How Tax Clarity™ works with Social Security Timing®

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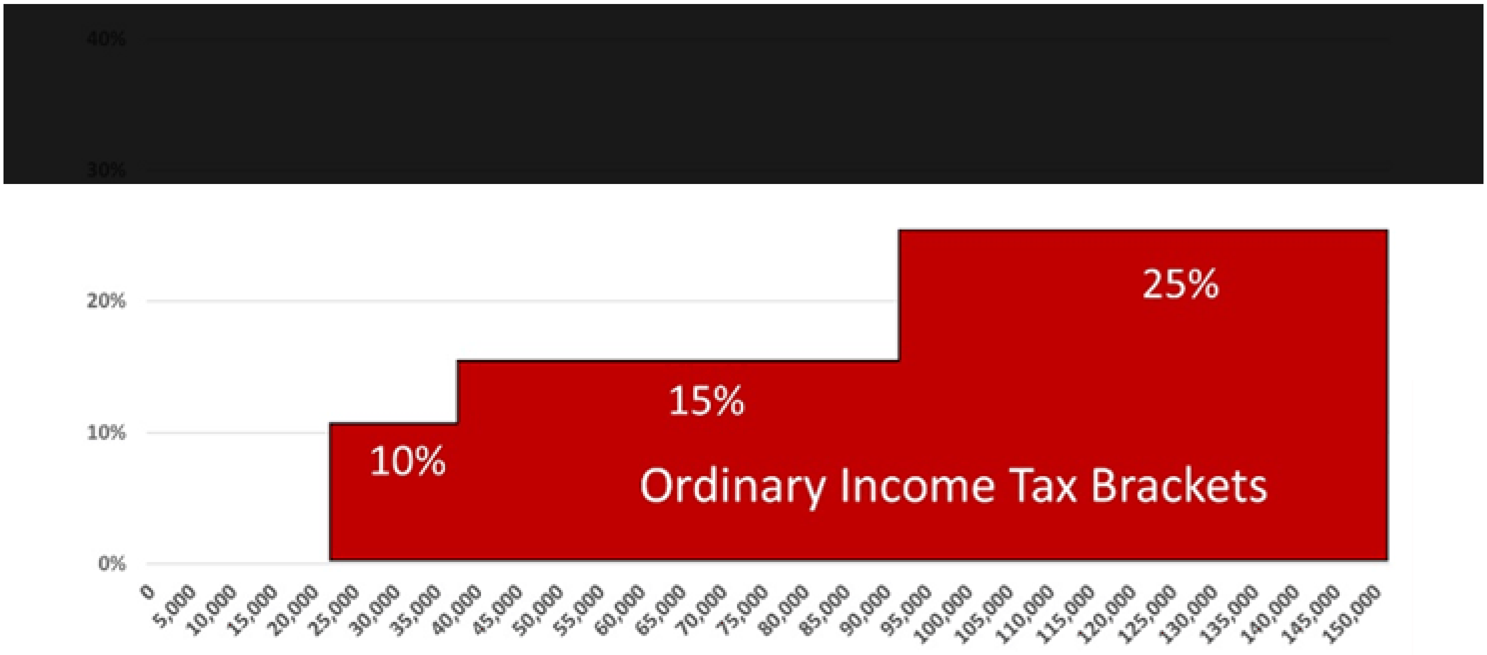
Last week, the makers of Social Security Timing® released another innovative software program for financial advisors to help their clients with their retirement planning decisions.

Tax Clarity™ is the first program that unveils the hidden marginal income tax rates that can cause significant financial damage to a retiree's cash flow.

Social Security Timing's original software program was developed so financial advisors could assist clients in evaluating their options relative to claiming Social Security retirement benefits. While the Social Security claiming decision is a critical foundational retirement planning decision, it frequently is made without looking forward to the impact of other changes in the retirement income plan. For example, once a retiree reaches the age of mandatory retirement plan distributions, that additional taxable income automatically adds additional income taxes to the equation.

