Cherry Tree Wealth Management

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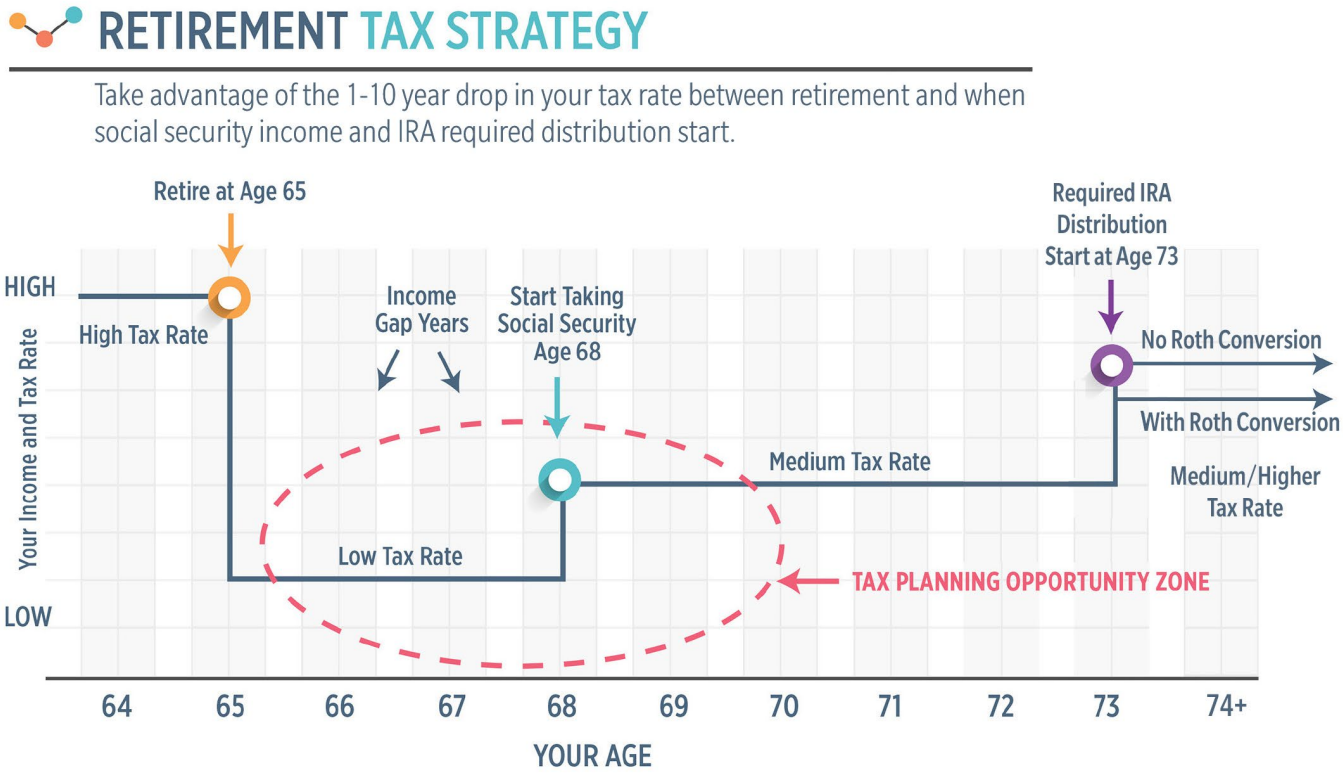
CHERRY TREE WEALTH INSIGHTS: Published by Keith Tufte, President of Cherry Tree Wealth Management, LLC, with insights on investing and wealth management.

INVESTING QUOTE OF THE MONTH:

Retirement is like a long vacation in Las Vegas. The goal is to enjoy it to the fullest, but not so fully that you run out of money." —Jonathan Clements

SMART TAX STRATEGIES AT RETIREMENT

There are some excellent tax planning strategies surrounding the years just after retirement that can save you significant amounts of money. These strategies involve taking advantage of the much lower tax rate you will likely have during the "gap years" between retirement age and when you start taking Social Security (by age 70) and when you are forced to start taking IRA required distributions (age 73). It is during these years that most people experience the lowest tax rate they are likely to experience over the rest of their lives. See the graph below which shows the "tax planning opportunity zone."



