Map Your Course

Help to Minimize the Risks to Your Retirement

Tax Bracket Risks

If you're like most Americans, you're looking forward to retirement. At the same time, you're also keeping a careful eye on expenses, unsure of how they will impact your savings.

The last thing you're expecting in retirement is an increase in your taxes. But a tax increase is a real possibility for some – even as they're living on less. They may lose the deductions they previously used to their advantage, they may end up paying taxes on their investments and their Social Security as they tap into them, and they may find that large purchases cause an unintended increase in their marginal tax rates.

The end result might be that a higher proportion of the savings retirees are using to live on will be lost to taxation. And the amount of taxes retirees pay can significantly diminish the amount of time their retirement savings can last.

Managing your taxes in retirement can make a big difference in income sustainability, especially in years when you want to withdraw a substantial amount of money for a purchase.

How Do You Minimize Your Tax Risk in Retirement?

One way to help avoid larger tax hits is by using an Indexed Universal Life insurance (IUL) policy. It will provide your loved ones with a death benefit in the early years, and its cash value[1] may also be used as a source of supplemental retirement income. That can help you avoid increases to your effective tax rate since a loan from an IUL policy is generally not counted as taxable income.[2,3]

Throughout this brochure we will cover some of the tax risks you may face, and how an IUL policy can help you manage these risks.

The information provided throughout this brochure should not be construed as tax or legal advice. Consult with your tax or legal professional for details and guidelines specific to your situation.

[1]The amount that may be available through loans or withdrawals, as defined in the contract.
[2]Any policy withdrawals, loans and loan interest will reduce policy values and benefits.
[3]For federal income tax purposes, tax-free income assumes: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); and (2) the policy does not become a modified endowment contract. See IRS §72, 7702(f)(7)(B), 7702A. This information should not be construed as tax or legal advice. Consult with your tax or legal professional for details and guidelines specific to your situation.

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A Look at Your Overall Tax Picture

There are some important tax concepts that you should understand as you are planning for retirement, such as:

- How each type of retirement income source may be taxed
- How one source of retirement income may impact the tax rates you pay on another source of income
- The tax rates that may apply to each source of retirement income
- The tax deductions and credits you may lose in retirement
- Additional taxes that may apply to the affluent

We will provide more details on each of these concepts in the following pages. We will also discuss potential solutions that can help you manage these risks while still allowing you to take the income you need to live out your retirement dreams.

Understanding the Types of Retirement Income and How They're Taxed

Tax-deferred accounts

Withdrawals from traditional IRAs and 401(k)s are taxed as **ordinary income**. You are usually required to start taking Required Minimum Distributions (RMDs) from these accounts the year after you reach age 72.

Taxable accounts

Profits from the sale of investments, such as stocks, bonds, mutual funds and real estate, are taxed at **capital-gains rates**:

- Long-term capital-gains rates apply to assets you have held longer than a year.
- Short-term capital gains are taxed at your **ordinary income tax rate**.

Interest income from bonds and rental property income are taxed as **ordinary income.**

Qualified dividends are taxed the same as long-term capital gains held over a year; and, nonqualified dividends are taxed at your **ordinary income tax rate.**

Municipal bond payments are federally tax-free.

Roth IRAs

As long as the Roth has been open for at least five years and you're age 59 1/2 or older, all withdrawals are **tax-free**. You are not required to take RMDs from your Roth and contributions can be accessed at any time.

Roth 401(k)

Like the Roth IRA, a Roth 401(k) allows you to withdraw contributions and earnings, tax and penalty free, if you are age 59 1/2 or older and you have met the 5-year rule. If the rollover is to a Roth IRA, the holding period within the Roth 401(k) does not carry over.

Pensions

Payments from private and government pensions are taxable at your **ordinary income tax rate**, assuming you made no after-tax contributions to the plan.

Social Security

Many retirees are surprised—and dismayed—to discover that a portion of their Social Security benefits could be taxable at **ordinary income tax rates**. Whether or not you're taxed depends on what's known as your provisional income: your adjusted gross income plus any tax-free interest plus 50% of your benefits.

