

Episode 227: Can \$1 Really Cost You \$20,000 in Retirement? How To Avoid Tax Cliffs

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Retirement income, tax traps, Affordable Care Act, subsidy cliff, Medicare surcharges, Social Security, RMD cliff, Roth conversions, tax planning, qualified charitable distributions, below-the-line deductions, effective marginal tax rate, income thresholds, tax maps, retirement researcher academy.

SPEAKERS

Speaker 1, Wade Pfau, Alex Murguia, Briana Corbin

Briana Corbin 00:00

The purpose of retire with style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to retirewithstyle.com/style, and sign up to take the industry's first financial personality tool for retirement planning. Welcome back to retire with style, where Wade and Alex continue their deep dive into the tax traps hiding in the retirement tax code. This week, they're covering the Affordable Care Act, subsidy cliff, qualified charitable distributions and the phase out of deductions you probably didn't know you had consider this your tax planning Survival Guide.

Alex Murguia 01:02

Hey everyone, welcome to retire with style. I'm Alex, and I'm here with my good buddy, Wade.

Wade Pfau 01:08

Hi, hi everyone, and good job, Alex. You got through that intro without any mistakes.

Alex Murguia 01:13

I got my name correct. I pronounced your name correctly. Wow. Things are coming up roses. What can

Speaker 1 01:19

I say? What

Alex Murguia 01:20

can I say?

Wade Pfau 01:21

Good sign for this episode.

Alex Murguia 01:23

So far, so good. So far, so good. We'll see. We'll see. And so we're gonna, we're continuing the thesis on taxes. Everyone's favorite from Wade's newly, new edition, retirement planning game, retirement planning guidebook, and Wade is playing the role of Vanna White. For those of you are just listening to the podcast and not looking at him, he's like, yeah. He's sort of pointing to his books. He's flexing. He's flexing. What can I say? And so the last episode we got a couple of we were talking about pitfalls from a tax perspective that people can face in retirement. We hit a few, and let's hit a couple more in this episode. Wade to round it off, what do you say?

Wade Pfau 02:12

I say that sounds like a wonderful plan.

Alex Murguia 02:14

Wonderful. Wow. High praise coming from a man of few words.

Wade Pfau 02:21

Wade

Alex Murguia 02:22

and histrionics go hand in hand. So Wade, one of those that we wanted to touch base upon, with regards to pitfalls, is the America sorry, the Affordability Care Act. The Affordable Care Act,

Wade Pfau 02:36

affordable, affordable,

Alex Murguia 02:37

affordable. See, it didn't last long. What are we? One minute and 40 time of death, one minute and 40 seconds into this episode. So what do we got on the Affordable Care Act, and why

Speaker 1 02:49

is it

Alex Murguia 02:49

tax pitfall?

Wade Pfau 02:50

Now there's a big potential pitfall if you're using the Affordable Care Act for health insurance, and especially kind of in that pre retirement phase. So you're most

Speaker 1 03:00

folks

Wade Pfau 03:00

will become eligible for Medicare at 65 and so you'd switch over to using Medicare when you're 65 but prior to 65 you might be using the Affordable Care Act for your health insurance, and there are subsidies for that coverage, and there used to be enhanced subsidies, but in 2026

we're back to the old pre 2021, regular subsidies. And the regular subsidies have a very significant cliff where, as soon as your income, your modified adjusted gross income, which is, there's always little provisions, but basically your adjusted gross income plus, well, it's all of your social security, if you have already claimed Social Security, maybe you're an early claimer. For this to be relevant, you'd have to be an early claimer for this to be relevant, 100% of your benefits, the untaxed part and the tax part, 100% of your Social Security, and then the other components of your adjusted gross income. If that exceeds 400% of your federal poverty line by \$1 you lose all of your subsidies at that point, and that could be more than \$20,000 depending on where you live and how much the the cost of the benchmark plan is in the county where you live.

