FIESTA AUTO INSURANCE FIESTA TAX SERVICE

2019.20 Training

Subject: Retirement/ 65 & Older | Talking Points

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From IRAs to Pensions, Find Out Which Are Taxable

You can contribute up to $5,500 to your IRA if you have earned income from a job or self-employment and you are under age 70½. If you are age 50 or older, you may contribute up to $6,500.

Traditional IRA Contribution

If your employer does not offer a retirement plan, your traditional IRA (non-Roth) contributions are fully deductible. If you do participate in an employer-sponsored plan such as a 401(k), your contributions may be reduced or phased out entirely based on your income. File IRS Form 8606, Nondeductible IRAs, if you are not deducting all of your traditional IRA contribution.

Retirement Savings Credit

If you contribute to an IRA or an employer-provided retirement account, such as a 401(k), you may be eligible for a credit. Also, if you're the designated beneficiary of an ABLE (Achieving a Better Life) account, you may be able to get a credit on contributions to your account. The retirement savings credit is 50%, 20%, 10% of your contributions, up to $2,000 ($2,000 each if married filing jointly). You must be age 18 or older to claim the credit and you cannot be a student or claimed as a dependent on another's return. The credit reduces any tax liability you may have and is in addition to any deduction or exclusion from income for the contribution.

Roth Contributions and Conversions

Contributions to a Roth IRA or 401(k) are not tax deductible. If you convert your traditional IRA or 401(k) to a Roth IRA or Roth 401(k), the conversion amounts are generally fully taxable.

Taxable Sources of Retirement Income

Expect that all of the following types of retirement income will be taxable at your ordinary income tax rates.

Withdrawals from retirement plans: If a plan was funded with pretax dollars, whether by you or your employer, it will result in taxable retirement income when withdrawn. Expect pretty much all withdrawals from IRAs, 401(k)s, 403(b)s, SEPS, SIMPLES, and other similar types of plans to be taxable.

Pension income: Most pensions are taxable; however, some types of military pensions or disability pensions may be partially or entirely tax-free. Your pension provider will send you a 1099 form at the beginning of each year that shows you how much of your pension is taxable.

Investment income in nonretirement accounts: Interest, dividends, and capital gains that occur in nonretirement accounts will be reported to you on a 1099 form each year and you will pay tax on most of this type of investment income as it is earned. The exception would be any capital gains that fall into the 0 percent tax rate; you don't pay tax on that portion of capital gains. Note, however, that interest, dividends, and capital gains that occur within tax-deferred accounts, such as IRAs or 401(k) plans, are not taxable in the year they occur. Instead, all such investment income within these types of accounts is deferred until you take a withdrawal. At the time of withdrawal, the withdrawal amount is taxable.

Withdrawals from an annuity: When you take withdrawals from a fixed or variable annuity (one that is not owned by an IRA or retirement account) the IRS rules say that any gain must be withdrawn first, and this gain is taxed as ordinary income. Once all gain has been withdrawn, you would be withdrawing your cost basis or principal. Withdrawals of basis are not counted as taxable retirement income.

Partially Taxable Retirement Income

The following sources of retirement income are not entirely taxable.

Social Security: Anywhere from 0 percent up to 85 percent of your Social Security income may be taxable, but never 100 percent of it. If your other sources of income are below the thresholds set by the IRS, then all your benefits will be tax-free, but if your other sources of income are in excess of the threshold, then a formula determines what percentage of your benefits will be subject to taxation. The good news is that 15 percent of your Social Security benefits will always be tax-free.

Nondeductible IRA withdrawals: If you have traditional pretax IRA contributions as well as after-tax, nondeductible IRA contributions, then a portion of each nondeductible IRA withdrawal may be considered gain and a portion would be the return of your basis. The gain portion is considered taxable retirement income.

Income from an immediate annuity that was purchased with after-tax money: When you buy an immediate annuity with after-tax money, a portion of each payment you receive is interest, and a portion is a return of principal. The interest portion is taxable. If the immediate annuity was purchased with pretax money, such as in an IRA or retirement account, all of the income will be taxable.

Proceeds from cashing in a cash value life insurance policy: Cash value life insurance policies have a cost basis, usually the total of all premiums you have paid. When you cash in the policy if your cash value exceeds your basis, then that portion is considered a gain and will be taxable. Beware: if you have an outstanding loan on the policy, the situation becomes more complicated. After you take a loan from a life insurance policy if you terminate the policy before repaying the loan, then a portion of the loan amount may become taxable income to you.

Tax-Free Retirement Income

Last but not least, the best kind of income: the tax-free kind. The following sources of income are generally tax-free.

Roth IRA withdrawals: Roth IRA withdrawals are tax-free if you meet the Roth IRA withdrawal requirements. Also, Roth IRA withdrawals are not included in the formula that determines how much of your Social Security is taxable, nor are they included in the formula that determines how much in Medicare Part B premiums you will pay.

Interest income from municipal bonds: Most municipal bond income is free from federal income taxes, but you may be subject to state income taxes on this form of retirement income.

Loans from life insurance policies.

Income from a reverse mortgage: Monthly payments or lump sums received from a reverse mortgage are not taxable. This gives a reverse mortgage a hidden advantage that many folks overlook.

After-tax contributions: If you saved money after-tax in a 401(k) or another company plan, withdrawal of that portion is not taxable.

Any return of principal or cost basis: For example, suppose you purchased a variable annuity with $10,000 of after-tax money. You cash it in at age 60 when it is worth $12,000. The $2,000 of gain is taxed as ordinary income. The $10,000 is your cost basis, or original principal, and is not taxable income to you.

Gain from the sale of your home: Most people receive gains from the sale of their primary residence tax-free—if the gain is less than $250,000 for a single or less than $500,000 for married filers, you have lived in the home for at least two of last five years, and you meet other IRS requirements.