- If provisional income is between $25,000 and $34,000 (if you're single), or between $32,000 and $44,000 (if you're married), up to 50% of your benefits are taxable. If you're below these thresholds, you don't have to pay taxes on your Social Security benefits
- If provisional income exceeds $34,000 (if you're single) or $44,000 (if you're married), up to 85% of your benefits are taxable.

Annuities

If you have an annuity that you annuitize to provide income in retirement, the portion of the payment that represents the money you paid for the annuity (the principal) is tax-free; the rest is taxable.

The insurance company that sold you the annuity will be able to tell you what amount is taxable. If you bought the annuity with pretax funds (such as from a traditional deductible IRA), 100% of your payment will be taxed as ordinary income.

Life insurance

In most cases, loans and withdrawals from a life insurance policy are received income **tax-free.**[4,5] This assumes the withdrawals do not exceed the amount of premiums paid (less previous withdrawals); and the policy is not a Modified Endowment Contract under IRS §72, 7702(f)(7)(B), 7702A.

[4]Any policy withdrawals, loans and loan interest will reduce policy values and benefits.
[5]For federal income tax purposes, tax-free income assumes: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); and (2) the policy is not a modified endowment contract. See IRS §72, 7702(f)(7)(B), 7702A. This information should not be construed as tax or legal advice. Consult with your tax or legal professional for details and guidelines specific to your situation.

How One Retirement Source Can Impact the Taxation of Another

Managing the taxation of your retirement portfolio is about more than understanding how each type of income source is taxed individually. It's also important to know how using these income sources together can impact your overall taxation.

For example, some withdrawals from a retirement portfolio will increase your realized ordinary income and will also increase Social Security taxation and long-term capital gains taxation when taken in the same year. This can increase your effective marginal tax rate.

Beware of the "Tax Snowball"

Your effective marginal tax rate is considerably different than the marginal income tax bracket you fall into for federal tax purposes. Your effective marginal rate can be much higher or much lower, depending upon the underlying asset's tax treatment and what impact it has on your other portfolio assets.

Because of the compounding effect of Social Security taxes, long-term capital gains taxes and your effective federal taxes, your overall total taxes may "snowball." This can cause you to pay as much as 55 cents on the dollar in taxes, making your spendable income only 45 cents on the dollar. This is not the way to manage assets for the long life you plan to live in retirement. You need to be tax smart. Before making abrupt changes in your retirement spending, it's wise to model the tax impact.

Knowing how to maximize the bracket you're in without stepping into a new bracket is an important factor in helping you preserve the assets in your portfolio.

Tax Terms to Know

Federal marginal income tax rate: The tax rate an individual would pay on one additional dollar of ordinary income.

Effective marginal tax rate: The individual's total taxes paid, divided by total income. This measures the total tax burden that the client bears on all his/her income.

2021 Ordinary Income Tax Rates

Married Filing Jointly

Taxable Income	Tax Due
0 - $19,900	10% of taxable income
$19,900 - $81,050	$1,990 + 12% over $19,900
$81,050 - $172,750	$9,328 + 22% over $81,050
$172,750 - $329,850	$29,502 + 24% over $172,750
$329,850 - $418,850	$67,206 + 32% over $329,850
$418,850 - $628,300	$95,686 + 35% over $418,850
$628,300+	$168,993.50 + 37% over $628,300

Single Filers

Taxable Income	Tax Due
0 - $9,950	10% of taxable income
$9,950 - $40,525	$995 + 12% over $9,950
$40,525 - $86,375	$4,664 + 22% over $40,525
$86,375 - $164,925	$14,751 + 24% over $86,375
$164,925 - $209,425	$33,603 + 32% over $164,925
$209,425 - $523,600	$47,843 + 35% over $209,425
$523,600+	$157,804.25 + 37% over $523,600

2021 Long-Term Capital Gains and Qualified Dividends Tax Brackets

This table shows the long-term capital gains and qualified dividends tax brackets. This structure presents opportunities for middle-income taxpayers to recognize capital gains at a 0% rate with careful planning.