Alex Murguia 04:11

So this is all before you're even touching Medicare. This is just

Wade Pfau 04:15

once

Speaker 1 04:16

you do

Alex Murguia 04:17

Medicare and but this has nothing to do right now with Medicare,

Wade Pfau 04:21

right? This is pre Medicare, pre age 65 and there's a special double whammy at ages 63 and 64

Alex Murguia 04:29

wonderful, by the way. No,

Speaker 1 04:30

yeah,

Alex Murguia 04:31

there's more, there's more, there's more. Screwing you over. Hang on,

Wade Pfau 04:37

yeah? Because not only does your income at ages 63 and 64 impact your subsidies for the Affordable Care Act that year, but that could also lead you to pay those Irma surcharges that we talked about last week on your Medicare premiums two years later, because your income from this year impacts your Medicare premiums two years later, and so if it exceeds those thresholds, you have to pay surcharges on med. Of care in two years, plus you're losing subsidies.

Alex Murguia 05:03

So orders of magnitude. What are some examples that that will make people like, oh my goodness, because you're saying, Okay, if you exceed 400% of the poverty line, your benefits go from this to that, you know, from good to bad. You know, that kind of thing. We're speaking in those terms, if you put some numbers behind it, what's the what's the gut punch?

Wade Pfau 05:26

Well, first, the poverty line depends on the size of your household, and also whether you're in the continental US, the 48 states, or Alaska and Hawaii, have their own thresholds. But if you're in the Continental, United States and you have a two person household, your federal poverty line is 21,000 \$150 so your 400% of that is \$84,600 suppose you live in a county where the the cost of the benchmark plan for the Affordable Care Act is that age is getting close to Retirement. It could be, say, just \$24,000 and then you're you've chosen an Affordable Care Act plan where the premiums are at least the \$24,000 so you'd be eligible for potentially the full subsidy. Well, if your modified adjusted gross income was \$84,600 at that point, you wouldn't get the full subsidy, but you might be getting, I'm just making this number up for the purposes of an example, but you might still be getting \$20,000 of your subsidies. If your modified adjusted gross income is \$84,601 you get zero subsidy. So you just wiped out \$20,000 you have to pay \$20,000 more for your health insurance that year.

Alex Murguia 06:42

So you may want title in lieu of a raise.

Wade Pfau 06:47

Yeah, it's the in terms of the effective marginal tax rate, that's just mind boggling high. \$1 leads to a loss of \$20,000 of subsidies. So that's definitely something you don't want to accidentally trigger to to say that, to be very say the least, so to speak,

Alex Murguia 07:05

yeah, and why is it sunseting? Was this in 2021 I assume covid made them sort of change it up a bit to get

Speaker 1 07:14

people 2021

Wade Pfau 07:15

to 2025 we had enhanced subsidies, which were a little more generous in that when you're below the 400% of the poverty line, but then it went on and you still you're eligible you expect only eight and a half percent of your income at levels above 400% of the federal poverty line. So you could still be getting some subsidy, even with a couple \$100,000 of income, depending on the cost of the benchmark plan in your county, and that all went away. The regular subsidies, not only are they less generous below 400% of the federal poverty line, but they drop off entirely at \$1 more than 400

Alex Murguia 07:54

so would you call this? No, I'm not being very critical. Would you call this a tax hit, or really more your income doesn't allow you to get this benefit anymore, even if it's by \$1

Wade Pfau 08:07

right? So it's not like an income tax, and it's really not a tax, but when you think about the implications of how much you're going to have to pay for things based on your income. You can frame it as a tax for the purpose of detriment.

Alex Murguia 08:25

I'm just doing it more for clarity. Yeah,

Wade Pfau 08:27

it's just technically, it's not a tax, but it is the loss of a benefit that you would have otherwise received.

Alex Murguia 08:35

Remember to mention this in your fourth edition. Wade, we got to get this, we got to get this cleared up. All right.

