

One key to creating a realistic retirement plan is to understand how taxes will affect your future income—and your quality of life. AARP's online Retirement Planning Calculator is a good tool to develop your plan. To get the most out of the Calculator, you need to be aware of some tax issues that may make a big difference to you when you retire.

Pre-Retirement Tax Issues

Hopefully, you're contributing as much as you can to some type of retirement savings on a regular basis. But the type of plan you contribute to can make a difference in your tax bill after you retire.

Whether you have a 401(k) or similar account offered by your employer, a retirement plan you've set up for your own small business, or an IRA, you can get a tax break for contributing to the account. Because the tax benefits are not the same, you need to choose the account that is best for you. Here are some basics. For more details, see AARP's Tip Sheets on 401(k)s and IRAs.

- **A traditional 401(k) or traditional IRA:** You receive a tax deduction in the same year you contribute. If you have enough income to meet your current needs and are concerned about reducing your current taxes, this type of account may be best for you. Just remember that when you start taking the money out, you'll need to pay income tax on it.
- **Roth 401(k) or Roth IRA:** The other option is a Roth 401(k), if your employer offers it, or a Roth IRA. You pay income tax on the money you use to fund either Roth in the same year that you make your contribution. When you retire and take the money out, the money you contributed, plus the earnings income, will be tax-free.

As part of your retirement planning, be sure to include in your retirement budget funds to pay the

income tax on withdrawals from your retirement accounts.

Also, see if you qualify for the Retirement Savings Contribution Credit. If you're a single taxpayer with an income up to \$25,000, or a married couple with income up to \$50,000, you can get a credit for up to \$1,000 (\$2,000 for a couple) for money you've put into a 401(k), IRA or similar IRS-approved retirement account.

Here's how it works: For example, if you and your spouse file jointly and earn \$32,000 and contribute \$1,000 to your IRA in 2008, the IRS will give you credit for half of it. That's \$500 off your tax bill.

Tax Issues in Retirement

When you retire and stop earning wages, your tax situation will change. Some changes will result from not getting a regular salary. Others will come from lifestyle decisions, such as where you live. As you create your retirement budget and make lifestyle decisions, check out how these tax issues could affect your bottom line:

- **Federal income taxes:** Depending on your income, you may have to pay taxes on some of your Social Security benefit. You'll also have to pay tax on payouts from a traditional pension, annuity, traditional IRA, 401(k) or similar account. Also, starting at age 70 1/2, you'll be required to take regular withdrawals (known as "required minimum distributions" or RMDs). If you're still working at age 70 1/2, check with your human resources department about delaying withdrawals from your retirement plan at work.
- **State income taxes:** As of 2008, seven states had no income tax at all. More than half of the states do not tax Social Security income, and more than half do not tax some or all of your pension income.

Taxes on Your Social Security Benefit

Here are the basic rules on who has to pay:

- If you get between \$25,000 and \$34,000 from Social Security, wages, interest and dividends, you pay tax on 50 percent of your Social Security benefit.
- If you get more than \$34,000, you pay tax on up to 85 percent of your Social Security benefit.
- A married couple filing jointly with income between \$32,000 and \$44,000 pays 50 percent, while a couple with more than \$44,000 pays taxes on up to 85 percent of their Social Security benefit.

States that offer these benefits may have high sales taxes, so check them both out if you're thinking about moving.

- **Property taxes:** As long as you own your home, you'll have to pay property taxes. Your county or town may require you to pay additional taxes. Many states and local areas have special laws giving older homeowners a reduction in their property tax, called a "homestead exemption" or a "circuit breaker credit."

- **Selling your home:** If you decide to sell your home, you may benefit from the federal "capital gains exclusion" on the profit. To qualify, you must have lived in the home for at least two out of the last five years. If you meet the residency requirement, when you sell you do not have to pay taxes on up to \$250,000 of profit from the sale if you're an individual, or \$500,000 for a couple. This is a great tax break if your home has gone up a lot in value.
- **Caregiving:** If you hire a caregiver for your spouse, a child or other person who depends on you financially—and if you are working—you may be able to get some tax relief. Known as the Child and Dependent Care Credit, this tax rule can help reduce your tax bill by between 20 and 35 percent of caregiving expenses, depending on your income.

Your To-Do List:

- Read IRS publications on the following tax issues discussed in this Tip Sheet. You can read them on the website at www.irs.gov or order copies by calling IRS's toll-free number, 1-800-829-3676.
 - Publication 590, Individual Retirement Arrangements
 - Publication 503, Child and Dependent Care Expenses
 - Publication 523, Selling Your Home
- Skim IRS Publication 554, "Older Americans' Tax Guide," to make sure you are aware of all the issues you need to know about.
- If you own or work for a small business, check out retirement savings options at the Small Business Administration website, www.sba.gov/services/training/nationwide/basics_whatish.htm.
- Learn about state taxes that affect seniors, at the website of the Institute on Taxation and Economic Policy, www.ctj.org/itep/pb30eld.pdf.
- Get help with tax filing from AARP's national, free Tax-Aide program. To find a local contact, contact Tax-Aide at taxaide@aarp.org, or call them at 1-888-AARPNOW.

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