	Single	Married Filing Jointly	Married Filing Single	Head of Household	Trusts
0% if income up to:	$40,400	$80,800	$40,400	$54,100	$2,700
15% if income up to:	$445,850	$501,600	$250,800	$473,750	$13,250
20% for:	$445,850+	$501,600+	$250,800+	$473,750+	$13,250+

What Else Impacts Bottom-line Taxes or Effective Tax Rates?

If you don't itemize, you can take the standard deduction, which was increased by the Tax Cuts and Jobs Act of 2017. However, if you do choose to itemize, the following items will impact your taxes:

- **Deductions**
  You can think of **deductions** as reductions of income for certain expenditures. You can track those items, such as mortgage interest, investment interest, etc., and complete a schedule A on your tax returns, or you can take the standard deduction, which is $12,550 for single filers and $25,100 for married couples filing jointly.* For many retired taxpayers, there simply are not enough deductions to warrant itemizing on schedule A, so the standard deduction becomes important.

- **Credits**
  Deductions reduce your taxable income, indirectly reducing tax. **Credits**, on the other hand, directly reduce the tax bill, dollar for dollar.

Two of the most common tax credits are the Health Coverage Tax Credit and the Earned Income Tax Credit. Less common is the Saver's credit, which may be accessed by people who take a part-time job in retirement. This credit basically incentivizes lower-income people to save into retirement accounts.

Tax deductions and credits retirees might lose

- Dependent children – usually, by your retirement, children will be independent
- Mortgage interest – if you own your home free and clear at retirement, you will no longer have this deduction
- Business deductions – if you ran your own business and retired, business deductions are no longer applicable
- 401(k) deferrals and IRA contributions – you must have earnings to make pre-tax contributions to employer-sponsored savings plans or IRAs. If you're no longer working and earning an income, you may no longer be able to lower your taxable income by making pre-tax contributions

*Married seniors filing jointly get $1,350 additional if over age 65. Single seniors filing get $1,700 if over age 65.

Additional Taxes and Considerations for the Affluent

Although we have covered most of the tax considerations retirees should be aware of, there are some additional considerations if you are affluent. The following items typically impact higher-income people, but could also impact those with lower incomes, if you were to do a Roth conversion or have a large, unusual purchase like a car or a new roof for your house.

1) **Medicare Excess Premiums**

   It's important to understand that your Medicare monthly premium will increase as your income increases. This can also impact your overall financial situation in retirement.

   Medicare is now means tested, and these thresholds include the full Social Security benefit. If you fall over the threshold, you end up paying an extra Medicare Part B and Part D premium. In the scope of the total tax bill, it's probably not much, but it's not insignificant either.

2021 Medicare Excess Premiums

Married Filing Jointly	Single Filers	Part B (Monthly)	Part D (Monthly)
0 - $176,000	0 - $88,000	$148.50	Plan Cost Only
$176,000- $222,000	$88,000 - $111,000	$207.90	Plan + $12.30
$222,000 - $276,000	$111,000 - $138,000	$297.00	Plan + $31.80
$276,000 - $330,000	$138,000 - $165,000	$386.10	Plan + $51.20
$330,000 - $750,000	$165,000 - $500,000	$475.20	Plan + $70.70
$750,000+	$500,000+	$504.90	Plan + $77.10

2) **Net Investment Income Tax**

   The 3.8% Net Investment Income Tax also impacts higher-income taxpayers. For individuals over the adjusted gross income threshold ($200,000 single, $250,000 joint), it creates an additional 3.8% tax on income that isn't derived from work or a return of your own capital

3) **Medicare Surtax on Wages and Self-Employment Income**

   Some employees and self-employed individuals are required to pay an additional 0.9% surtax over and above the regular Medicare tax. This requirement is based on the amount of Medicare wages and net self-employment income the individual earns that exceeds a threshold amount.