Speaker 1 08:41

Yeah,

Alex Murguia 08:43

all right.

Wade Pfau 08:44

So tax credit loss, loss of a tax

Alex Murguia 08:46

user benefit money is coming out of your pocket, to the tune of, in this example, 20, whatever \$1,000 no one wants to eat. That is there anything in the Affordable Care Act that would also give people pause for concern that could have loss of benefits, tax increase, etc.

Wade Pfau 09:05

Well, that that's the issue, is just these credits or subsidies that's

Alex Murguia 09:09

enough in and of itself,

Wade Pfau 09:10

your income, yeah. What more do you want than losing \$20,000 of sub \$26,000

Alex Murguia 09:15

losing 26,000

Wade Pfau 09:18

in the example I in the retirement planning guidebook, in the example I use last year with the enhanced subsidies, when you got to 400% of the federal poverty line, they still would have gotten a subsidy of 24,638 with the regular subsidies, it's 23,792 But the problem is one more dollar.

Alex Murguia 09:41

Yeah. So your advice, your advice is to be, if for people who are on the Affordable Care Act would be, would be something along the lines of, know what is going to trigger that 400% of the poverty line income? Because if you're over it by \$1 you're going to lose the affordable. Care

Act benefit. That's effectively what you're saying. And yeah, probably going to run you 25 grand a benefit that will disappear.

Wade Pfau 10:08

So we always talk about the value of delaying Social Security, but if you're using the Affordable Care Act for health insurance, there's an even bigger value from delaying Social Security. You might lose your entire social security benefit, like, because of the increased sub increased health insurance costs. So, oh,

Alex Murguia 10:26

you mean because the Social Security income will put you over the top? Well,

Wade Pfau 10:30

it could help put you over the top. And

Speaker 1 10:32

then, yeah, if

Wade Pfau 10:33

your benefits are \$24,000 and then you're losing \$24,000 of subsidies, you just didn't need to claim Social Security, yeah,

Alex Murguia 10:42

okay. And then, just to be clear, once you get Medicaid, it's Medicare, it's no longer an issue, because you're switching from the Affordable Care Act to the Medicare plan,

Wade Pfau 10:53

right? And so Irma is a problem, but you don't this is only relevant if you're using the Affordable Care Act for your health insurance and are eligible for are eligible for subsidies.

Alex Murguia 11:05

And you said Irma is a problem, for those of you that maybe didn't listen to the last episode, Irma would be a problem because, in generality, what would what could happen?

Wade Pfau 11:12

Well, Irma is the surcharges on Medicare premiums that also get triggered by having \$1 too much. And there's five different thresholds of five different surcharges added to your bill. You don't that's not as catastrophic having like one Irma surcharge in one year.

Alex Murguia 11:30

Yeah. What's the range? More or less? Are you thinking of here? Yes, a couple grand. Or is it like, you know, 25,000 Thank you very much.

Wade Pfau 11:38

No, it's more like 1000 to \$1,500 a person depending which you're triggering. But for a couple, you double that so

Alex Murguia 11:49

well, 3000 could be very significant, depending on your, you know, your level of income.

Wade Pfau 11:55

Yeah, no, it matters. It's not as big of impact as losing out on your ACA subsidies 100% but yeah, and it's, it's only something that happens for one year. You get to reset every year and begin anew. So it's not the end of the world if you get hit by a Medicare surcharge, but, and, of course, it's not the end of the world if you lose your ACA subsidies, but it could be a much bigger hit.

Alex Murguia 12:18

Okay, so lions and tigers and bears. We got the ACA, the ACA you're taking if you're on the Affordable Care Act that could disappear if you're over a threshold by even \$1 you got the Medicare surcharge via Irma, you know, you've got the Social Security tax torpedo, you know, nice word. And then we've got the R required minimum distribution cliff, you know, Wow, very eloquent. These, these names, any what's the deal with that?

