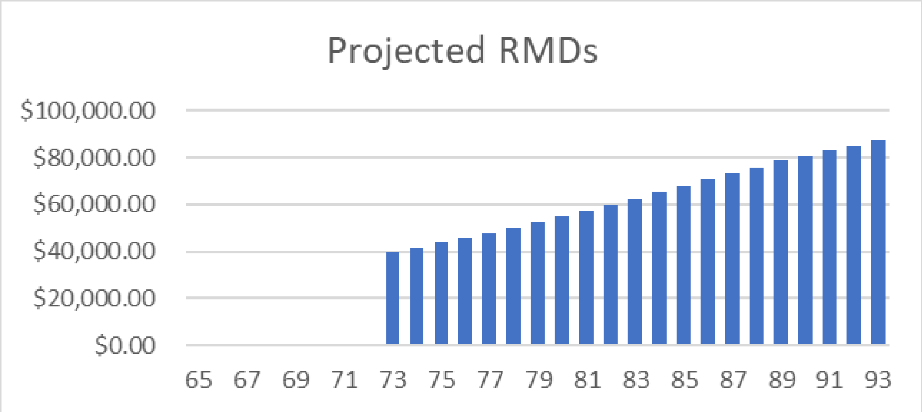
- Deadline for taking first RMD
- <u>April 1 following the year participant turns 73</u>
- Exception if still working
  - RBD is April 1 following year of retirement
  - Applies only to current employer's retirement plan

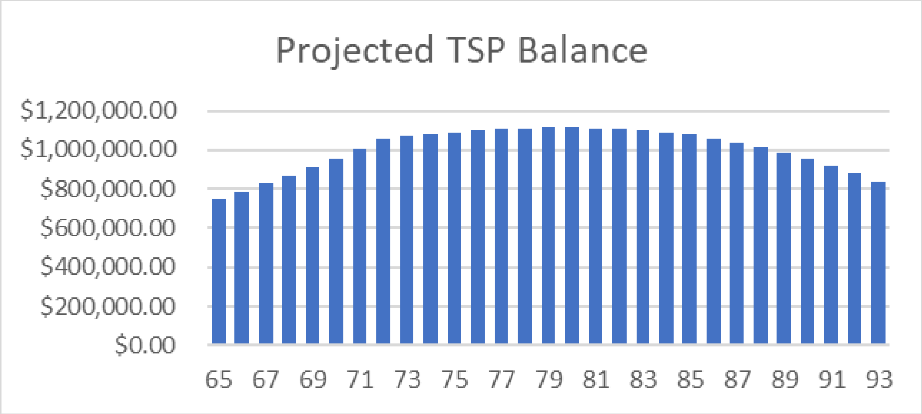
<u>RMDs due by December 31 every year thereafter</u>

Required Minimum Distributions

Delaying TSP withdrawals until RMDs

- Delaying TSP withdrawals until RMDs may not be the best strategy
  - 65-year-old with $750,000 TSP
    - No distributions before age 73
    - RMD at age 73* = $39,824
    - RMD at age 85* = $68,119





* RMD is equal to the prior year's ending balance (12/31) divided by factor found in Uniform Lifetime Table. Factor for 73-year-old is 26.5; factor for 85-year-old is 16.

The above example is for illustrative purposes only and not indicative of any investment. Values are based on a hypothetical 5% return. References to future returns are not promises or even estimates of actual returns an investor may achieve.

Required Minimum Distributions

Consequences of Delaying Withdrawals

Potential consequences

- Larger withdrawals may push into higher marginal rate
- Stealth taxes may increase effective marginal rate
  - Net investment income tax
  - IRMAA
  - Loss of deductions

Beware: Mandatory withholding is not the tax owed

Potential strategies

- Spend down TSP & tax-deferred retirement plans while tax rates are lower
- Series of Roth conversions prior to year money is needed

Roth IRA Conversions

Reasons to Consider a Roth Conversion

- Nonqualified dollars available to pay taxes
- Increasing tax rates
- Reduce RMDs
- IRMAA
- Change in tax filing status (joint to single)
- Estate planning objectives
- SECURE Act

Roth IRA Conversions

Process of Roth IRA Conversion

- Roth IRAs are funded with after-tax dollars
  - Conversions are typically taxable
- Dollars eligible for conversion
  - Traditional TSP
  - Traditional IRAs
  - Eligible rollover distributions*
  - SIMPLE IRA – after two years from initial deposit
  - SEP IRA

