Tax Bomb Planner

Pete Matthews Jr – https://3nt.xyz – © October 20, 2022

Most younger people don't know about the finances of retirement; that was me, too. I squirreled away a bunch of money. With a lot of effort, I figured out when I definitely had enough. I retired. I could have done better. I highly recommend this little $6 book:

The Tax Bomb in Your Retirement, How the Roth IRA Can Help You Avoid It

by Josh Scandlen. Getting this right can be worth many thousands of dollars. Here are a few takeaways:

- Tax rates will be going up: the percentage of retirees continues to increase, as do total retirement benefits, while the percentage of workers decreases.
- When saving for retirement, contrary to conventional wisdom, it is usually correct to put the money into a Roth account when you are allowed to, even if this means contributing less than you could to a traditional retirement account. This after-tax money will grow completely tax free. In retirement, withdrawals from Roth accounts will not be income and therefore won't affect Social Security, Medicare and other benefits.
- When in your 60s, before retiring, consider converting traditional retirement accounts to Roth accounts. You will pay taxes in advance and enjoy the benefits in retirement.

The Tax Bomb Planner – No Warranty

This spreadsheet will do various calculations based on a few simple inputs. The point is to be able to estimate the impact of doing a Roth conversion, especially if you are already retired, as I am. Many of the ideas came from Scandlen's book.

The calculations on the first page of the file are based on the rates I researched and put on the second page. I do not warrant any of this, so be sure to sanity-check the results before acting upon them. Better, employ skills with Excel to carefully examine the calculations in the spreadsheet. Over the few years I have been using the tax bomb planner, I have found many bugs.

Roth Conversion

A conversion from a traditional to a Roth retirement account may incur extra costs if you and/or your spouse

- starts Social Security benefits before or during the year of the conversion, and/or
- starts Medicare benefits before or during the year that is two years after the year of the conversion.

If you work with a financial advisor and/or a tax preparer, you should consult with those folks about the tax bomb. If you are rolling your own:

1. Prepare a draft of your federal taxes for the present year, using your tax preparation software.
2. Plug information from that draft into the Tax Bomb Planner. Adjust the amount of your conversion as needed.
3. Plug information from the Tax Bomb Planner into your draft federal taxes.
4. Double-check everything.

Even if a conversion does not appear to provide a clear win, there may be scenarios where squeezing the taxes out of your assets saves you or your heirs money, especially when you can pay the taxes with additional cash, for example:

- Massachusetts estate taxes kick in at $1M, taxing the whole estate, counting Roth and tax-inflated traditional retirement accounts the same way.
- While any inherited IRA has required minimum distributions, your heirs will owe no tax on a distribution from an inherited Roth — they gain control over their tax situation.
- Because a Required Minimum Distribution (RMD) cannot be used in a Roth conversion, for a person required to take them, a conversion creates income beyond the RMD. However, the RMD can be used to pay the taxes on the conversion.
- When you or your spouse dies, the tax brackets are halved for the survivor. *Here come the taxes!*

Important for younger people: As my father before me, I annuitized a major chunk of traditional retirement funds. That, together with Social Security income, gives us a steady income stream. I sleep well at night, and mostly ignore stock market results.

However, we pay taxes on both the annuity income and on 85% of the Social Security income. Had I instead annuitized Roth funds, we might be paying little or no federal income tax now. (Taxability of Social Security income is based on modified adjusted gross income, which is AGI plus untaxed income. A distribution from a Roth account is not income.) In effect, we pay tax on almost double the income that I chose to defer. ***Go Roth!***

Updating the Spreadsheet for a New Tax Year

Tax Brackets

Look up the U.S. tax brackets for the current year (2022).

Look up the standard deduction and box check addition, $13,850 (single), 27,700 (MFJ), and $1,500 (box) for 2022.

Look up “tax on social security.” The brackets have not changed since 2020.

1. Select the “Rates” tab.
2. Change the first heading to 2022.
3. Update this first table with the *Single* tax brackets. All but the last should propagate to MFJ. Enter the last value for MFJ only.
4. In the next table, update the heading to 2022.
5. Update this table with the *Single* standard deduction and box values. These changes should propagate to MFJ.

For married filing separately, change MFJ to MFS and enter those values, overriding the formulas for MFJ. Also change to MFS on the Calc sheet, line 5. For head of household, change MFJ to HH in the same manner. It’s better not to mess with the Single stuff.

Income-Related Monthly Adjustment Amount (IRMAA)

“The higher the beneficiary’s range of modified adjusted gross income (MAGI), the higher the IRMAA.” The MAGI from two years prior applies to the Medicare year (e.g. 2021 for 2023). Search for “IRMAA brackets for 2023”.

Look up “standard medicare fee 2023” – I found Medicare Part B is decreasing from $170.10 to $164.90 for 2023. (The annual deductible is decreasing from $233 to $226, which does not affect the tax bomb planner.) Also check for changes to the monthly IRMAA Part D surcharges ($12.20, etc.), which has not changed from 2020 to 2023.

Important: because cells have required labels, do not delete lines or cells. Change or copy data as needed. The IRMAA MAGI tables have been revised for tax year 2022 so that the first table is the current tax year, with labels such as S_max1. The second table is for the next year, with labels such as SP_max1. The third table is for the second year after, with labels such as SPP_max1.

Here is the plan to update the three tables at the bottom for tax year 2023, next time around:

6. Select the “Rates” tab.

7. Scroll down to the table beginning “2023 U.S. | 2021 MAGI Max Est,” which is the middle of the three tables. Copy those two cells to the same location of the preceding table. Similarly, copy the “2024|2022” heading cells from the third table to the second. Update the heading for the third table to “2025|2023.”
8. Copy the block of cells for the first three columns from the second table (A39:C44) to the first table (A29:C34).
9. Copy the standard rate for Part B from the second table (D40) to the first (D30). This change should cascade down the column.
10. Check that the contents of the first and second tables are now identical.
11. Update the second and third columns of the second table with the researched values for 2024|2022.
12. Update the researched standard rate for Part B in the second table (D40).
13. Take a WAG at the part B standard fee for the third table and enter it (D50). Check that the third table makes sense, extrapolated from the first two tables and the WAG.

Now, on the Calc sheet, update the years:

14. Line 3, current tax year (B3).
15. Bottom line, two years out.