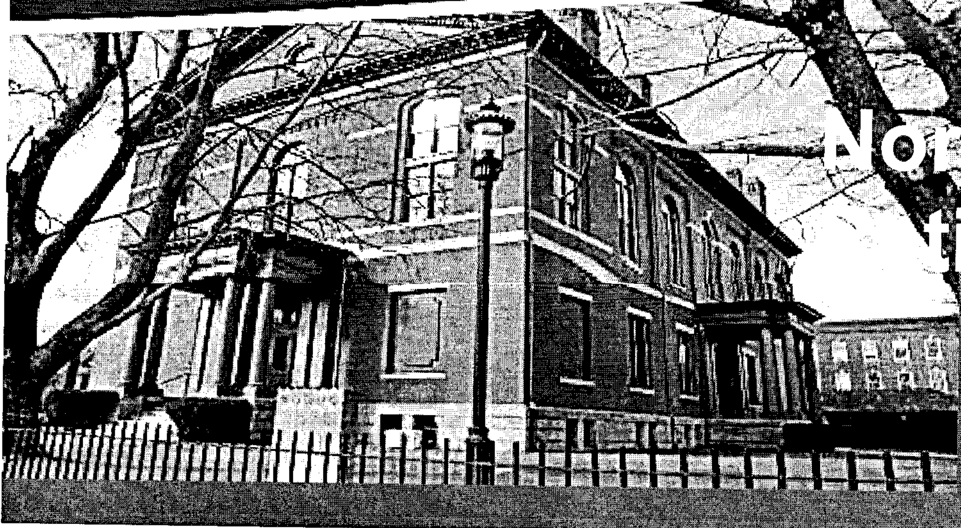

Northbridge
tirement News

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The IRS this month warned retired Americans about a possible surprise in their tax bill. The agency's concern: Because a sweeping 2017 law cutting taxes for individuals and businesses changes how income tax is calculated for most people, many could end up owing money for 2018.

But for most retirees, the real surprise is that they'll owe less -- not more -- in taxes next April. That's because the law includes important changes that lower many people's federal taxes -- and these changes will especially benefit retirees.

The two biggest changes that will help many retirees: A significantly higher standard deduction and the lower tax rates. Tax filing data show that a higher percentage of retirees claim the standard deduction because it's more valuable than their itemized deductions. That's because most older taxpayers don't carry a mortgage or rent their home, and therefore they don't have enough expenses to itemize.

The tax law also doubled the size of the standard deduction, and the additional standard deduction for filers over age 65 will still be available. In 2018, the standard deduction for single filers is now $12,000 (up from $6,350), and it's $24,000 (up from $12,700) for taxpayers who are married filing jointly. Plus, single tax filers over 65 can claim an additional $1,600, and married filers over 65 can claim an additional $2,600.

Retirees who do itemize deductions can claim more of their qualified medical expenses in 2018 than what they were allowed to claim in 2017. That's because the new rules lower the income threshold for claiming these expenses from 10 percent of adjusted gross income to 7.5 percent. In 2019, the income threshold will revert to 10 percent, unless Congress extends it.

Retirees have good reason to pay close attention to the income tax they owe and how they pay it. They typically receive nonwage income for which tax withholding is optional -- recipients

must elect it. In contrast, workers who receive income from wages have taxes withheld on a mandatory basis, typically through the use of automated withholding tables.

It's important for retirees to get their tax withholding right. Withhold too much, and you're starving for cash flow all year and getting a large tax refund the following year. Withhold too little, and you're setting up for a large surprise tax bill, and in some cases, a penalty for paying too little. For more information on penalties for paying too little, see IRS Publication 505, Tax Withholding and Estimated Tax.

So it's important that retirees know how to make sure taxes are withheld from their sources of income, which typically include payments from pensions or annuities, Social Security benefits and IRA withdrawals.

Retirees who receive payments from an annuity or pensions can elect withdrawals or change the tax withheld by completing a Form W-4P and providing it to the payer. Like the Form W-4 used for wage income, you can specify your tax filing status and the number of withholding allowances. Alternatively, you can simply specify a dollar amount of federal income tax to be withheld from each monthly payment.

A common source of retiree income is benefits paid from Social Security. Withholding federal income tax from Social Security payments is optional and isn't based on withholding allowances. Instead, recipients who want to have federal tax withheld must complete a Form W-4V and choose to have the tax withheld at one of four flat rates – 7 percent, 10 percent, 12 percent or 22 percent.

Tax withholding on IRA distributions is voluntary, so recipients must instruct the IRA custodian about withholding taxes, specifying either a percentage or a dollar amount to deduct from each withdrawal.