Unfortunately, most individuals and their financial advisors think that additional income in retirement will be taxed at their relative federal income tax bracket, such as the 10, 15 and 25% brackets that cover the range of taxes experienced by the vast majority of retirees.

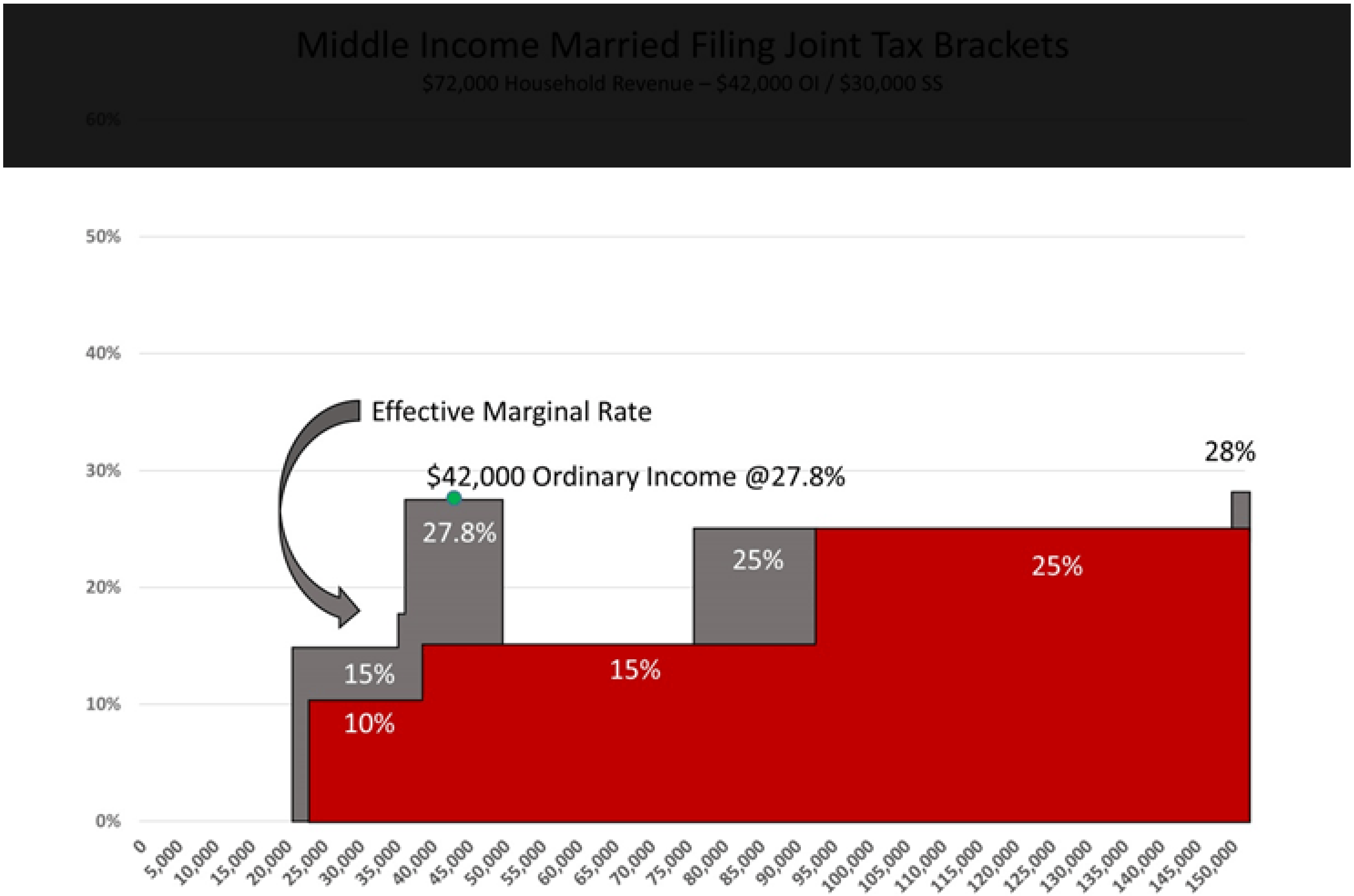


The reality for Social Security recipients is that they have to deal with not only the increasing brackets from 15 to 25%, but also the additional reality of what's known as the effective marginal rate. This is the rate at which one additional dollar will be taxed when added to income. Those rates fall into the following ranges: 18.8%, 27.8%, 46.3% and most amazing of all, a 55.5% marginal rate. That means for each dollar of additional income, more than half will be lost in income taxes. Up until now, today's retirees had to make their Social Security claiming decisions without being able to clearly see how those claiming decisions would be reflected in their spendable household income. As we teach in our two-day Social Security training, The School, an advisor can assist not only in the optimization of a client's Social Security retirement benefit, but also with their net household income and ultimate net worth.

Case study

When we consider the optimization of Social Security benefits, we look to the following case in which a couple is considering early retirement at age 62. Their household income consists of $42,000 of ordinary income (pensions or IRA withdrawals or the like) and $30,000 of Social Security benefits. As an alternative, we consider a claiming strategy that provides some interim Social Security benefits while the ultimate benefit at age 70 maximizes at $52,000. The Social Security benefits are then supplemented with $20,000 of ordinary income so that the second scenario has the identical household income.

