

Tax basics for retirement that physicians often overlook

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When planning for retirement, physicians should consult with their financial adviser about designing an income strategy to preserve assets while generating the necessary income needed to live the lifestyle they worked so hard to achieve. Physicians should also discuss ways to protect their portfolio from potential downturns in the market or from a major health incident. Understanding which type of investments to withdraw first and how they might be taxed can have a profound impact on a physician's retirement plan.

Doctors who don't already have a financial planner can contact AMA Insurance and inquire about their Physicians Financial Partners program. This program provides physicians access to vetted financial professionals across the country.

Here are some tax considerations, planning opportunities and sequencing strategies to help physicians before and during retirement.

Type of income. Identifying the type of income to take and when—and understanding how it's taxed—can impact the overall efficiency of a physician's plan. For example, income from your 401(k) will be taxed as ordinary income for most people, while earnings from your stock portfolio are taxed as capital gains. In addition, your Social Security benefits will be subject to taxation, but only if your income reaches a certain threshold. Income generated from a Roth IRA, on the other hand, will not be taxed.

Social Security. "Fifty-five percent of all filers will take Social Security before they reach full retirement age," Carlo Cordasco, vice president of Nationwide Retirement Institute, said during an educational session hosted by AMA Insurance Agency Inc. "About one-third of filers will take their benefit when they reach full retirement age. That decision will impact how much you'll receive over the rest of your lifetime."

Your choice on when to file could increase your annual benefit by as much as 76%. That estimate would be for a physician who has fully retired at age 66, comparing early filing at age 62 and receiving

reduced benefits of 75% of primary insurance amount versus delayed filing at age 70 and receiving credits to increase benefits by 32% of primary insurance amount.

“It’s not just a checkers game of when you should take your Social Security,” said Cordasco. “It’s a tri-level chess game of multiple strategies going on at one time.”

Health savings. About 38% of all employers in the U.S. are now offering high-deductible health care plans with health savings accounts (HSAs) attached to them, said Cordasco, adding that “the nice thing about an HSA is that it provides a triple tax advantage.” The money going into the HSA is not taxed, the earnings grow tax free and withdrawals from the account are not taxed either—if they’re used for qualified medical expenses. That can create quite a bit of savings.

Required minimum distributions (RMDs). RMDs are minimum amounts that must be annually withdrawn from your retirement plan, like a 401(k). RMDs start the year you reach 70-and-a-half years of age or, if later, the year in which you retire. This can affect how you’re taxed by possibly generating more income than you need each year, moving you into a higher income tax bracket in retirement. Some investments, like a Roth IRA, are not subject to RMDs. It’s important to know the differences as you design your income strategy for retirement. Otherwise, you might be forced to take out more than you need.

Pension rollover. Before retirement, physicians may have an opportunity to move money out of a pension into other types of investments. If you’re looking for some guaranteed income in the future, you may consider setting aside a portion of the funds into an annuity.

Much like a traditional pension plan—that pays you a guaranteed amount each month—an annuity product is designed to generate guaranteed income as well. The income from the annuity might be used to cover your recurring monthly expenses in retirement—your rent or mortgage, utilities, groceries or other household goods. Guaranteed income from an annuity might also help address the risk of longevity, eliminating fears of running out of money if you live longer than expected.

Life insurance. Permanent whole life insurance products can generate cash values within the policy. These dollars build up over time and can be “pulled” from the policy in the form of loans. The cash can be withdrawn tax-free and it can serve as an alternative income source—especially if it’s not directly tied to the market.

In years when the market drops, pulling cash from an insurance policy with a fixed rate of return can help preserve your other assets—until the market recovers. In the meantime, though, the available cash in your life insurance policy might provide a tax-advantaged source of income during the downturn.

Planning opportunities. Understanding the different types of savings vehicles and how they’re used

to generate income can have a significant impact on retirement. Addressing market volatility concerns, the impact of inflation and how your investments will be taxed, are all important considerations when designing a retirement income strategy. In addition, understanding what investments to pull from first and how you might preserve assets during market downturns can be equally important.

Most people spend years saving for retirement, but few spend time developing an adequate income strategy for retirement. This presents a significant planning opportunity, and one that could make a considerable difference in your retirement years.