In retirement, total income needs only be $65k to be in the 28% marginal tax bracket while it needs to be more than $146k when you are working to reach the same 28% marginal tax bracket. Most likely, you will not be in a lower tax bracket in retirement!! My CPA told me yesterday that I should figure on a 30% tax on withdrawals from my retirement accounts.

Retirees' income taxed unfairly

Marginal rates punish middle-income Social Security recipients

SCOTT BURNS

Last week a retired reader wrote about discovering that he was in a higher tax bracket than he expected to be.
He isn't alone. An entire generation of middle-income savers has been hoodwinked by federal tax policy in a true "give with one hand, take with the other" gesture. If you're retired and reading this, there's a big chance you are one of them.

Here's how it happened.

Congress voted in 1983 to start taxing Social Security benefits. The formula was written in such a way that few retirees would be affected in 1984. But the provision wasn't indexed for inflation. So more retirees pay the tax every year.
These aren't fat cats. As I demonstrated last week, the taxation of Social Security benefits is strictly a middle-class tax. It can nearly double the tax bills for people with total incomes well under $100,000. During the same period, workers were encouraged to participate in defined contribution retirement plans and individual retirement accounts. The idea was that you could reduce your tax bill while working, enjoy tax-deferred growth and pay taxes at a much lower rate when you retired. But taxes are complicated. And the slow escalation of the tax on Social Security benefits was neither mentioned nor considered.

Rate escalates quickly

To have useful information, we have to watch what economists call our marginal tax rate. That's the tax rate we pay on our highest dollar of income. If you can earn an additional $1,000 and it is taxed at 10 percent, you'll be a lot more eager than if you earn an additional $1,000 and it is taxed at 40 percent. And if your next $1,000 of income is taxed at 100 percent, well, you might not show up for work at all. That, of course, assumes you have a choice.
So let's see what the marginal tax rate is for the retired couple with average Social Security benefits that I examined last week. If we add the average Social Security worker's retiree benefit and the related spousal benefit, we know that a typical retirement starts with a Social Security income of $23,343. (Yes, benefits can be higher or lower. But when the Social Security Administration cuts the checks, this is a typical amount for a couple.)
If you have no other income, that $23,343 will be tax-free. In fact, you can have other income of $18,000 and still have no income tax to pay. The trouble starts with more income. Here are the figures:
› An additional $6,000 (total other income $24,000) creates a federal income tax bill of $343. This implies a marginal tax rate of 5.7 percent ($343/$6,000). That isn't much to complain about.
› Another $6,000 (total other income $30,000) increases the tax bill from $343 to $1,265, an increase of $922. This implies a marginal tax rate of15.4 percent. Again, not much to complain about.
› But add $6,000 more (total other income $36,000), and the tax bill rises to $2,561, an increase of $1,296. That's a marginal tax rate of 21.6 percent on the added $6,000. The total income involved is $59,343, and our tax law says that taxable income on a joint return up to $72,501is taxed at no more than15 percent.
But wait, it gets worse.
› Add another $6,000, bringing the total income from all sources to $65,343, and the tax bill increases from $2,561to $4,256, an increase of $1,695. That's a marginal tax on the last $6,000 of 28.2 percent.

Big burden, small return

Let's try to get our heads around this. This retired couple has a total income of $65,343, yet they pay taxes at a 28.2 percent rate on the last $6,000. Meanwhile, a non-retired couple needs a taxable income of more than $146,400 to pay taxes at a 28 percent rate. Does that strike you as reasonable tax policy? Me either. It strikes me as a punitive tax for middle-class savers who are retired. But what about another possibility? Could the revenue from the tax help Social Security remain solvent? Answer: no way. According to the most recent Trustees Report, the tax now provides only 3.2 percent of total revenue. It will rise to only 4.8 percent by 2022. The tax is a small benefit for Social Security but a big burden for retirees.

Scott Burns is a syndicated columnist and a
principal of the Plano-based investment firm
AssetBuilder Inc. Email questions to scott@scottburns.com .