

Paying Estimated Income Taxes in Retirement

When you are a W2 employee, your employer withholds a certain percentage of your salary from each paycheck based on what your tax liability is assumed to be for the year. However, when you are retired and taking distributions from retirement accounts, the burden of paying your tax liability falls on you!

For many people, estimating your tax liability can be difficult - especially at the beginning of the year.

If you can accurately predict your total taxable income and tax liability for the year, one of the first two options might make the most sense. If you are unaware of what your total tax liability will be until the end of the year, the third option will likely provide you with the most flexibility with paying your taxes.

Below are three strategies that aim to making the process of paying estimated taxes a breeze!

- 1) Withhold a certain percentage from each pre-tax IRA distribution
- 2) Make quarterly estimated tax payments based on your expected taxable income from all sources and how much you expect to pay in taxes at the end of the year; or
- 3) Make a single end-of-year IRA distribution, withholding enough to cover your entire tax liability for the current year

Pay your income tax withholding from a single IRA distribution:

Using this strategy, you can avoid quarterly estimated tax payments. You can simply withhold 100% of the tax owed from a single late-year distribution to meet the entire year's tax obligations.

Paying your estimated income taxes this way accomplishes the following:

- 1) Simplifies the tax-paying process
- 2) Provides more time to determine the correct amount of tax to be paid
- 3) Potentially generates earnings on funds that would have been used to pay taxes during the year.

(See back side for a specific example)

EXAMPLE:

If you determine you will owe \$25,000 in federal and state income tax, take a \$25,000 distribution from your IRA and designate 100% of the \$25,000 distribution to be withheld for federal and state income tax purposes. Your IRA custodian will make your tax payment directly to both federal and state tax agencies. Please note that you can also use your Required Minimum Distribution (RMD) to cover all or some of your tax liability for the year using this same methodology.

Note that a single IRA distribution can be made at the end of the year to pay for the full year of taxes.

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