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Tax Planning and Your Retirement

Contents

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Our Federal Income Tax System

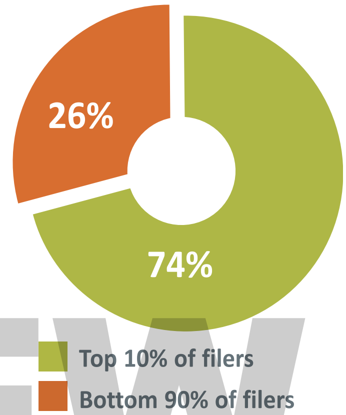
Progressive. The United States has a progressive tax system. Generally, the more taxable income you have, the higher the tax rate that will apply to your next dollar of income. For example, in 2023, a single filer is subject to a 10 percent tax rate on the first $11,000 of taxable income, a 12 percent tax rate on taxable income above $11,000 up to $44,725 — and the rate continues to step up until it reaches a top marginal rate of 37 percent, which applies to taxable income over $578,125. *(See tax tables on pages 5–6.)*

Voluntary. The federal income tax system has voluntary reporting. This simply means taxpayers are responsible for calculating their own taxes, reporting their taxes appropriately to the government, and paying any taxes due.

Unequal. Not everyone pays federal income tax equally. For the 2020 tax year, the top 50 percent of taxpayers were responsible for paying about 98 percent of total federal income taxes, as measured by reported adjusted gross income (AGI). About 74 percent of total federal income tax in 2020 was paid by the top 10 percent of filers — those with an adjusted gross income of $152,321 or more.

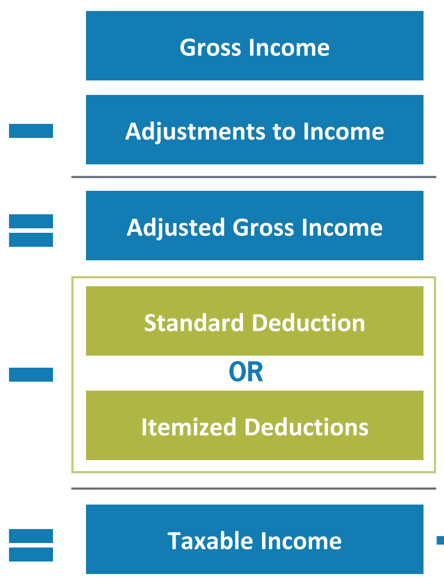
Source: IRS Statistics of Income, 2022 (2020 data is most recent available)

Percent of Total Federal Income Tax Paid for the Year



Federal Income Taxation at a Glance

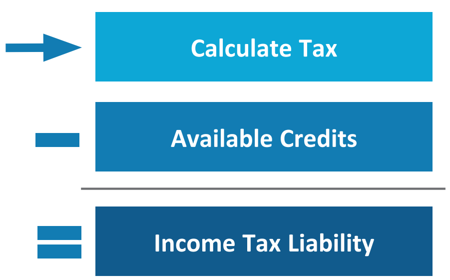
This is a simple illustration of how the federal income tax system works.



Gross income includes all your taxable income, such as wages and tips, dividends, capital gains, interest income, and taxable pension and Social Security income.

You then subtract **adjustments to income**, such as deductible contributions to a traditional IRA (with limitations), to compute your **adjusted gross income**.

After subtracting deductions (using the standard deduction or itemizing deductions), you arrive at your **taxable income**, which is used to calculate your tax. After subtracting any available credits, you arrive at your **income tax liability**.



Recent Tax Legislation

The **Tax Cuts and Jobs Act** was a sweeping $1.5 trillion tax-cut package that passed in late 2017 and dramatically reshaped the tax landscape. The legislation made significant changes to the tax rules that govern businesses and that relate to individuals. Most of these tax changes were effective on January 1, 2018. Changes affecting individuals are scheduled to expire at the end of 2025, whereas most of the business tax changes are permanent.

The **Setting Every Community Up for Retirement Enhancement (SECURE) Act** was enacted in December 2019 as part of a larger federal spending package. The legislation expanded savings opportunities for workers and included new requirements and incentives for employers that provide retirement benefits. It also eliminated the age limit for contributing to a traditional IRA. Most provisions were effective on January 1, 2020.

Tax changes were included in several pieces of legislation passed in 2020 to help support the economy and alleviate financial hardship during the COVID-19 pandemic. This legislation included the **Families First Coronavirus Response Act (FFCRA)**, the **Coronavirus Aid, Relief, and Economic Security (CARES) Act**, and the **Consolidated Appropriations Act, 2021**, which among other changes, permanently lowered the medical expense deduction to 7.5 percent of adjusted gross income. An additional relief package, the **American Rescue Plan Act of 2021 (ARPA)**, was passed in 2021.

Last year's **Inflation Reduction Act** included a host of health care and energy-related provisions and credits, a new corporate alternative minimum tax, and a funding infusion for the Internal Revenue Service (IRS).