Wade Pfau 12:57

Yeah, the required minimum distributions can push you over the cliff.

Alex Murguia 13:01

Thank you. Yeah, so wait, I want you to be that hand like in that Sylvester Stallone movie cliffhanger that holds on and doesn't let go for dear life of whoever is like on that cliffhanger, what? How are you going to bring them back over the cliff?

Wade Pfau 13:18

Well, by understanding what RMDs are going to do and potentially planning for that. And that's getting into like Roth conversions are the planning tools available because you when you hit age 73 or if you're born in 1960 or later, when you hit age 75 you now have to take a percentage out of your IRA your tax deferred accounts, whether you want to spend it or not, you're required to take it out, it's an age based percentage, and pay taxes on it. You're not required to spend it so you could reinvest in your taxable brokerage account, but you do have to pay taxes. And the RMD Cliff idea is for people who primarily focused on saving as much as they could in their tax deferred accounts, they might have pretty healthy account balances by the time their RMDs begin, and the RMDs could be a lot more than they want to spend. And it's now unavoidable ordinary income that can cause all these pitfalls the other tax problems, like, I don't want to spend this money, but I have to pay taxes on it, and it's triggering me to pay tax on more social security, and it's triggering me to pay 15% on all my capital gains, and it's triggering me to have to pay a Medicare surcharge. It wouldn't be an issue for the Affordable Care Act, because you're not using it by those ages, but unless you have a younger spouse. Now the

Alex Murguia 14:42

silver lining could be for some people listening, Yeah, but you're that's all because your account grew so life is good for you. And yes, I guess, but still, your can't grew because you were probably very vigilant about kind of making sure you're doing things the right way. So. This is just an extension of doing things the right way,

Speaker 1 15:02

yeah,

Alex Murguia 15:03
and gone

Wade Pfau 15:04

well, I mean, and so the idea here is to help reduce the impact of that. That's where we talk later about like Roth conversions and things. So you voluntarily pay taxes to reduce that IRA account balance at times you can do so at a lower effective marginal tax rate, so that when RMDs do begin, they cause fewer tax headaches for you.

Alex Murguia 15:25

Now, when you say RMD cliff, just going back to you, stated a bunch of reasons why, you know, taking RMDs could cause sort of these knock on effects elsewhere, with with, you know, income rates. Is it? Is it a death by paper cuts, because a lot of little things hit you at once, or is there? Because when I think of Cliff, I think of like, one big bomb, if you will, that gets dropped the way you said it, it sounded like more like a bunch of grenades.

Wade Pfau 15:52

Yeah, a bunch of grenades, because it's put it's pushing you through the tax map. And if you got to see chapter 10 of the retirement planning guidebook to look at these tax maps, but it's pushing you through the tax map. So it's pushing you through the Social Security tax torpedo. It's pushing you through the preferential income stacking problem we talked about, if you keep going, it could be pushing you through Medicare Irma surcharges, and it's also, we haven't talked yet about it, but it could be pushing you through the phase out of your below the line tax deductions.

Alex Murguia 16:20

Okay? So then your your RMDs could be to a point, because your tax deferred account has grown so much that, remember, you get taxed when money comes out, you get taxed as income, and at a certain age, the government starts wanting you to take out money, because they want the money that they've never taxed you on, you know, and that's fair, and they base it on your life expectancy, so they want you to pay out thinking that by the time you die, you'll have zero in that account, right? Which is another distribution strategy in and of itself. But that being the case, what you're you're saying is that's going to cause a lot of tipping points in these other areas that will then harm you. I Hence you're thinking, you know, what we can do. There are conversions and things like that, proper tax planning. But effectively the RMD cliff, what you're saying is that your RMDs can be to such a degree, it could be to such a degree that your income now is very high. And the sad part is, you're not going to need to use all that money. Obviously, life is good, but you're not going to need to use all that money, but you have to take it out anyways and be taxed on it. You can always reinvest it, but you're going to be taxed on it. And that then could cash could cause cash flow issues, if you will, especially if you don't want to just draw from the account to pay taxes, to pay for taxes,

