COULD **HIGHER TAXES** DERAIL YOUR RETIREMENT APPROACH?

5 Ways Taxes Can Rise — And How to Protect Yourself

These materials are not intended to provide tax, accounting or investment advice. Be sure to consult a qualified professional in these areas about your individual situation.

Taxes are an important topic when it comes to retirement. After all, the more you pay in taxes, the less income you'll have to spend.

When it comes to retirement, there are three possibilities for your taxes:

- **Your taxes could be lower in retirement than they are today.** This is the premise of tax-deferred savings vehicles like 401(k)s and IRAs: you defer your taxes to the future in hopes that your tax rate will be lower in retirement than it is during your working years.

- **Your taxes could be the same in retirement as they are today.** Savers who want to maintain their pre-retirement lifestyle once retired often need to maintain a similar annual income in retirement. For these savers, their tax rate may stay the same in retirement because their income needs stay the same in retirement.

- **Your taxes could be higher in retirement than they are today.** This is a risk many savers are beginning to understand. With our current federal debt and recent congressional spending, tax rates in the future could be higher than they are today.

Rising taxes in retirement is an important risk for savers to understand. This is especially true for individuals who have saved all or the majority of their retirement assets in tax-deferred vehicles, like IRAs and 401(k)s[1]. These popular savings vehicles defer taxes to the future. If taxes are higher in retirement than they are today, savers with IRAs and 401(k)s could pay more in taxes than planned. That's because in a rising tax environment, a larger portion of their IRA or 401(k) withdrawals would go to the IRS.

Some savers are most concerned about higher taxes in retirement, since higher taxes pose the greatest risk to traditional tax-deferred savings vehicles.

So you may be wondering: Will my taxes be lower, the same, or higher in retirement?

It is not possible to predict the future. However, we can consider some of the potential ways your taxes could rise in retirement. It may be important for you to understand these factors and consider whether they could potentially impact your retirement approach.

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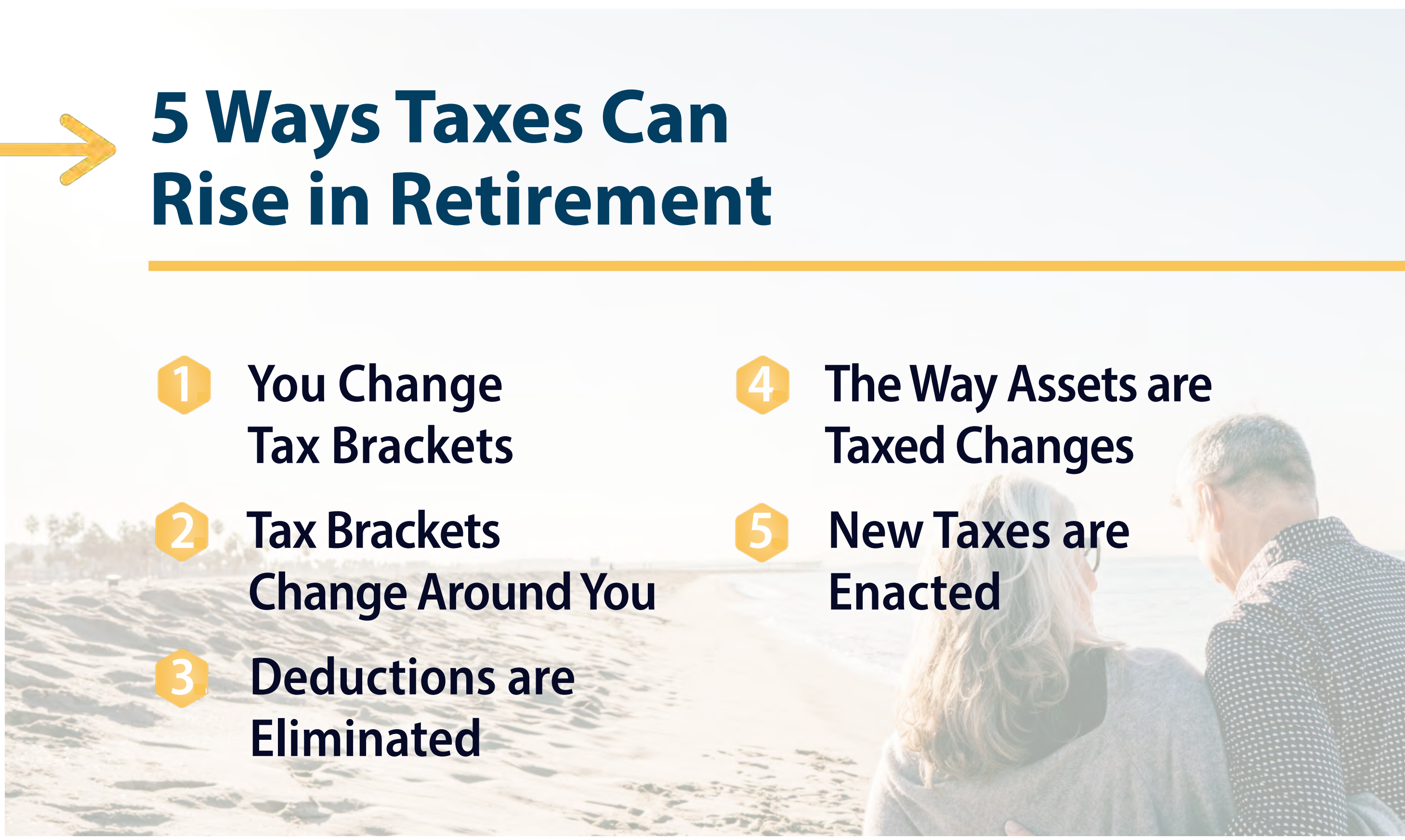


