Using your savings

BlackRock

Tax considerations for your retirement savings

One of the first choices that you make when saving for retirement can affect your future tax liabilities: what type of account you choose. Retirement accounts have specific tax benefits which often differ among various retirement accounts.

How traditional and Roth retirement accounts are taxed

With a traditional individual retirement account (IRA) or 401(k) plan, you don't pay ordinary income taxes on the money you're contributing. Instead, you're taxed when you withdraw your savings at your then-current income tax rate. This may reduce your tax expense in the year that you contribute. You could further benefit later if your tax bracket in retirement is lower than it is today.

With a Roth IRA or Roth 401(k) plan, you pay taxes on what you save now. Because you've already met your tax obligations for that income, withdrawals will be tax free after age 59 ½ and the account's been open for five years. As a result, a Roth account might make more sense if you're further from retirement and in a low tax bracket today. Note, however, that your eligibility to contribute to a Roth IRA account is based on your income level. In the 2023 tax year, your income must be less than $153,000 if you're filing by yourself and $228,000 for joint filers. For a Roth 401(k), there is no income limit for contributions.

You can split your savings between a Roth IRA and Roth 401(k), or switch which type of account you use. Doing so could require you to pay income taxes on the balance at that time, so you'll want to consider any switch carefully.

Which retirement income is taxed?

When you're withdrawing income in retirement, bear in mind that taxes can take a chunk of it. Common retirement account taxes include:

01 *Federal taxes*. If you have a traditional 401(k) or traditional IRA, withdrawals from those accounts are generally taxed as ordinary income. Also, the IRS generally requires that you begin to take annual required minimum distributions (RMDs) during the year in which you turn 73 years old.

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02 *State taxes.* Only a handful of states have no state income tax. Unless you live in one of these states, you'll likely owe state taxes on at least a portion of your income from your traditional 401(k) and traditional IRA accounts, though some states exempt Social Security benefits and pension payouts.

03 *Taxes on earnings from taxable accounts.* Payouts from non-qualified accounts, such as dividends or proceeds from the sale of an investment (capital gains), are generally subject to federal tax and potentially state tax, depending on where you live. You may want to account for the ebb and flow of capital in these accounts in your retirement planning.

Some of the top retirement tax concerns

- If you're concerned about the withdrawals from your traditional 401(k) and IRA being taxed as ordinary income when you're in retirement, you may be able to convert these retirement accounts into plans like Roth IRAs that offer tax-free withdrawals and pay taxes before you reach retirement.
- Consider becoming more familiar with your state income tax exemptions. Some states impose little or no state income tax, while others exempt Social Security benefits and pension payouts.
- If you file a joint tax return with your spouse and your income exceeds certain amounts, you could owe federal income tax on up to 85% of your Social Security benefits.
- Dividends or proceeds from the sale of an investment (capital gains) may be subject to federal tax and potentially state tax, depending on your state of residence. Consider discussing the impact of these taxes with a professional.

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