Wade Pfau 17:42

yeah, and the simplified analysis of it is it pushes you into a higher tax bracket, so You're unnecessarily getting pushed into the, say, 32% bracket, or whatever the case is. But the more complete analysis is not only that, but it's triggering all these pitfalls we're talking about too. So it's causing you to pay a much higher effective marginal tax rate than what the income tax

brackets would show. And it just gives some examples. So at age 73 if you had a million dollars in an IRA the RMD on, that would be \$37,736 at age 75 it's 40,650 at age 90, it would be \$81,967 but that's for in a million dollar account. If you had like a \$3 million IRA at age 75 your RMD is \$121,951 and you probably also have social security, other income sources and things. It's just, if you don't want to spend anywhere near that much, your R D is binding again, you don't have to spend it, but it could be caught. You might have to pay a lot higher effective marginal taxes on that then would have been possible had you done some tax planning in it.

Speaker 1 18:59

Yeah,

Alex Murguia 18:59

and this is proper planning, even set up. You know how you want to be impactful. There's charitable stuff you can be doing, but that's beyond right now.

Wade Pfau 19:06

Yeah, we haven't even gotten into

Alex Murguia 19:08

that. Yeah, we haven't.

Briana Corbin 19:10

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Alex Murguia 19:34

So let's say you're looking at that RMD and you're thinking, you know, oh, I don't want to fall off the cliff, or it's almost like I don't want to gap up in taxes that I I could avoid paying. You know, to a large extent, what are some below the line deductions that that can be done here?

Wade Pfau 19:52

Well, that that's another pitfall that's not a

Alex Murguia 19:54

tax

Wade Pfau 19:56

cliff. Yeah, that's we can move on the final

Alex Murguia 19:59

we. Can we move on? Are we done? Is there anything in the RMD that I think we've without getting into art, without getting into like Roth conversions, which is a whole episode in itself, is there?

Wade Pfau 20:11

Well, it's a pitfall. You mentioned the charitable if you're charitably inclined, there's some things you can do, like a qualified charitable distribution that's all covered in the book as well. If you want to talk about that sort of thing too,

Alex Murguia 20:23

sure, let's, let's talk about that sort

Wade Pfau 20:25

of thing. So we're

Alex Murguia 20:27

in the spirit of giving.

Wade Pfau 20:28

If you're charitably inclined, giving through your IRA can be one of the most like tax efficient approaches to do, because you have to think about, like, who's going to be paying the tax bill, and charities get to pay a 0% tax rate. So you want those assets to go to charities. And a qualified charitable distribution is up to this year. It's \$111,000 I believe, and that can include RMDs you can send directly to a qualified charity from the IRA and keep that out of your adjusted gross income. Gross income. It's very different. A below the line deduction is not the same thing. I can't if I take my RMD out and then I donate it to a charity so it becomes a below the line deduction. That's what we talked about a couple episodes back. It doesn't affect my adjusted gross income. So I'm still getting hammered by all those pitfalls.

Alex Murguia 21:22

As soon as you take the money out, a transaction has occurred,

Wade Pfau 21:25

yeah, and so it's in my adjusted gross income, and then I could donate it, get a below the line deduction, but then I have to itemize, and that now there's a new floor. I can't deduct. I can only deduct more than half a percent of my adjusted gross income on charitable giving, things like that, the qualified charitable distribution lets me send it directly from the IRA to a charity and avoid having it ever show up in my adjusted gross income. So it's a much more powerful way to get money to a charity from the IRA than taking it out and then donating it as a below the line deduction. So that, yeah, that can help if you're when you're at the point of RMDs, and that's possible to do after age 70 and a half, which used to be when RMDs begin, but RMDs are now higher ages, but they did not change at 70 and a half for qualified charitable distributions.