* RMDs are not eligible for conversion

IRA — Individual Retirement Account
SEP — Simplified Employee Pension
SIMPLE — Savings Incentive Match Plan for Employees
www.irs.gov

Roth IRA Conversions

Things to Know About Roth Conversions

- May not convert from traditional TSP to Roth TSP
- Five-year rule applies to each conversion
  - Doesn't apply if older than 59½
- Earnings may be distributed tax-free with qualified withdrawal
  - Older than 59½
  - Roth account open for at least five years
- IRS Roth IRA distribution ordering rules
  - Regular contributions
  - Conversions of taxable assets
  - Conversions of nontaxable assets
  - Earnings

Making The Most of Charitable Contributions

Qualified Charitable Distributions (QCD)

A QCD is a distribution paid directly to a charity from an IRA

- Permitted from IRAs only
- No allowable from the TSP
- Must be 70½ or older
- Up to $100,000 per person, per year

Benefits of a QCD

- Excluded from total income
- Satisfies some or all of an IRA owner’s RMD

Qualified Charitable Distributions

Charitable Donations: Cash vs. QCD

Taking RMD and donating cash: married couple age 65

	2022	2023	2024	2025	Total
Other Itemized Deductions	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Charitable Contributions	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Total Itemized Deductions	$ 20,000	$ 20,000	$ 20,000	$ 20,000	$ 80,000
Standard Deduction	$ 28,700	$ 28,700	$ 28,700	$ 28,700	$ 114,800
Deductions Taken	**$ 28,700**	**$ 28,700**	**$ 28,700**	**$ 28,700**	**$ 114,800**
Marginal Tax Rate	22%	22%	22%	22%	22%
Tax savings from deductions	$ 6,314	$ 6,314	$ 6,314	$ 6,314	$ 25,256

Qualified Charitable Distributions

Charitable Donations: Cash vs. QCD

Using RMD for Qualified Charitable Distribution: married couple age 65

	2022	2023	2024	2025	Total
Other Itemized Deductions	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Charitable Contributions	$ -	$ -	$ -	$ -	$ -
Total Itemized Deductions	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Standard Deduction	$ 28,700	$ 28,700	$ 28,700	$ 28,700	$ 114,800
QCD	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Total Reduction in Income	**$ 38,700**	**$ 38,700**	**$ 38,700**	**$ 38,700**	**$ 154,800**
Marginal Tax Rate	22%	22%	22%	22%	22%
Tax savings	$ 8,514	$ 8,514	$ 8,514	$ 8,514	$ 34,056
			Tax savings from QCD strategy		**$ 8,800**

Qualified Charitable Distributions

Using TSP to Fund QCD

- Transfer single withdrawal to Traditional IRA
- Keep in mind
  - RMD is based on prior year’s ending balance
  - To ensure entire QCD goes towards satisfying RMD, IRA RMD must be greater than or equal to desired QCD

Qualified Charitable Distributions

Using TSP to Fund QCD

- Example: TSP participant turns 73 in 2023
  - 12/31/2022 balance = $500,000*
  - 2023 RMD = $18,867 ($500,000 / 26.5)
  - Desired 2023 QCD = $10,000

- Transfer to IRA
  - Must be completed prior to 12/31/2022
  - Amount required to satisfy $10,000 of RMD with QCD
    - $10,000 x 26.5 = $265,000

Other Tax Saving Options

Bunching Deductions

Consistent Charitable Contributions:

	2023	2024	2025	2026	Total
Other itemized deductions	$ 20,000	$ 20,000	$ 20,000	$ 20,000	$ 80,000
Charitable contributions	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Total itemized deductions	$ 30,000	$ 30,000	$ 30,000	$ 30,000	$ 120,000
Standard deduction	$ 27,700	$ 27,700	$ 27,700	$ 27,700	$ 110,800
Deductions taken	**$ 30,000**	**$ 30,000**	**$ 30,000**	**$ 30,000**	**$ 120,000**
Marginal tax rate	24%	24%	24%	24%	24%
Tax savings	$ 7,200	$ 7,200	$ 7,200	$ 7,200	$ 28,800

Other Tax Saving Options

Bunching Deductions

Bunched Charitable Contributions:

	2023	2024	2025	2026	Total
Other itemized deductions	$ 20,000	$ 20,000	$ 20,000	$ 20,000	$ 80,000
Charitable contributions	$ 40,000	$ 0	$ 0	$ 0	$ 40,000
Total itemized deductions	$ 60,000	$ 20,000	$ 20,000	$ 20,000	$ 120,000
Standard deduction	$ 27,700	$ 27,700	$ 27,700	$ 27,700	$ 110,800
Deductions taken	**$ 60,000**	**$ 27,700**	**$ 27,700**	**$ 27,700**	**$ 143,100**
Marginal tax rate	24%	24%	24%	24%	24%
Tax savings	$ 14,400	$ 6,024	$ 6,024	$ 6,024	$ 34,472

Isolate IRA Basis

Isolate IRA Basis for Tax-Free Roth IRA Conversion

Traditional IRA Basis

- Created from after-tax contribution to a Traditional IRA
- TSP does not permit after-tax contributions
- Not the same as Roth IRA contributions
  - Earnings on basis is taxed when distributed from IRA
- Basis may be distributed and/or converted tax-free, **however**…

Isolate IRA Basis for Tax-Free Roth IRA Conversion

IRS Pro-rata Rule

- Prevents IRA owners from withdrawing or converting only basis

Instead…

- Withdrawals and conversions consist proportionately of basis and pre-tax money
  - Based on proportion of basis and pre-tax money for all IRAs
  - Includes all IRAs - Traditional IRA, SEP IRA, and SIMPLE IRA
  - Does not include - Employer plans, such as TSP

Isolate IRA Basis for Tax-Free Roth IRA Conversion

IRS Pro-rata Rule Applications

Pro-rata rules apply to all withdrawals and conversions, except

- Rollovers to employer-based retirement plans
  - Thrift Savings Plan
  - 401(k)

Strategy to isolate IRA Basis for tax-free Roth IRA conversions

- Transfer all pre-tax money from IRA to TSP
- Convert remaining IRA (consists of all basis) tax-free to Roth IRA

Isolate IRA Basis for Tax-Free Roth IRA Conversion

How <u>Not to</u> Convert Basis Tax-Free

Traditional IRA 1

Post-Tax: $ 25,000
Pre-Tax: $ 0
Value $ 25,000

Convert to Roth

Roth IRA

Value $ 25,000

Traditional IRA 2

Post-Tax: $ 0
Pre-Tax: $ 125,000
Value $ 125,000

Traditional IRA 2

Post-Tax: $ 0
Pre-Tax: $ 125,000
Value $ 125,000

Thrift Savings Plan

Value $ 500,000

Thrift Savings Plan

Value $ 500,000

Pro-rata Calculation

	$	%
Post-Tax	$25,000	16.7%
Pre-Tax	$125,000	83.3%
Total Value	$150,000	100%

Allocation of $25k conversion

	$	%
Post-Tax	$4,175	16.7%
Pre-Tax	$20,825	83.3%
Total Value	$25,000	100%

Result:
$20,825 is taxable

Isolate IRA Basis for Tax-Free Roth IRA Conversion

How to Convert Basis Tax-Free

Traditional IRA 1

Post-Tax:	$	25,000
Pre-Tax:	$	0
Value	**$**	**25,000**

Traditional IRA 2

Post-Tax:	$	0
Pre-Tax:	$	125,000
Value	**$**	**125,000**

Thrift Savings Plan

Value	**$**	**500,000**

Step1

Transfer

Pre-tax to TSP

Traditional IRA 1*

Pre-Tax:	$	0
Post-Tax:	$	25,000
Value	**$**	**25,000**

Traditional IRA 2

Pre-Tax:	$	0
Post-Tax:	$	0
Value	**$**	**0**

Thrift Savings Plan

Pre-transfer Value	$	500,000
Transfer from IRA	$	125,000
Post-transfer Value	**$**	**625,000**

Step2

Convert to Roth**

Roth IRA

Value	**$**	**25,000**

Pro-rata Calculation

	$	%
Post-Tax	$ 25,000	100%
Pre-Tax	$ 0	0%
Total Value	$ 25,000	100%

Allocation of $25k conversion

	$	%
Post-Tax	$ 25,000	100%
Pre-Tax	$ 0	0%
Total Value	$ 25,000	100%

Result:
$0 is taxable

** Conversion will be tax-free if only basis remains in IRA and is converted to Roth IRA.

Thank You!

Federal Benefits Webinar

Presented by Marco Capaldi

Email mjc@reliancebenes.com

Closed Captioning (CC) is available on the recorded version of this webinar.