THERE ARE TWO SMART TAX STRATEGIES TO USE DURING THESE GAP YEARS:

1. **Take long-term capital gains on purpose with a 0% tax rate.** For a couple the 0% capital gains tax rate goes up to $94,050 of gains in 2024. The amount of capital gains you can take with a 0% tax rate is larger than most people think. A simple formula to estimate how much capital gains a couple can take at the 0% tax rate is $123,250 minus your gap year taxable income. Assume a couple has $60K of income already from interest income, dividends, pension, part-time work, etc. They may be able to take an estimated $63,250 in capital gains with a 0% tax rate each year. This is a general estimate and will not apply to all taxpayers.

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2. **Roth conversions.** Transfer money from your regular IRA to a Roth IRA at relatively low tax rates. This will likely not happen with a 0% income tax rate, but it could be the lowest tax rate you will experience over the rest of your life because Social Security income and mandatory IRA distributions will increase your income and tax rate once you start taking those.

Which of these two smart retirement tax strategies is best for you?

It depends on each person's retirement balance sheet size and tax status, level of income, age, and other factors. It is not an all-or-nothing decision, as you may wish to do some of each strategy. Taking capital gains with a 0% income tax rate seems to be a good first choice for most people if they have a sizeable taxable brokerage account with significant unrealized capital gains. This is especially true and helpful for those with a concentrated position in one stock or fund with large capital gains. Taking some tax-free capital gains in these concentrated positions will save you income taxes in the future and allow you to better balance and diversify your portfolio to reduce risk.

Choosing to do Roth conversions can be a smart choice for people who have most of their retirement assets already in IRA and/or 401K type accounts, and not much in taxable brokerage accounts. If 75% or more of your liquid retirement assets are in IRA/401K accounts doing some Roth conversions at low tax rates may be smart to consider. It could also be smart for those who do not have big unrealized capital gains in a taxable account. If your retirement income is above $123,000 you likely will not qualify for the 0% capital gains tax rate, so you may want to consider some Roth conversions. Benefits of doing some Roth conversion include 1) it reduces the amount you have in IRA accounts which will reduce your future IRA required distributions (and taxes) starting at age 73, 2) those dollars in the Roth will never be taxed again, 3) your children would rather inherit a Roth account than an IRA account, 4) you are likely taking money out of your IRA for the Roth conversion and the lowest tax rate of the rest of your life, 5) Roth IRAs do not have forced taxable distributions at age 73 and beyond like regular IRA accounts, and 6) you can take some money out of the Roth in retirement tax-free and manage down your overall income and tax rate this way.

Other factors to consider (Affordable Care Act Health Insurance, Medicare, State Income Taxes).

Taking capital gains on purpose and/or doing Roth conversions increases your income. It is wise to consider how this may affect other financial areas for you. Some people who retire early (before age 65) have taken advantage of Affordable Care Act health insurance which can be subsidized depending on your level of income. Be aware of how increasing your income may affect your health insurance availability and premiums. Higher income can also slightly increase your Medicare premiums. Increasing your income by taking capital gains and/or Roth conversions can increase your state income taxes.

Everyone's financial and tax situation is unique so it is important to look at a customized solution for each person or family. It can be smart to work with your tax CPA to run these strategies through their tax software to decide exactly how much in capital gains you can take with a 0% tax rate, or which strategy might be best for you. Please contact us if you wish to discuss how these strategies might work best for your situation.

Cherry Tree Wealth Management, LLC (CTW) provides unique wealth management services for a select group of client families to help give them peace of mind. Author Keith Tufte, (President of CTW) has over 25 years of successful investment management experience as a Wall Street Analyst, Mutual Fund Portfolio Manager, Director of Equity Research for a major mutual fund firm, Hedge Fund Portfolio Manager, and Wealth Management Advisor. Please FORWARD this e-mail to friends/relatives/business associates that you think may have an interest. Please see our website at http://www.cherrytree.com.

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