Alex Murguia 22:20

Okay, and what are the below the line, deduction pitfalls?

Wade Pfau 22:24

Yeah, so things that phase out

Alex Murguia 22:26

now, just like we did in that last episode, remember, above the line? You know when you were doing your taxes, above the line sets you up for what your adjusted gross income will be. Then

after the adjusted gross income amount. There's a lot of there's below the line deductions which then lead to your taxable income.

Wade Pfau 22:49

Yeah, and the new one, it's not even big. We talked about how you have to itemize to get any benefit anyway, with below the line. But there's this new temporary for the next through 2028, next few years, the age 65 plus bonus deductions that were introduced last year. You get those regardless of itemizing. So it affects everyone. Those things phase out. For single people, starting at adjusted gross incomes of \$75,000 for married filing jointly, starting at \$150,000 they phase out over the next \$100,000 range. And so what that tends to do is this is usually going to hit you in around the 22% bracket. Depends on all the exact circumstances. But now, when you take \$1 out of your IRA, pay 22% on that dollar, but it causes you to lose 12 cents for two people, six cents for one person, we'll consider two people over 65 causes you to lose 12 cents from your bonus age 65 plus deduction. So you end up actually paying a 22% rate on \$1.12 instead of on \$1 and so your 22% tax bracket actually becomes an effective marginal tax rate of 24.64% and that hits you for a full \$100,000 range of income, starting at \$150,000 for couples. So that's not the end of the world, but it's just another annoyance. And if you decide you're willing to pay at 22% you may not want to go into that threshold or that range where you're you're losing that age 65 plus bonus deduction now,

Alex Murguia 24:34

and just for people, repeat what the 65 bonus deduction is.

Wade Pfau 24:39

It's \$6,000 per person, age 65 and older, is an additional below the line deduction available.

Speaker 1 24:46

Your

Alex Murguia 24:46

regular standard deduction?

Wade Pfau 24:49

Yeah, it it's separate from the stand. You don't have to itemize to get it.

Speaker 1 24:54

No, but you

Alex Murguia 24:55

get this, let's say you just do standard deduction. You do standard deduction, then you get an extra. Bump because you're 65 and over,

Wade Pfau 25:01

yeah, and you get

Alex Murguia 25:02

it.

Wade Pfau 25:03

You get it either way, if you're either doing the standard deduction or itemizing that extra \$6,000 but then that \$6,000 per person fee,

Alex Murguia 25:12

but you're saying, you know, with some below the line deductions, it may not carry over to that \$6,000 bump that you get being over 65

Wade Pfau 25:22

well, you'll get it regardless of whether you itemize or not. It's just it phases out once your income exceeds I am talking

Alex Murguia 25:29

about the income phasing out.

Wade Pfau 25:31

Yeah,

Alex Murguia 25:32

okay,

Wade Pfau 25:33

that's the first one that you run into. Another one is this, the salt deduction the state and local income tax. It's this year now up to 40,400 of state and local income taxes is deductible, but starting at \$500,000 and that's for both singles and married filing jointly, it's going to phase out over the next \$100,000 plus a little bit range at a rate of 30 cents per dollar. So what that one does is now this is we're getting to be wealthier people or higher income people, because it doesn't even it's not an issue till you reach \$500,000 so this is not for everyone, but at \$500,000 you're in the 32% bracket. And then you get the phase out of your state and local income taxes, your 32% bracket becomes an effective marginal tax rate of 41.6% and then if you later get pushed into the you're entering the 35% bracket, that becomes a 45.5% effective marginal tax rate because

Alex Murguia 26:33

you're not able to take advantage of the state deduction.

Wade Pfau 26:36

Well, because it's phasing out.

