HAYES ADVISORY GROUP

RETIREMENT PLANNING

Knowledge is Power

October 2023 Question Of The Month.

"Hi Brian. There has been a lot of talk and press about the benefits of saving in a Roth IRA. However, for my case, I am just not seeing it. My husband and I make a good living and are in a higher tax bracket than we will be in at retirement. So for us, isn't it best for us to save in a traditional IRA and 401k and take the tax deduction now and pay taxes later when our taxes are lower in retirement? Thank you." Melissa

Hi Melissa. Your question is a very good one and is on a topic that everyone must make the proper decision in order to maximize their retirement plan. As you probably have heard me say several times - saving for retirement is very important, but how you save is more important. What I mean by that is in order for your retirement savings to be worth as much as possible, you have to save in right types of accounts for your specific situation.

Now, your reasoning in your question is correct. If you are in a higher tax bracket now than you will be in retirement, then you should take the tax deduction now and pay taxes later. Remember, the ultimate retirement goal is to pay the least amount of taxes on your retirement account money as possible. Thus again, if you can save more taxes now than you will pay later, then saving in a traditional IRA or 401k is the proper way for you to go.

However, the problem for many people is they actually will not be in a lower tax bracket in retirement, and thus they are saving incorrectly which will cost them a lot more in taxes. Why is that the case? Well, for several reasons.

The main reason is how the tax system works in retirement. When you take money out of a traditional retirement savings plan, that money of course is taxable at that time. However, that money also counts in the provisional income formula which determines how much your Social Security is taxed. Thus, in most cases, traditional retirement savings withdrawals cause Social Security to be taxed. In addition to this, that income also gets calculated into the formula which determines how much your Medicare part B premium costs. So, not only is that money taxable, but it can cause other taxes as well and most people are not aware or consider this when saving for retirement. Roth income is not taxable in retirement and also is not counted in these formulas.

Next, you have to consider inheritance and estate taxes. Again, traditional retirement savings income is taxable to the people who inherit your money. Normally for married couples, one person passes away before the other which causes the surviving spouse to have to file as a single person, which is an immediate tax increase in most cases. And since you lose one of the Social Security checks when a spouse passes away, the surviving spouse may very well need more income from the retirement savings, which again is taxable now at higher single rates.

Next, you have to consider the many deductions that you may lose in retirement. During your working years, many people are able to deduct mortgage interest and charitable contributions which saves tax dollars. In addition, you get tax credits for children. In retirement, these deductions usually go away.

And finally, you have to also give some serious consideration to where tax rates will be in the future. Todays tax rates are near historic lows, but that will probably be changing here very soon based on the over spending and national debt issues. So, you very well may be in a higher tax bracket now than you will be in retirement at todays tax rates, but that very well may not be the case in the future.

So as you can see, there are many things that you have to think about and consider when determining how to properly save for retirement in order to minimize your overall taxes in retirement. Many people are shocked and surprised that they actually have to pay more in taxes in retirement based on all of the factors above. Again, if you are absolutely sure you are in a higher bracket now than you will be in retirement, then you are saving correctly. But do yourself a favor and factor in all of the above information to make sure you still feel that will be the case.

Join me this weekend on The Retirement Money Matters Educational Radio Show Program where we will answer this question in more detail as well as several more retirement planning questions. The show airs on Sunday morning at 8 on WWKI (100.5 FM), or online at www.theretirementmoneymattersshow.com. You can also obtain this information by reaching out to us at Hayes Advisory Group at 452-PLAN (7526), 800-939-1603 or brian@hayesadvisorygroup.com.