Government Executive

Timely Tax Tips

By Tammy Flanagan

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April is already upon us, and I hope most of you are either finished or in the last stages of preparing your 2016 tax returns. If you have recently retired, you may be learning that their are some benefits to leaving the workforce when it comes to income taxes. For those of you in the planning stages, it might be a good time to think through the tax implications of preparing for your separation from federal service.

FIrst, for some good news: Some states don't tax your retirement income, and others don't have a state income tax at all. The National Active and Retired Federal Employees Association provides a state by state tax guide for federal retirees. If your state does tax federal retirement benefits, the Office of Personnel Management will not withhold state income taxes unless you choose to have such withholding after your retirement is processed. You may use OPM Services Online to make this selection. Some retirees choose to make estimated tax payments directly to their state tax office.

When it comes to federal income taxes, most, if not all, of your retirement income is taxable. You won't pay Social Security or Medicare wage taxes any more (unless you go back to work), but there are ordinary income taxes to consider.

The good news is that a portion of your retirement is tax-free because you have already paid tax on your Civil Service Retirement System or Federal Employees Retirement System retirement contributions during your federal career. To figure out the tax-free portion of your retirement benefit, you will need to consult IRS Publication 721. Be sure you have tax withholding or pay estimated federal taxes on your CSRS or FERS annuity, or you may owe a penalty if the total of your withheld tax and estimated tax doesn't cover most of the tax shown on your return.

Generally, you will owe the penalty for 2017 if the additional tax you must pay with your return is $1,000 or more and greater than 10 percent of the tax to be shown on your 2017 return. For more information, including exceptions to the penalty, see Chapter 4 of IRS Publication 505.

In addition to your CSRS or FERS annuity benefit, don't forget about your Thrift Savings Plan withdrawals. Remember that taking too large of a payout in one year can push you into a higher federal tax bracket. The TSP offers a publication, Tax Information: Payments From Your TSP Account, that will guide you through the mandatory withholdings from your payments and those that can be changed.

In addition to ordinary income tax, there may be a 10 percent early withdrawal penalty applied if you take money out of your account before age 59 ½. But if you were 55 or older in the year you left federal service, you can make a partial withdrawal or begin a series of monthly payments from your TSP account without paying the penalty. Qualified public safety employees who retire in the year they turn age 50 or later are also exempt from the penalty.

Then there are Social Security retirement benefits. Some people receive them tax-free, but if you have a pension or other retirement income, you may find that as much as 85 percent of your Social Security retirement will be taxable. Most states don't tax Social Security benefits, but some do, so be sure to check the tax rules of your state.

According to this Kiplinger slide show, retirees often overlook tax breaks available to them. For example, did you know that a 65-year-old gets a larger personal deduction than someone younger? Also, taxpayers age 65 and older get a break when it comes to deducting medical expenses. Those who itemize deductions on their 2016 returns get a deduction if their medical bills exceed 7.5 percent of adjusted gross income. For younger taxpayers, the adjusted gross income threshold is 10 percent. If you're married, only one spouse needs to be 65 to use the 7.5 percent threshold.

For those of you who are qualified for Medicare, did you know that your income may affect the premium you pay for Medicare Part B? Historically, taxpayers have funded three-fourths of the Part B premium and the enrollee has paid only one-fourth of the cost. Under current law, however, some higher-income enrollees pay more than the traditional share. Medicare Part B has a 2017 premium of $134 per person per month. Some beneficiaries pay a little less than this due to a "hold harmless" provision, but some pay a lot more.

To determine your 2017 income-related monthly adjustment amounts, Social Security will use your most recent federal tax return file with the IRS — which is not the one you're getting ready to file this month. Most likely, it will be from your return filed last year, covering tax year 2015. But depending on the time of the year, the IRS may provide information from a return filed in 2015 for tax year 2014.

A reader recently let me know that he appealed the surcharge on Medicare Part B premiums using form SSA-44. He was already over 65 and was making use of the special enrollment period for those who delay Part B enrollment until after retirement. They are not charged the late enrollment penalty as long as they were covered by current employment health insurance and completed the enrollment within eight months of their retirement date.

In the reader's case, he had an income while working that would have caused the Part B premium to double with the surcharge for both he and his wife, who file jointly. So he filled out the appeal form and dropped it off in person at his local Social Security office to make sure he had all the needed documentation. He was advised to file the form again at the end of the year once he had his income figures for 2017.

Tax planning is an important part of the retirement preparation process. And the time to think about it is before you retire, so you don't get any unpleasant surprises when you figure out your actual net retirement income.

Photo: Pictures of Money, via Flickr

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http://www.govexec.com/pay-benefits/retirement-planning/2017/04/timely-tax-tips/136789/