Alex Murguia 26:37

Yeah,

Wade Pfau 26:38

if I had say, I had

Alex Murguia 26:40

the point, or is it just goes to, you know, whatever, some de minimis amount, and then it baselines,

Wade Pfau 26:45

well, yeah, say I had a \$50,000 of state and local income tax. I could deduct 40,400 of that. But that starts phasing out at these income thresholds until it gets down to 10,000 I can always deduct 10,000 but I cannot deduct that other \$30,400 if I go all the way through the phase out range, which is only an issue if I'm itemizing. So it may become less of an issue before the end, because I may not have enough other below the line deductions to itemize. But anything I'm if I'm itemizing, you know, I'm that's a big impact on it's really, each dollar of incomes really causing me to pay taxes on another dollar and 30 cents because I'm losing below the line deduction. Now,

Alex Murguia 27:34

what can somebody do about this? No, it doesn't sound like there's much here, other than just do

Wade Pfau 27:39

it. Yeah, it's more like if you're doing Roth conversions, this is probably going to be a break where you would stop your Roth conversion to avoid phase out of your state and local income tax deduction.

Speaker 1 27:51

And

Wade Pfau 27:54

that one's temporary, too. And then the other one, that's less of an issue, but it's still just worth paying attention to is for, for me,

Alex Murguia 28:03

when you say temporary, you mean because it's gonna disappear, or it's gonna,

Wade Pfau 28:07

yeah, it's only around through, I think, 2028 or 2029

Alex Murguia 28:13

and then what happens after that? Then

Wade Pfau 28:15

it's back to what it was before. It's just up to \$10,000 is deductible, so

Alex Murguia 28:18

just 10,000 and you're done,

Wade Pfau 28:20

and no phase out.

Alex Murguia 28:22

Okay?

Wade Pfau 28:23

And then with qualified medical expenses, you can only deduct the amount in excess of seven and a half percent of your adjusted gross income. So you also get a phase out with that. That one's less damaging, but if you're in the if you're being hit by that, \$1 of income means another seven and a half cents of your medical expenses are not deductible, so you're really paying tax on \$1.07 1.075 cents. So it's going to increase your effective marginal tax rate by the whatever it was. You multiply that by 1.075

Alex Murguia 29:01

and this could be something that happens quite a bit, especially as you get older and health care costs and the like, or chronic illness and the like. So would you mind walking through an example? Because I think it's an important topic for let's say somebody in their early 70s diabetes comes, you know, they get diagnosed with diabetes or something like that. Just a framework for how they could be thinking about

Speaker 1 29:24

this.

Wade Pfau 29:24

Yeah, I've got an example in the book, so let me just kind of book.

Alex Murguia 29:28

Oh, what book are we referring to here? The

Wade Pfau 29:30

retirement planning guidebook. But yeah, we've got a couple so married filing jointly. They have \$20,000 of eligible medical expenses. And this is important, because if that was the only below the line deduction, itemizable deduction, they'd still just take the standard deduction. So they've got \$20,000 in medical expenses, and they have \$32,200 of other itemized deductions.

Speaker 1 29:59

So.

Wade Pfau 30:00

This is going to be binding, and they're under 65 Okay, so now they're starting their total below the line deductions, and it's 52,200 the 32,200 of other itemized deductions, and the \$20,000 of medical deductions. Now they can only deduct the amount of their medical expenses that exceeds seven and a half percent of their adjusted gross

Speaker 1 30:24

so the

Alex Murguia 30:24

first seven and a half percent, they can't deduct anything. It's it's any amount after the seven and a half percent,

Speaker 1 30:30

well,

Wade Pfau 30:31

if their adjusted gross income is zero, they could deduct the full 20,000 if their adjusted gross income is \$1 they could only deduct the \$19,999 yeah,

Speaker 1 30:44

because

Alex Murguia 30:45

seven and a half percent, or whatever is not deductible.

Wade Pfau 30:48

Yeah.

Alex Murguia 30:49

So it's another kind of thing to look out for.