Manage Your Tax Risk **and** Take the Income You Need

It's important to have a bucket of pre-taxed or non-taxable assets to pull extra income from during retirement. It helps you minimize tax bracket creep and may also lower the taxes you pay on your Social Security and long-term capital gains

Three types of pre-taxed or non-taxable assets:

- **A Roth IRA:** No doubt you're already familiar with the Roth IRA. Because you have already paid taxes on your contributions to a Roth IRA, you can pull from this bucket in retirement without increasing your taxable income.
- **A Roth 401(k):** Like a Roth IRA, a Roth 401(k) can also be accessed in retirement without increasing your taxable income.
- **A Cash Value Life Insurance Policy:** You can also take supplemental retirement income from the cash value[6] in an indexed universal life insurance policy without increasing your taxable income.[7] Distributions from a life insurance policy can be taken income tax-free.[8]

Types of life insurance distributions:

	Repayment Options	Impact on the Death Benefit	Charges	Taxation
Loans:[7,8]	When you take a loan from your policy's cash value,[6] you have the option to repay your loan at any time as long as your policy hasn't lapsed.	If you choose not to repay your loan, your death benefit will be proportionately reduced by the amount of the loan, including any accrued interest.	Although you'll be charged interest on your loan, your loan amount will also continue to earn interest. You have an option to take your loans either as an index loan or a standard loan. Your agent/producer can help explain the differences.	Loans are generally federal income tax-free as long as your policy doesn't lapse and your policy isn't a Modified Endowment Contract.[8]
Withdrawals:[7,8]	A withdrawal can't be repaid.	Any withdrawals permanently reduce the death benefit.	A fee of up to $100 may apply to each withdrawal request.	Any withdrawals up to the amount of the premiums paid can be taken income tax-free. Anything in excess will be taxed as ordinary income.[8]

The case studies on the following pages will show you how a life insurance strategy might work for your retirement planning situation.

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Case Study 1:

Maximize Your Retirement Income Using Tax-Free Sources

Mr. and Mrs. Brown are married and filing jointly, and both are 50 years old. They plan on retiring at age 67 and project the following sources of annual income:

- $50,000 combined Social Security
- $20,000 of net long-term capital gains
- $40,000 of ordinary income from a qualified retirement plan
- $10,000 pension
- **Total Income = $120,000**

Considering today's tax laws and the income outlined above, the Browns will pay an estimated $7,951 in federal income taxes on their $120,000 income.* This takes into account standard deduction of $25,100, plus $1,350 each since they are over 65. Although their federal marginal tax rate is 22%, their effective tax rate is 6.63%. (Note: Example does not reflect state taxes.)

How could we improve their tax situation?
Alternate portfolio assets to draw from could be useful. For example, if the Browns had a properly funded IUL policy or a Roth IRA they could use to provide supplemental retirement income – how would that affect their taxes?

Instead of having $40,000 of ordinary income in retirement, let's consider what would happen if that income came from a tax-free source, such as an indexed universal life insurance policy[9] or a Roth IRA.

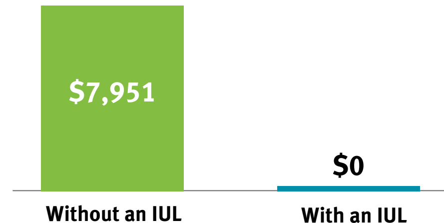
New sources of income:

- $50,000 combined Social Security
- $20,000 of net long-term capital gains
- $0 of ordinary income from a qualified retirement plan
- $40,000 of income from an IUL policy[9,10]
- $10,000 pension
- **Total Income = $120,000**

With this scenario, they have no federal tax burden on their $120,000 income.* Now that the Browns have no ordinary income, their provisional income is reduced to $55,000. With the higher standard deduction, this means they have a 0% marginal and effective tax rate.

By creating a tax-free bucket of income this couple reduced their tax rate from 6.63% to 0%. This saves them $7,951 in taxes. When these savings are replicated over a 20- to 30-year retirement, the savings can really add up – and that can help make your sources of retirement income last longer.

*As calculated for 2021 by the Tax Clarity™ software.