Tax Map for early claiming

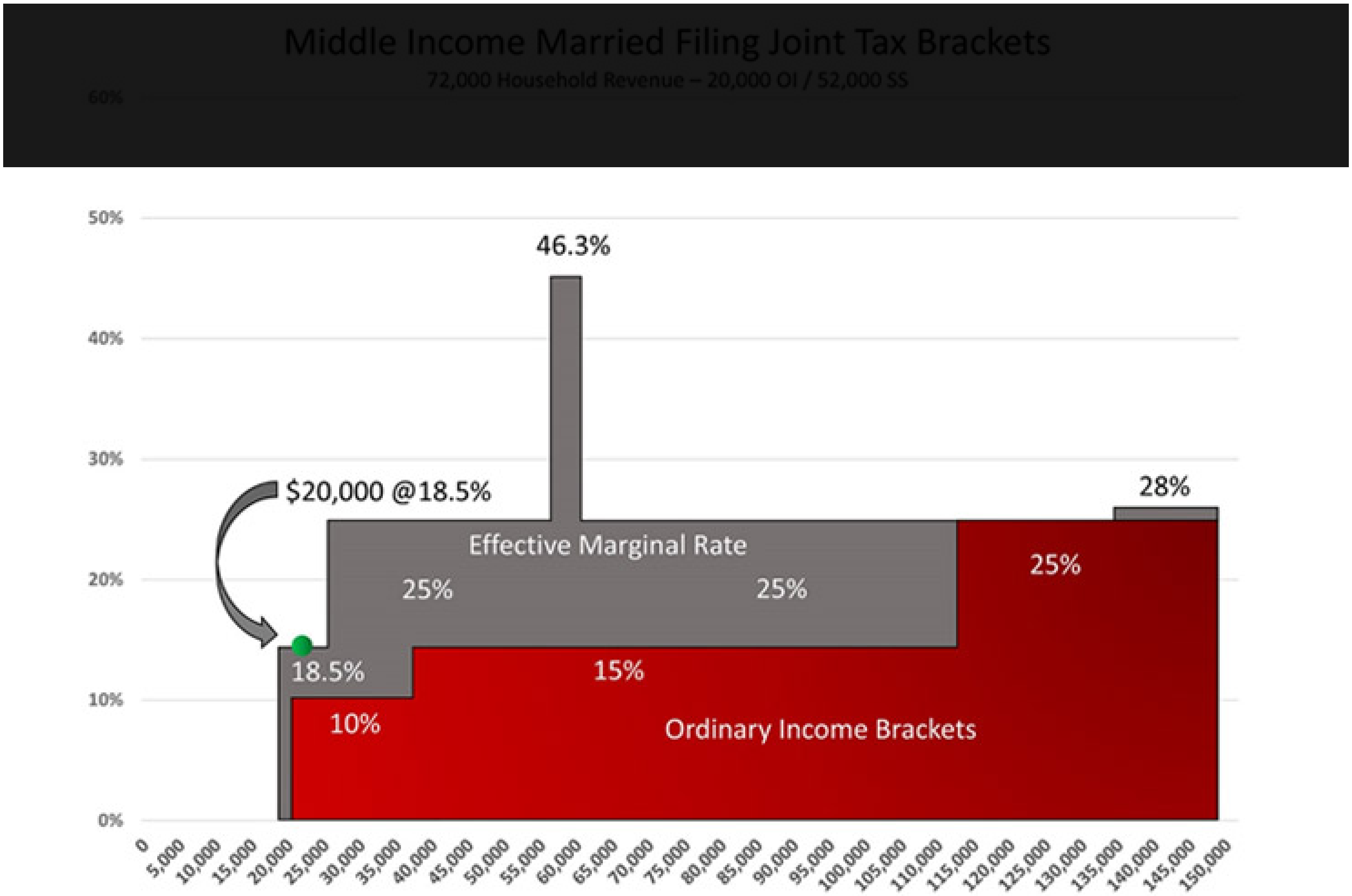


In the early claiming strategy — shown here in what we call a Tax Map illustration — you can see that the client's ordinary income and Social Security blend has landed them in the 27.8% effective marginal rate on their next dollar of income. Tested for various jurisdictions across the United States, this couple would have an average annual state and federal income tax bill of $6,011.

If however, the clients can delay the claiming of their Social Security retirement benefits to age 70, their blend of ordinary income and Social Security benefits