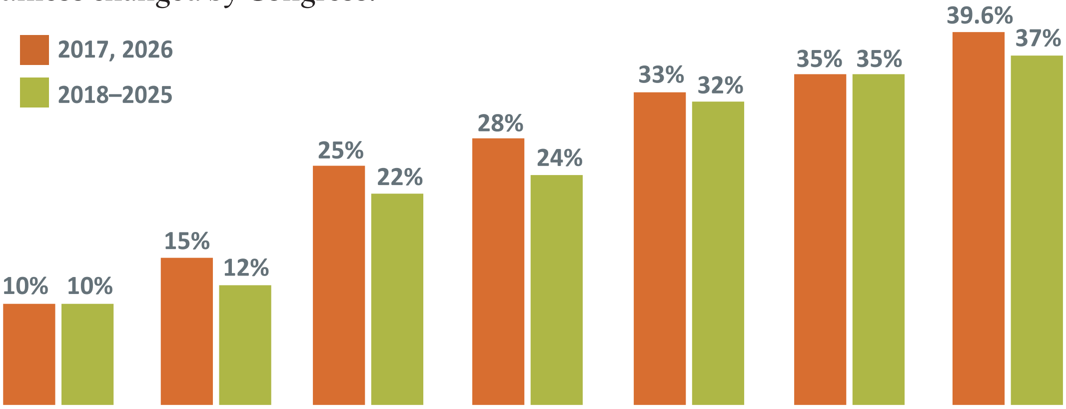
And the omnibus spending bill passed in the final days of 2022 included legislation we refer to as **SECURE 2.0**, which made significant changes to retirement plans and IRAs. Many of these changes are already effective, while others will take effect in future years.

How SECURE 2.0 Affects Retirement Planning

The 2019 SECURE Act raised the age at which retirement savers must begin taking distributions from their traditional IRAs and most work-based retirement savings plans to 72. SECURE 2.0 raises that age again to 73 beginning in 2023 and 75 in 2033. Among other provisions, SECURE 2.0 also implements changes to the penalty that applies when you fail to take required distributions, and the rules that apply to required distributions from Roth 401(k) accounts.

Marginal Tax Rates

The Tax Cuts and Jobs Act replaced five of the seven previous marginal income tax brackets with lower rates. These rates are scheduled to expire after 2025, unless changed by Congress.



Taxes Aren't Constant

U.S. tax laws change with relative frequency, which adds a layer of uncertainty when making financial decisions.

Additional tax changes are likely.

2023 Tax Tables, by Filing Status

Single	
If taxable income is:	**Then income tax equals:**
Not over $11,000	10% of taxable income
Over $11,000 to $44,725	$1,100.00 + 12% of the excess over $11,000
Over $44,725 to $95,375	$5,147.00 + 22% of the excess over $44,725
Over $95,375 to $182,100	$16,290.00 + 24% of the excess over $95,375
Over $182,100 to $231,250	$37,104.00 + 32% of the excess over $182,100
Over $231,250 to $578,125	$52,832.00 + 35% of the excess over $231,250
Over $578,125	$174,238.25 + 37% of the excess over $578,125

Head of Household	
If taxable income is:	**Then income tax equals:**
Not over $15,700	10% of taxable income
Over $15,700 to $59,850	$1,570 + 12% of the excess over $15,700
Over $59,850 to $95,350	$6,868 + 22% of the excess over $59,850
Over $95,350 to $182,100	$14,678 + 24% of the excess over $95,350
Over $182,100 to $231,250	$35,498 + 32% of the excess over $182,100
Over $231,250 to $578,100	$51,226 + 35% of the excess over $231,250
Over $578,100	$172,623.50 + 37% of the excess over $578,100

2023 Tax Tables, by Filing Status

Married Filing Jointly (and Surviving Spouses)	
If taxable income is:	**Then income tax equals:**
Not over $22,000	10% of taxable income
Over $22,000 to $89,450	$2,200 + 12% of the excess over $22,000
Over $89,450 to $190,750	$10,294 + 22% of the excess over $89,450
Over $190,750 to $364,200	$32,580 + 24% of the excess over $190,750
Over $364,200 to $462,500	$74,208 + 32% of the excess over $364,200
Over $462,500 to $693,750	$105,664 + 35% of the excess over $462,500
Over $693,750	$186,601.50 + 37% of the excess over $693,750

Married Filing Separately	
If taxable income is:	**Then income tax equals:**
Not over $11,000	10% of taxable income
Over $11,000 to $44,725	$1,100 + 12% of the excess over $11,000
Over $44,725 to $95,375	$5,147 + 22% of the excess over $44,725
Over $95,375 to $182,100	$16,290 + 24% of the excess over $95,375
Over $182,100 to $231,250	$37,104 + 32% of the excess over $182,100
Over $231,250 to $346,875	$52,832 + 35% of the excess over $231,250
Over $346,875	$93,300 + 37% of the excess over $346,875

State Income Taxes

Nine states have no general income tax — Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming. For retirees, this means no state income tax on Social Security benefits, retirement plan withdrawals, and pension payouts.

Source: taxfoundation.org, February 21, 2023

Effective Tax Rate

Another way to think about your tax situation is in terms of your effective tax rate, which is basically the total amount of tax paid divided by your taxable income.

A single filer with $50,000 in taxable income would be in the 22 percent marginal tax bracket but would have an effective tax rate of 12.62 percent. The formula for 2023 tax liability would be:

First $11,000 at 10% = $1,100.00
Next $33,725 at 12% = $4,047.00
Next $5,275 at 22% = $1,160.50
$6,307.50

$6,307.50 ÷ $50,000 = 12.62% effective tax rate

