5 New Taxes to Watch Out for in Retirement

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Factor in these new types of taxes in retirement. (iStockPhoto)

Once you retire, you will probably have less money coming in than you did while you were working. Some people even drop into a lower tax bracket when they retire. There are also a variety of tax breaks specifically for older people. However, several new types of taxes might come up in retirement. Here are some of the taxes retirees might incur.

Required minimum distributions. Annual distributions from traditional 401(k)s and traditional IRAs are required after age 70 1/2. Income tax will be due on each withdrawal. A retiree in the 25 percent tax bracket who withdraws $5,000 from an IRA will owe $1,250 for income tax on the distribution. "Many people will start taking money out of their retirement account in big chunks to get this done with, but that's a mistake that can sometimes throw you into a higher tax bracket," says Jill Schlesinger, a certified financial planner and Senior CFP Board Ambassador.

[See: How to Max Out Your 401(k) in 2017.]

There are a couple of ways to delay or avoid paying tax on required minimum distributions under very specific circumstances. Savers who work in retirement for a company they don't own may be able to delay required minimum distributions from the 401(k) associated with their current job until they actually retire, if the plan allows it. However, distributions from 401(k) plans from previous employers and traditional IRAs are required regardless of your employment status. Also, people age 70 1/2 or older who directly transfer up to $100,000 from an IRA to a qualified charity can satisfy their distribution requirement without paying any tax on the transaction. "They can actually send it directly from the IRA and it counts toward their RMD, yet it won't be considered in their taxable income," says Steven Podnos, a certified financial planner for Wealth Care in Cocoa Beach, Florida. "That may help them keep inside a lower bracket and pay overall lower taxes."

Distributions from Roth 401(k)s are also required after age 70 1/2, unless you are still working for a company you don't own. However, if you are taking a withdrawal from a Roth account that is at least 5 years old and you are over age 59 1/2, you won't have to pay income tax on the distribution.

Roth IRAs don't have any distribution requirements for the original account owner. Your money can continue to grow tax-free in a Roth IRA for the rest of your life, and you don't have to withdraw the money unless you need it. "As you get older, it's so nice to have this Roth asset that has already been taxed and is not subject to RMDs," Schlesinger says. Distributions from Roth IRAs in retirement are often tax-free.

[Read: How to Pay Less Taxes on Retirement Account Withdrawals .]

Two required minimum distributions in the same year. Taxpayers who turn 70 1/2 during 2017 must take their first required minimum distribution by April 1, 2018. However, all subsequent distributions must be taken by Dec. 31 each year, so the second RMD will be due by Dec. 31, 2018. Taking two distributions in the same year can result in an abnormally high tax bill in a single year. In some cases, taking the distribution during separate calendar years can help to keep your tax bill manageable, but there are also cases when it makes sense to double up. "Let's say in the year you turn 70 1/2 you are still working and in a higher tax bracket. You might not want to take the RMD and tack that on top of your earned income," says Jennifer Failla, a certified financial planner for Strada Wealth Management in Austin, Texas. "If you retire the next year, you can take them both when you don't have another source of income."

Forgetting a 401(k) or IRA withdrawal. There's a 50 percent tax penalty if you fail to take annual distributions from your traditional retirement accounts after age 70 1/2. That tax penalty is applied in addition to the income tax you owe on traditional retirement account distributions. A retiree in the 25 percent tax bracket who skips a $5,000 required IRA withdrawal will owe $3,750 in taxes and penalties. "If you have four different IRA accounts, you can do a calculation based on the total value of those IRAs and take one distribution, but you can't do that with a 401(k)," Schlesinger says. "You have to take a separate distribution from the 401(k)."

You can no longer claim a tax break for IRA contributions. Many working people are able to reduce their taxable income by contributing to an IRA. However, once you turn age 70 1/2 you are no longer eligible to claim a tax deduction for saving in a traditional IRA. However, people who are still working in their 70s can continue to save in a 401(k) plan and defer paying income tax on deposits, often until they actually retire. You can also continue to make contributions to a Roth IRA regardless of your age.

[Read: 6 Social Security Calculators That Can Help You Decide When to Claim.]