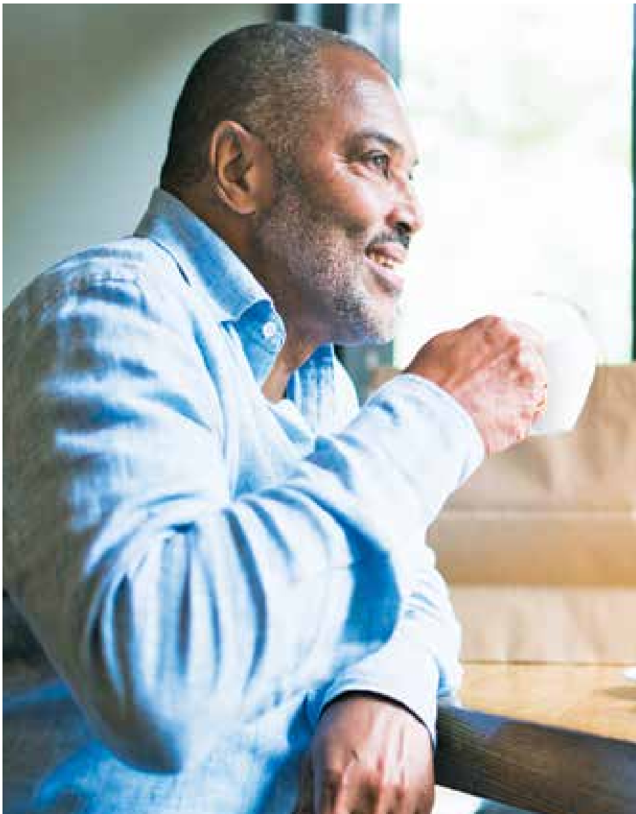
Case Study 2:

It's Not Too Late to Fund an IUL Policy

John Green, a 50-year-old male, is currently funding his employer-sponsored retirement plan. He wants to save as much as possible for retirement and is trying to be smart with his savings. Now that he has turned 50, he is allowed to make catch-up contributions to his retirement savings.

What is a Catch-up Contribution

The catch-up contribution provision was created by the Economic Growth and Tax Relief Reconciliation Act of 2001. It allowed individuals over age 50 to set aside more savings for retirement by contributing an additional amount to their 401(k) and/or individual retirement account (IRA).



His employer does not have a Roth feature in their qualified plan, so instead, he chooses to put his $7,000 catch-up contribution, plus an additional $3,000 annually toward funding an indexed universal life insurance policy. In a typical year, John receives a raise of $3,000 so he plans to use that money to help with the additional funding.

He makes a $10,000 annual contribution to an Income Advantage IUL policy with a death benefit of $215,000, which may increase over time as the accumulation value increases. After 18 years, he has paid $180,000 in premiums and has a projected cash value[11] of $291,486 (based on a projected rate of 6.17%).

At this point, he starts taking annual distributions of $20,000 for 32 years to supplement his retirement income.[10] By the time he turns age 93, Mr. Green will have received total tax-free income of $640,000.[9] Mr. Green pays in $180,000 over 18 years and receives $640,000 in income – more than $460,000 more than his total premiums paid.

For John Green, this is the perfect time to save – clients at age 50 often are empty nesters, at or near their highest earning capacity. They may have paid off their mortgage, so this is a great time to identify and use "found" money in their budget for retirement goals.

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[10] Any policy withdrawals, loans and loan interest will reduce policy values and benefits.

[11] The amount that may be available through loans or withdrawals, as defined in the contract.

Death benefit proceeds from a life insurance policy are generally not included in the gross income of the taxpayer/beneficiary (Internal Revenue Code Section 101(a)(1)). There are certain exceptions to this general rule including policies that were transferred for valuable consideration (IRC §101(a)(2)). This information should not be construed as tax or legal advice. Consult with your tax or legal professional for details and guidelines specific to your situation.

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This brochure is only a brief summary of some of the key features of this policy. For more complete information, you should refer to the form of the policy, including any applicable riders and endorsements to the policy, and other materials about the policy that you will receive. We strongly urge you to thoroughly review all of these items and to discuss any questions you have with our licensed agent/producer or with your own professional advisors, as appropriate.

All guarantees subject to the financial strengths and claims-paying ability of the issuing insurance company.

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