5 Ways Taxes Can Rise in Retirement

1. You Change Tax Brackets
2. Tax Brackets Change Around You
3. Deductions are Eliminated
4. The Way Assets are Taxed Changes
5. New Taxes are Enacted

5 Ways Taxes Can Rise in Retirement

1 YOU CHANGE TAX BRACKETS

Your federal tax bracket determines what percentage of your income you will owe in taxes. Some savers may not maintain the same tax bracket throughout retirement. One reason for a tax bracket change in retirement is if a spouse passes away, and the surviving spouse moves from filing married/joint to filing as a single filer. Single filer bracket rates are applied to significantly less income than joint filer rates, so the total amount of taxes you pay could go up, as more of your income is subject to higher bracket rates[2].

2 TAX BRACKETS CHANGE AROUND YOU

Even if your filing status stays the same in retirement, tax brackets could change around you. This occurs when Congress passes new laws impacting tax brackets. For example, in 2017, Congress passed and the President signed into law comprehensive tax reform, sometimes known as the Trump Tax Cuts[3]. This legislation temporarily lowered tax bracket rates for many Americans. But this law - and its lower bracket rates - will expire in 2025. That means in 2026, tax bracket rates will revert back to their older, higher levels. If you are evaluating your retirement assets based on today's tax rates, it's important to remember those rates will likely be higher starting in 2026 - even if your income needs stay the same.

3 DEDUCTIONS ARE ELIMINATED

Your tax bracket is only one factor that can potentially impact your taxes in retirement. How much of your income is subject to taxation is another way you could possibly pay more taxes in retirement than planned. If you make $100,000 a year and can deduct $20,000, you likely pay taxes on $80,000 of taxable income. But if next year you can only deduct $10,000, you would suddenly pay taxes on $90,000 of taxable income instead. Your bracket didn't change, but you ended up paying more in taxes because more of your income was subject to taxation. In the 2017 Federal Tax Reform legislation, we saw an elimination of some deductions[3], so it is an area Congress could return to in the future.

4 THE WAY ASSETS ARE TAXED CHANGES

You could also end up paying more taxes in the future if the government changes the way retirement assets are taxed. One example of this could be Social Security. Before 1984, Social Security benefits were not taxable. Based on legislation passed in 1983, Social Security payments became taxable up to 50% of the benefits, and in 1993 that amount was raised to 85%[4]. Congress could potentially pass new legislation making an even higher amount of the benefit taxable for some retirees. If that happened, you could pay more in taxes because more of your retirement income would be subject to taxation.

5 NEW TAXES ARE ENACTED

The final way your taxes in retirement could be higher than they are today is if Congress passes new taxes on retirement assets. There was discussion of this during the Congressional debate over President Biden's Build Back Better agenda. The legislation in Congress included trillions of dollars in new government spending, and to offset that spending, trillions of dollars in new taxes

For example, one tax provision included in the House Democrat's bill enacted a new annual Required Minimum Distribution (RMD) from Qualified retirement accounts like IRAs and 401(k)s. This RMD would be applicable at any age, and would be triggered when a saver's retirement assets reached a value above a congressionally-mandated limit. The proposal would require savers above this cap to withdraw from their accounts 50% of the excess above the cap each year - whether they need the income or not - and pay taxes on that withdrawal, in essence ending the tax-preferred status of those funds[5].

Now is an important time to consider your taxes in retirement.

Many experts believe Congress will need to raise additional tax revenue in the near term. Our national debt has swelled to more than **$31 trillion**[6]. Congress is debating trillions of dollars in new spending priorities, and will need increased tax revenue to offset that spending. Simply put, there's every reason to believe Washington will be searching for more tax revenue in the near term. And recent Congressional debate shows retirement accounts are a key place Congress may look[5].

When it comes to taxes in retirement, you may want protection against two related risks:

TAX RISK, which is the risk your taxes are not lower in the future than they are today because of your income needs or filing status.