Social Security taxes. You might have to pay taxes on part of your Social Security income. If the sum of your adjusted gross income, nontaxable interest and half of your Social Security benefit exceeds $25,000 for individuals and $32,000 for couples, half of your Social Security benefit will be taxable. If these income sources exceed $34,000 for individuals and $44,000 for couples, as much as 85 percent of your Social Security payments could be subject to tax. Income received from a part-time job, dividends, interest, taxable pension payments and withdrawals from traditional 401(k)s and IRAs could all lead to your Social Security benefit becoming taxable. However, Roth 401(k) and Roth IRA distributions in retirement are not typically taxable and probably won't contribute to your Social Security benefit being taxed. "It's very rare that people don't have to pay taxes on Social Security," Podnos says. "If you have any significant income other than Social Security, you're going to have your Social Security at least partially taxed."

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10 Tax Breaks for People Over 50

Slideshow

(Getty Images)

The perks of aging

Once you turn 50, and especially after age 65, you can qualify for extra tax breaks. Older people get a bigger standard deduction, and they can earn more before they have to file a tax return at all. Workers over 50 can also defer or avoid taxes on more money using retirement and health savings accounts. Here are some ways to save money on taxes as you age.

Bigger standard deduction

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Bigger standard deduction

If you don’t itemize your tax deductions, you can claim a larger standard deduction if you or your spouse is age 65 or older. The standard deduction amount for older taxpayers is $1,250 higher than the deduction for people under age 65. And if a retiree is unmarried and not a surviving spouse, the standard deduction is $1,550 higher than that of younger taxpayers.

Higher tax-filing threshold

(Getty Images)

Higher tax-filing threshold

People age 65 and older can earn a gross income of up to $11,900 ($23,200 for couples both age 65 and older) before they are required to file a tax return. That's $1,550 (or $1,250 per spouse) more than the tax-filing threshold for younger workers.

Property tax breaks

(Getty Images)

Property tax breaks

Property tax rules vary considerably by state and local jurisdiction. However, in some places people who are above a certain age and who also earn below a specific income level qualify for property or school tax deferrals or exemptions.

Credit for the elderly or disabled

(Getty Images)

Credit for the elderly or disabled

If you or your spouse is age 65 or older, you have a low income and you file using form 1040 or 1040A, you could be eligible to claim a tax credit. Retirees who qualify may be able to reduce their tax bill by taking the credit. Younger people who are retired and disabled might also qualify.

Additional IRA deduction

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Additional IRA deduction

Workers age 50 and older can contribute an additional $1,000 to an IRA, or a total of $6,500 in 2017. A 50-year-old worker in the 25 percent tax bracket who maxes out his IRA would save $1,625 on his current tax bill, $250 more than the maximum possible tax break of $1,375 for a younger retirement saver in the same tax bracket.

401(k) catch-up contributions

(Getty Images)

401(k) catch-up contributions

The tax savings is even bigger for older workers with access to a 401(k) plan. Employees age 50 and older can defer paying income tax on $6,000 more than younger workers if they contribute that amount to a 401(k) plan, or a total of $24,000. An older worker in the 25 percent tax bracket who maxes out his 401(k) plan could save $6,000 on his current tax bill, $1,500 more than a younger worker in the same tax bracket could potentially save. Income tax won't be due on this money until it is withdrawn from the account.

No more early withdrawal penalty

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No more early withdrawal penalty

Younger workers who raid their retirement accounts are hit with a 10 percent early withdrawal penalty unless the money is used for a couple of specific purposes. However, once you turn age 59 1/2, you can withdraw money from an IRA for any reason without incurring the 10 percent tax. And if you leave your job at age 55 or later, you can begin penalty-free 401(k) distributions from the account associated with the job you most recently left at that time. However, income tax will be due on withdrawals from traditional retirement accounts at any age.

Avoid tax on required minimum distributions

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Avoid tax on required minimum distributions

After age 70 1/2, you are typically required to withdraw money from your traditional retirement accounts and pay the resulting income tax bill. However, if you don't need the money, there is one way to avoid income tax on withdrawals from traditional retirement accounts. Retirees ages 70 1/2 and older who transfer any amount up to $100,000 directly from their IRA to a qualified charity will not owe income tax on the contribution.

Higher HSA contribution limit

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Higher HSA contribution limit

Workers with high-deductible health plans can claim a tax deduction on contributions to a health savings account. Distributions from these accounts are tax-free when used to pay for qualifying medical expenses. Individuals who are age 55 or older by the end of the tax year are eligible to contribute up to $4,400 to a health savings account, $1,000 more than their younger counterparts.

Free tax help

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Free tax help

The Tax Counseling for the Elderly program provides free tax assistance to those age 60 or older. IRS-certified volunteers assist older taxpayers with basic tax return preparation and electronic filing between Jan. 1 and April 15 each year.

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