produces a much different Tax Map. Not only has the landscape of the marginal rates changed, but the combined state and federal tax has been reduced by an average of 90% in the cases that we sampled. The average combined tax bill for 2015 was cut to $614 per year.

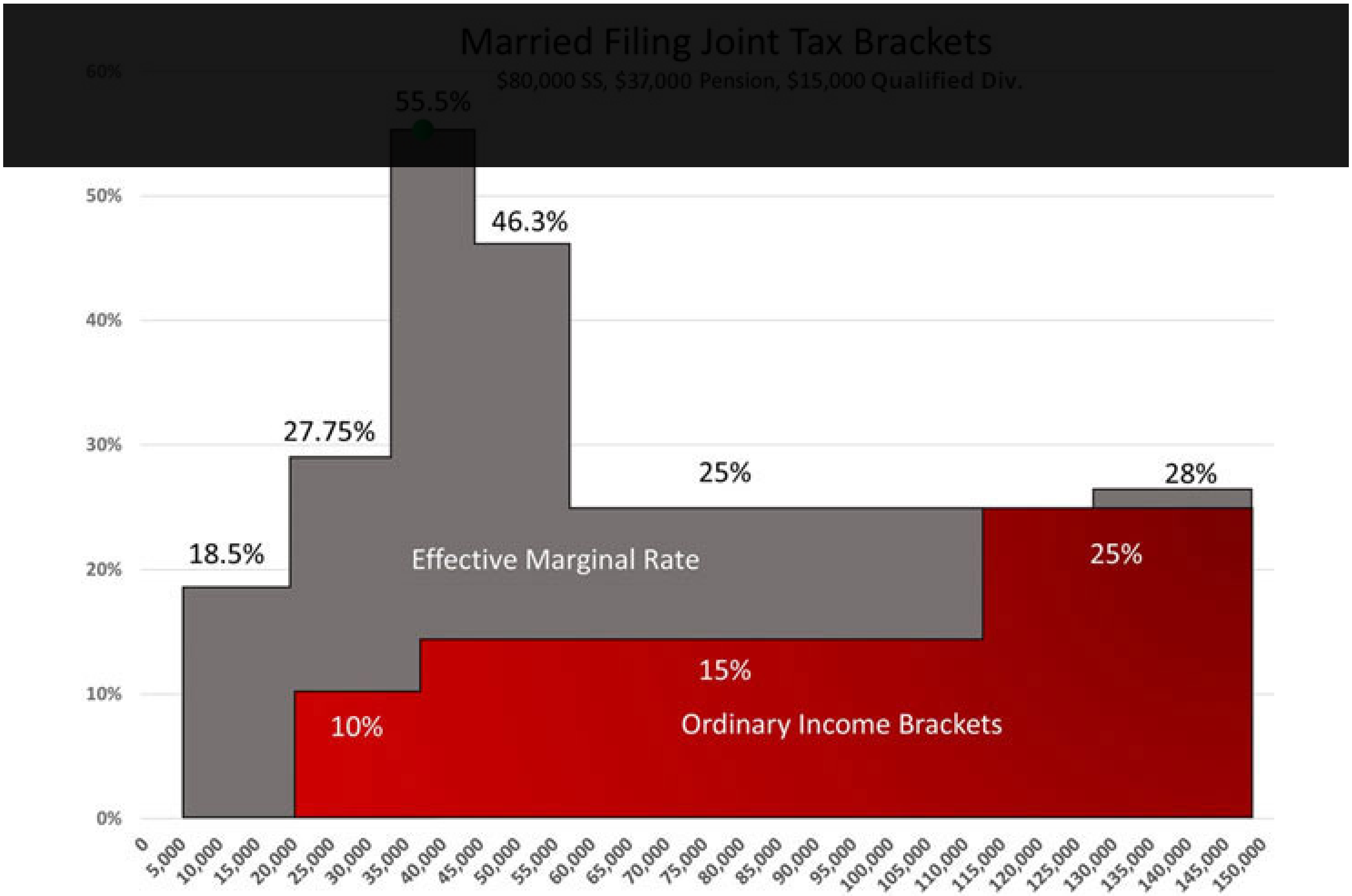
The Bipartisan Budget Act of 2015 eliminated and is phasing out some Social Security claiming strategies that would have provided additional income to clients you helped with Social Security Timing. You can help clients replace that lost income, by using Tax Clarity to find additional net household income.

