

THE WALL STREET JOURNAL.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djreprints.com>.

<http://blogs.wsj.com/experts/2016/08/07/how-a-roth-ira-can-mitigate-the-widows-tax-penalty/>

THE EXPERTS | WEALTH MANAGEMENT

How a Roth IRA Can Mitigate the 'Widow's Tax Penalty'



While a couple are still in their 60s, decisions about investments can protect a surviving spouse from higher taxes when that time comes, according to WSJ Investing Expert Jonathan Guyton. *PHOTO: ISTOCK PHOTO*



By

JONATHAN GUYTON

Aug 7, 2016 10:00 pm ET

Jonathan Guyton is principal at Cornerstone Wealth Advisors Inc., a fee-only advisory firm in Minneapolis.

Few events are more jarring than the premature death of a spouse. It's a life transition of monumental proportions. When it comes to the implications for finances, we tend to first think of this as a matter of quantity: Will the surviving spouse have enough assets and income as they move forward with their life?

But also important is a question of strategy: Can these assets and income be constructed to mitigate the cruelest tax increase in our tax code, which occurs when a survivor

becomes a “single” taxpayer?

Especially when a surviving spouse is well along in retirement, the toll can be rather shocking. Single taxpayers reach each tax bracket at far lower incomes than married couples. For singles, this happens twice as quickly when moving from the 15% federal bracket to the next bracket, 25%. It's the biggest jump in the tax code.

The key to avoiding it often depends on the couple's planning moves while still in their 60s.

MORE IN WEALTH MANAGEMENT

- You Have \$10 Million and 10 Years to Live. What Would You Do? (<http://blogs.wsj.com/experts/2016/08/11/you-have-10-million-and-10-years-to-live-what-would-you-do/>)
- So You Think You Want to Work for a Nonprofit? (<http://blogs.wsj.com/experts/2016/08/07/so-you-think-you-want-to-work-for-a-nonprofit/>)
- What Brexit Can Teach Investors About Trying to Time the Market (<http://blogs.wsj.com/experts/2016/08/07/what-brexit-can-teach-investors-about-trying-to-time-the-market/>)
- Why I've Changed My Strategy on Tax Withholdings (<http://blogs.wsj.com/experts/2016/08/07/why-ive-changed-my-strategy-on-tax-withholdings/>)
- Six Items on My Financial To-Do List as I Turn 50 (<http://blogs.wsj.com/experts/2016/08/07/six-items-on-my-financial-to-do-list-as-i-turn-50/>)

In 2016, the line separating these two brackets is \$37,650

taxable income for singles and \$75,300 for married couples. In other words, single taxpayers get there twice as soon as married couples – a consequence of no “marriage penalty” at these income levels. While this may seem fair enough, it can be a cruel surprise to the recently widowed spouse the year after her beloved's death. Adding insult to injury, she will almost always have a larger portion of her Social Security benefit included as taxable income than when married.

THE EXPERTS



The Experts are a group of industry and academic thought leaders who weigh in on topics covered in the [The Journal Report](#).

Imagine a married couple with \$100,000 in income from Social Security, IRA withdrawals and/or pensions. After deductions/exemptions, assume \$73,000 is taxable. They land in the 15% bracket and owe approximately \$10,000 in Federal tax – or about 10% of income. Now imagine that the widowed

spouse, on keeping the larger Social Security check and all financial assets (since, as the

movie tell us, you can't take it with you), still has an \$80,000 income with \$61,000 taxable after deductions/exemptions. This places her above the \$37,650 line and well into the 25% single Federal bracket; it generates an approximately \$11,000 Federal tax bill — or about 14% of income and about \$1,000 more than when married, even with \$20,000 less income. Ouch!

Fortunately, planning strategies can mitigate some impact of this “widow's penalty.” The key is lessening the taxable income, which, due to the spouse's death, now finds itself in the 25+% marginal tax brackets for the widow's remaining life.

To illustrate, consider a same-aged couple with \$1 million in financial assets the first year of their required minimum distributions (RMDs); assume that \$750,000 are IRAs, with the rest in a brokerage account. Assume further that they rebalance annually to a 50/50 stock/bond asset allocation with the simplistic assumption that stocks return 7% and bonds 3% each and every year. Thus, they earn 5% annually. Their first RMD is about \$27,400. A decade later, after withdrawing each RMD, their IRA value is \$785,000. The age 80 RMD is now about \$42,000, 53% higher, regardless of who is/is not living. The higher this RMD amount, the more Social Security will also be taxable and the more likely that taxable income crosses into the 25% bracket. And should this year be the first as a survivor, she would almost certainly be well over that line.

By contrast, suppose that by age 70 this couple had completed annual Roth IRA conversions that moved 20% (\$150,000) of their IRA assets to a Roth IRA. By withdrawing from brokerage assets for income these years, the tax rate on these annual conversions could easily have stayed at 15% bracket. RMD amounts are now also 20% lower; the first year's is about \$21,900, and the age 80 amount is about \$33,600.

This is not only over \$8,000 less taxable income at age 80, which can be replaced by tax-free Roth withdrawals, there's likely more Social Security that also can remain tax-free. If these lower taxable IRA and Social Security amounts are on a widow's tax return, the lower taxable portion avoids what would otherwise be taxed at 25%. Savings could easily be \$1,000 annually.

Note that these Roth conversions would probably not be worth doing had they also made significantly more Social Security taxable. However, if the couple was waiting until age 70 to claim the larger benefit and using brokerage assets for income, this would be a nonissue. Even if full Social Security was already being collected, conversions could be worthwhile if they occurred while living in a state with no income tax and where a future move to a higher-tax state was likely.

So it's important to keep doing long-term planning even after retirement begins. Couples can't escape the likelihood that one spouse will outlive the other. But they can

protect that survivor better through strategies such as this.

Read the latest **Investing in Funds & ETFs Report**.

Read More From **THE EXPERTS** 

Share this:

[BEREAVEMENT \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/BEREAVEMENT/\)](http://blogs.wsj.com/experts/tag/beravement/)

[INVESTING IN FUNDS \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/INVESTING-IN-FUNDS/\)](http://blogs.wsj.com/experts/tag/investing-in-funds/)

[JONATHAN GUYTON \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/JONATHAN-GUYTON/\)](http://blogs.wsj.com/experts/tag/jonathan-guyton/)

[ROTH IRA \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/ROTH-IRA/\)](http://blogs.wsj.com/experts/tag/roth-ira/)

[TAXES \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/TAXES/\)](http://blogs.wsj.com/experts/tag/taxes/)

[WEALTH MANAGEMENT \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/WEALTH-MANAGEMENT/\)](http://blogs.wsj.com/experts/tag/wealth-management/)

[WIDOWERS \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/WIDOWERS/\)](http://blogs.wsj.com/experts/tag/widowers/)

[WIDOWS \(HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/WIDOWS/\)](http://blogs.wsj.com/experts/tag/widows/)

Copyright 2014 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.