LEGISLATIVE RISK, which is the risk our government introduces new or expanded taxes that impact your retirement approach.

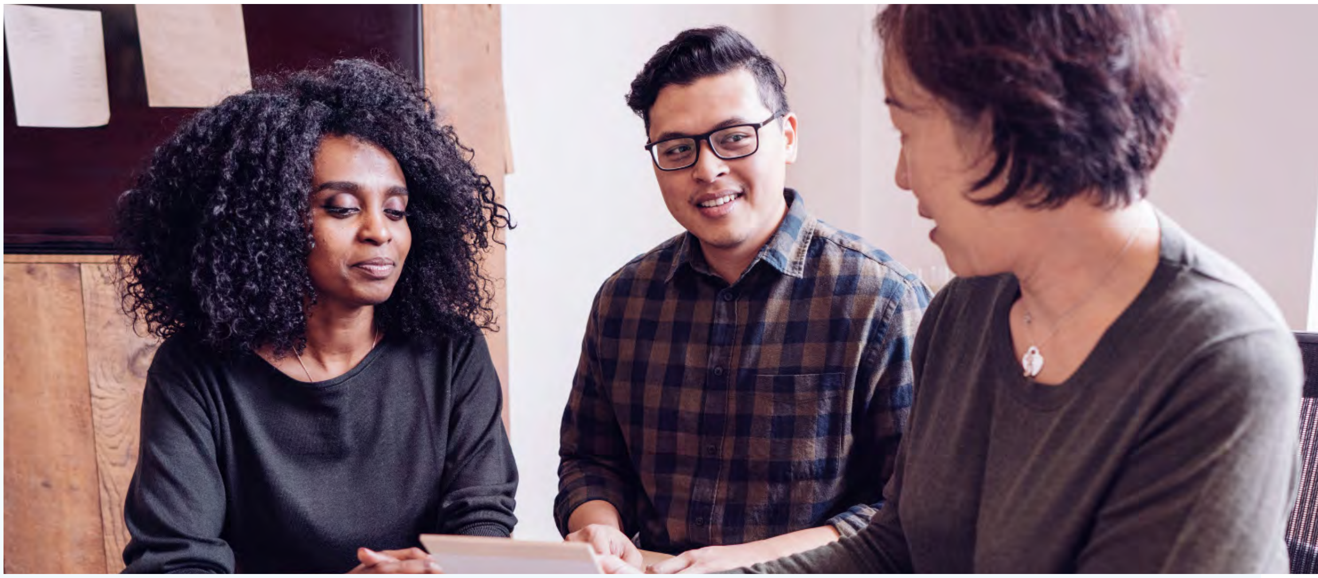
So what actions can you take today to help protect yourself from these risks?

Tax diversification may be a valuable option to consider.

Some savers choose to address the risk of variable taxes in retirement by incorporating **tax-free strategies** into their retirement approaches. Tax-free assets can serve as a hedge against rising taxes in the future. Since Roth IRAs, Roth 401(k)s and other tax-free savings vehicles are funded with after-tax dollars, no taxes are due on the funds when they are withdrawn in retirement. That means if Congress raises taxes in the future, these funds would not be impacted[7].

By ensuring a portion of your retirement funds are in tax-free accounts, you may feel better protected against the risk of rising taxes in retirement. And that could help you have a more **complete approach** to protecting your funds in retirement.

If you have questions or concerns, be sure to work with a qualified professional to develop a retirement approach that works for you.



DISCLOSURES

1 “Types of Retirement Plans,” Internal Revenue Service. Accessed June 2022. Available online: https://www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans

2 “2022 Tax Brackets,” Tax Foundation. Updated November 2021, Accessed June 2022. Available online: https://taxfoundation.org/2022-tax-brackets

3 Public Law 115-97, Passed December 22, 2017. Complete legislation available online: https://www.govinfo.gov/content/pkg/PLAW-115publ97/pdf/PLAW-115publ97.pdf

4 “Social Security History,” U.S. Social Security Administration, Accessed June 2022. Available online: https://www.ssa.gov/history/InternetMyths2.html#:~:text=The%20taxation%20of%20Social%20Security,President%20Reagan%20in%20April%201983

5 “Responsibly Funding Our Priorities Section-by-Section,” Fact Sheet, U.S. House Committee on Ways and Means, published September 15, 2021 and accessed June 15, 2022. Available online: https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SubtitleISxS.pdf

6 “Debt to the Penny,” U.S. Treasury Fiscal Data. Accessed June 23, 2022. Available online: https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-penny

7 “Ten Differences Between a Roth IRA and a Designated Roth Account,” Internal Revenue Service, Accessed June 2022. Available online: https://www.irs.gov/retirement-plans/ten-differences-between-a-roth-ira-and-a-designated-roth-account

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