Wade Pfau 30:52

So like as you're going through that the 10% bracket becomes 10.75% 12% becomes 12.9% 22% becomes 23.65% and so on. And they would be impacted by that. In this example, when their adjusted gross income gets to \$266,667 that's where all \$20,000 falls below seven and a half percent of their adjusted gross income. So that would be the point where they no longer get to deduct any medical expenses.

Alex Murguia 31:26

Yeah,

Wade Pfau 31:27

and they'd be back to their, well, their 32,200 of other itemized deductions, which is the same as their standard deduction.

Alex Murguia 31:35

And this is key, and we can get into it in the next episode. This is key when determining when to say, uncle, when you're doing Roth conversions, right,

Wade Pfau 31:46

right, right. This is all about, well, yeah, it's very important for Roth conversions and for sourcing income sources between different types of taxation.

Alex Murguia 31:56

So in terms of this, the last few series of episodes, we've gone from, you know, tax efficiencies, from things you can do proactively to reduce taxes, you know, according to the law, here we're addressing it in a different way, which is things you don't want. You want to make sure that your income doesn't exceed XYZ by even \$1 because if you do that, you're going to have a cascade of taxes falling on top of you, which will make your effective tax rate go from I'm making it up 20% to 27% all of a sudden, because you took one extra dollar of income, either be it through here or there, it's going to affect, invariably, Social Security, potentially Irma, potentially all these

other things that we've been discussing. You know, the Affordable Care Act, availability, etc, etc. Is that a correct thing?

Wade Pfau 32:48

Great. Summary.

Alex Murguia 32:52

Thank you. Thank you. Thank you. Thank you.

Wade Pfau 32:55

Yeah. So then, yeah, you then want to start this. These are the pitfalls from generating income so that you don't want to if you had the opportunity to either stop doing a Roth conversion, or, like, if I could have just taken some money from my Roth instead of my IRA, or I could have taken some money from my the growing line of credit and my reverse mortgage, Home Equity Conversion Mortgage, if I had other options that would allow me to meet my spending without adding to my adjusted gross income? Well, these are the things I want to be mindful about so that I don't accidentally trigger these problems.

Alex Murguia 33:35

Yeah, and it's not like we're in a business of telling people to take out loans or anything like that, but let's say you're within \$2,000 of a threshold for a particular tax year. Take the HELOC. You know, three months later, when it's a new year, pay it off. You know, because that tax year, taking it three months earlier, it's going to put you at a certain income level that could that that \$3,000 that you needed all of a sudden is a \$9,000 expense to get that 3000

Speaker 1 34:06

so

Alex Murguia 34:06

it just makes no sense.

Wade Pfau 34:08

Yeah, so that, and that's where the the tax maps become really helpful to plan around all that. And

Alex Murguia 34:16

what can you find out about the tax maps with

Wade Pfau 34:18

well, you learn about them in chapter 10 in the retirement planning guidebook. And if you join our retirement researcher Academy, you'll have access to our tax map calculator, which allows you to create them with your own personal income numbers.

Alex Murguia 34:32

And another thing we have there too is we have funded ratio calculators. We have the RESA now we're filling it with tons of good stuff, the payroll calculator for distribution management. So it's a great little resource that we're creating for for the community, and we strongly encourage

you folks to just check it out. All right. Wade next episode. We take down the Roth conversions. What do you say?

Wade Pfau 34:54

Yeah, we can talk about that some more next time. And also capital gains harvesting.

Alex Murguia 34:58

Capital gains harvesting. La. Feels good. All right, everyone, we'll catch you next week on retire with style. I'm Alex, and I'm signing off.

Wade Pfau 35:06

Thanks, everyone. I'm Wade. Catch you next time

Alex Murguia 35:09

bye.

Briana Corbin 35:11

Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you. Consult your financial advisor. All investing comes with the risk, including Risk of Loss past performance does not guarantee future results.