Tax Map for delayed claiming



Social Security recipients face the highest marginal rates in the country

As a part of the testing process in the development of Tax Clarity, we looked at numerous combinations of the various components of income in the retirement income plan. As a result of our analysis, we found that today's Social Security recipients may be exposed to the highest marginal rates for all tax payers. As an example, consider the following case: clients are both over age 65 and claim the standard deduction. They have Social Security retirement benefits of $80,000 (two current maximum benefit wage earners deferring benefits to age 70). Pensions and IRA withdrawals add an additional $37,000 of income. Finally, the clients have inherited a portfolio of stocks that produce $15,000 of qualified dividend income.



Note that the couple lands in the highest marginal rate possible in the country today. The primary reason for the massive tax on the next dollar of income is that each dollar of ordinary income drags 85% of an equivalent amount of Social Security benefits onto the tax return. Then the combined ordinary income and additional Social Security income pushes the qualified dividend into taxable status. As a result, an additional $1.85 of formerly untaxed qualified income is taxed at the 15% rate. When these two separate consequences are added together, one additional dollar of income will lose 55.5% in federal income taxes. State income taxes will only add additional insult to this injury.

Conclusion

By using Tax Clarity in combination with Social Security Timing, financial advisors are able to broaden the scope of their planning advice in a way like never before.

Until the release of Tax Clarity, retirees and pre-retirees could only guess at the financial consequences of their retirement income planning decisions. Armed with a visual representation of the true net tax consequence of clients' combined income streams, advisors can help their clients understand more of the complexities surrounding the building of their retirement income plan. No longer will the consequences of income planning for retirees be hidden behind the false wall of the 10, 15 and 25% income tax brackets.

Finally, advisors and their clients will be able to see the consequences of the financial decisions that they need to make in setting up and planning for their retirement as well as the management of their planning over their retirement years. We are pleased to be able to assist financial advisors in their efforts to provide clear and effective retirement planning advice to their clients.

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← Micro-site to be disabled Jan. 4 as part of improvements

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