

Tax Considerations for Retirees

Are you aware of these potential tax breaks and tax-saving opportunities?

The federal government offers some major tax breaks for older Americans. Some of these perks deserve more publicity than they receive.

At age 65, the Internal Revenue Service gives you a larger standard deduction. For 2020, standard deductions look like this for taxpayers 65 and older: single filer or married filing separately, \$14,050; head of household, \$20,300; married filing jointly or qualifying widow(er), \$26,100 (when one spouse is 65 or older) or \$27,400 (when both spouses are 65 or older). The standard deductions for younger taxpayers range from \$1,650-\$2,600 less.¹

There are two situations where your standard deduction may be limited at age 65 or older, or disappear entirely. One is when another taxpayer claims you as a dependent. The other is when you are married and filing separately, and your spouse itemizes deductions.¹

You may be able to write off some medical costs. The I.R.S. will let you deduct qualifying medical expenses once they exceed 7.5% of your adjusted gross income (AGI). The list of eligible expenses is long. Beyond out-of-pocket costs paid to doctors and other health care professionals, it also includes things like insurance premiums for extended care coverage, travel costs linked to medical appointments, and payments for durable medical equipment, such as dentures and hearing aids.²

Are you thinking about selling your home? Many retirees consider this. If you have lived in your current residence for at least two of the five years preceding a sale, you can exclude as much as \$250,000 in gains from federal taxation (a married couple can shield up to \$500,000). These limits, established in 1997, have never been indexed to inflation. This exclusion is only allowed once every two years.³

Low-income seniors may qualify for the Credit for the Elderly or Disabled. This incentive, intended for people 65 and older, can be as large as \$7,500 based on your filing status. You must have very low AGI and nontaxable income to claim it, though. It is basically designed for those living wholly or mostly on Social Security benefits.⁴

Affluent IRA owners may want to make a charitable IRA gift. Generally, once you reach age 72, you must begin taking required minimum distributions (RMDs) from a traditional IRA. You may not be looking forward to these annual withdrawals, especially if you are well off. You have another option: you can make a Qualified Charitable Distribution (QCD) using those traditional IRA assets.⁵

You can donate up to \$100,000 of traditional IRA assets to a qualified charity in a single year this way, and the amount donated counts toward your required withdrawal. The amount of the

QCD is excluded from your gross income for the year of the donation. Eligibility to make a QCD still begins at 70½, even though the Setting Every Community Up for Retirement Enhancement (SECURE) Act raised the starting age for annual traditional IRA distributions from 70½ to 72.⁵

It must be mentioned that withdrawals from traditional IRAs are taxed as ordinary income (and, if taken before age 59½, may be subject to a 10% federal income tax penalty).

Of course, some states also give seniors tax breaks. For example, the following 11 states do not tax federal, state, or local pension income: Alabama, Hawaii, Illinois, Kansas, Louisiana, Massachusetts, Michigan, Mississippi, Missouri, New York, and Pennsylvania. Twenty-eight states (and the District of Columbia) refrain from taxing Social Security income.⁶

Unfortunately, your Social Security benefits could be partly or fully taxable. They could be taxed at both the federal and state level, depending on how much you earn and where you happen to live. Whether you feel this is reasonable or not, you may have the potential to claim some of the tax breaks mentioned above as you pursue the goal of tax efficiency.⁷

This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

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Citations.

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