CPA Practice Advisor

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Think taxes get a lot easier when you retire? Like everything else in life, it depends, especially since the tax aspects of Social Security, 401(k) withdrawals and IRAs can get pretty confusing.

"I get a lot of clients asking me about taking money out of a retirement account, but seldom are they aware of the affect that has on the taxability of their Social Security benefits," said Laurie Ziegler, EA, an enrolled agent with Sass Accounting in Saukville, WI. "Most of the time, if Social Security is your only income, it's not taxable, and you probably don't need to file a federal income tax return. But what a lot of people are unaware of is that they can be taxed on their Social Security if other

If the amount is greater than the base amount for your filing status, a part of your benefits will be taxable. If you are filing a joint return and you and your spouse have a combined income of more than $44,000, up to 85 percent of your benefits maybe taxable, so instead of adding half your benefits to your other income, you would add 85 percent, and subtract nontaxable income.

Taxpayers can find the base amounts on the IRS website. It's wise to consult an enrolled agent ***before*** such a transaction, because there are ways to minimize the tax impact, such as splitting a withdrawal between two years.

Then, there are 401(k) and other similar tax-deferred retirement savings plans: Many retirees are confused about the tax implications of withdrawing from them. Some of the options the NAEA recommends for 401(k)s are:

- **Taking a regular distribution.** If you are 59½ years-old and retired, you can take a regular withdrawal from your retirement account, but you must pay taxes on it. No penalties will apply.
- **Roll it over into an IRA.** You'll have greater control over your money, and if you or your spouse has earned income, you can still contribute up to $6,000/year at age 50 or over. Just make sure you tell your employer to transfer your 401(k) assets directly to the IRA custodian. Otherwise, your company will withhold 20 percent for taxes if it sends the money to you. Then you'll have 60 days to move the entire 401(k) balance – even the 20 percent you didn't receive – into an IRA. You won't have to pay taxes on this money until you withdraw it.
- **Take a lump sum.** As with many of these options, you'd be wise to consult with an enrolled agent first. If you cash out your company retirement account entirely, you will have to pay taxes at your regular income tax rate on the entire amount – not just earnings. A big lump sum could inflate your annual earnings to the point at

which you would be subject to the alternative minimum tax (AMT), and nobody

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