Top Tax Reminders for Seniors

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Tax season is a great time of year to analyze your income sources and make any necessary adjustments. Three of the most common mistakes I see while preparing clients' tax returns are 1) forgetting to take required minimum distributions, 2) withholding too little tax throughout the year, and 3) missing records for deductions, particularly medical expenses.

Required Minimum Distributions

Anyone who has reached the milestone of 70 ½ years must address taking required minimum distributions (RMD) from their retirement accounts such as IRAs and 401(k)s. The penalty for failing to withdraw a RMD is 50% of the amount that should have been withdrawn. If you've missed a RMD, you can always try to gain the sympathy of the IRS by requesting an abatement of the penalty; however, it is much easier to just comply with your RMD requirement than risk the 50% penalty.

Most financial institutions allow you to schedule annual RMD withdrawals. I recommend scheduling your withdrawal around a time of year when you anticipate additional expenses, such as when property taxes are due or when you typically take an annual vacation. RMD withdrawals can also be spread throughout the year for individuals who prefer a regular flow of income. Regardless of how you schedule your RMD, be sure you take it annually to avoid any surprise penalty.

Bonus Tip: While you're scheduling your annual RMD, double check the beneficiary designation on your account. This is the #1 free estate planning tool that many forget to update. Failing to name a beneficiary could result in unintended income tax consequences for your estate. If you've done any recent estate planning, be sure your beneficiary designation fits into your plan. Since beneficiary designations supersede any directions in your will or trust, it is always a good idea to consult your estate planning attorney if you have questions about your beneficiary designations.

Income Tax Withholding

Did you know you can have federal tax withheld from your social security check and your RMD withdrawal? If you're retired, you no longer have an employer sending monthly income tax withholding to the IRS on your behalf. This means that, come April 15th, you could find yourself writing an uncomfortable check to Uncle Sam. For some taxpayers, arranging for federal and state income tax withholding is a smart idea.

Social security income is only tax free for single taxpayers with less than $25,000 of “combined income” which includes: 50% social security, any taxable income, and tax exempt income. For married taxpayers the threshold is $32,000. If I am a single taxpayer and I receive $14,000 in social security, $20,000 from my pension, and $10,000 of tax exempt bond interest, then part of my social security benefits are taxable. I can plan ahead by requesting that social security withhold a portion of my monthly benefits. When I prepare my annual tax return, part of my tax liability will already be paid. To start a withholding, complete IRS Form W-4V and deliver it to your local social security office.

The same withholding can be done when you schedule your RMD. Typically, financial institutions withhold a standard 10% for federal taxes. For single taxpayers, the 10% tax bracket ends at $9,275 of taxable income and at $18,550 for married taxpayers. By increasing this withholding to better match your personal tax bracket you can ensure sufficient taxes are withheld to cover your tax liability.

Missing Records for Deductions

Every year, many of my clients are missing receipts for legitimate deductions. I realize it is cumbersome to keep every receipt, especially when some expenses seem insignificant. However, all those little expenses really add up.

For example, two prescriptions that each cost $10 a month seems insignificant. However, those prescriptions total $240 for the year. If you are in the 25% tax bracket, those prescriptions could save you $60 in tax. It doesn’t cost anything to keep receipts so you might as well reap the benefits of your expenses.

I recommend designating a folder or large envelope as your “Tax Folder” at the beginning of every year. Keep it in a convenient location where you can easily drop receipts or statements. If you are married, be sure your spouse is well aware of the Tax Folder and the importance of keeping receipts. At the end of the year, it is much easier to simply go through the folder and total the receipts than hunt through drawers, purses, or piles for documentation. If you use online bill payment or make online charitable donations, create a folder in your email account to store electronic receipts.

Summary

This tax season, take stock of your income sources and prepare yourself for the next tax season. If you owe money to the IRS on your 2016 tax return, consider increasing the withholding from your social security or RMD. If you’re turning 70 ½ this year or if you’ve forgotten to withdraw a RMD, take a few minutes to set up automatic distributions—this could save you thousands in penalties later on. Lastly, don’t forget your 2017 Tax Folder. At the end of the year, you’ll be glad you collected all those pesky receipts.