

**THE COMPLETE CARDINAL GUIDE  
TO PLANNING FOR AND LIVING IN RETIREMENT  
WORKBOOK**

NAVIGATING SOCIAL SECURITY,  
MEDICARE AND SUPPLEMENTAL INSURANCE,  
LONG-TERM CARE, IRA, LIFE INSURANCE,  
POST-RETIREMENT INVESTMENT AND INCOME TAXES

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The Complete Cardinal Guide to Planning for and Living in Retirement Workbook

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**KEY QUESTIONS**

- Is Social Security income taxed?
- What are Medicare surcharges?
- Can you postpone income taxes?
- Are there income taxes associated with death?
- What are some long-term-care implications of income taxes?
- Can you prepare your taxes by yourself?
- Is aid available to those who need help preparing their taxes but can't afford the cost?

*Corresponds to Chapter 8, "Income Taxes," in **The Complete Cardinal Guide**.*

## 7.1 The History of the Income Tax

When the 16th Amendment to the Constitution was ratified in 1913, the income tax became a permanent feature of the US financial system. Early 1040 tax forms were one page long, including the instructions. Over the decades, as a result of political wrangling and various special-interest efforts to influence the American economy, we now have a tax code that most citizens don't understand. There are both tax breaks and tax penalties you need to learn about that impact your financial situation when you turn 65, go on Medicare, start collecting your Social Security check, start drawing down your IRA, possibly need long-term care, and pass away and leave money to your spouse or kids.

## 7.2 Social Security Taxes

Many people pay federal income taxes on their Social Security benefits. This usually happens only if you have other substantial income in addition to your benefits (such as wages, self-employment earnings, interest, dividends, and other taxable income that must be reported on your tax return).

No one pays federal income tax on more than 85% of his or her Social Security benefits, based on Internal Revenue Service (IRS) rules. If you:

- 1. file a federal tax return as an individual and your combined income\* is:**
  - a. between \$25,000 and \$34,000, you may have to pay income tax on up to 50% of your benefits.
  - b. more than \$34,000, up to 85% of your benefits may be taxable.
- 2. file a joint return and you and your spouse have a combined income\* that is:**
  - a. between \$32,000 and \$44,000, you may have to pay income tax on up to 50% of your benefits.
  - b. more than \$44,000, up to 85% of your benefits may be taxable.
- 3. are married and file a separate tax return, you probably will pay taxes on your benefits.**

*\*Note:*

	<i>Your adjusted gross income</i>
+	<i>Nontaxable interest</i>
+	<i>1/2 of your Social Security benefits</i>
=	<i>Your combined income</i>

Each January you will receive a Social Security Benefit Statement (Form SSA-1099) showing the amount of benefits you received in the previous year. You can use this Benefit Statement when you complete your federal income tax return to find out if your benefits are subject to tax.

If you do have to pay taxes on your Social Security benefits, you can make quarterly estimated payments or choose to have federal taxes withheld from your benefits.

## Reading Check

If you live on Social Security and a small amount of other income, will you pay income taxes on your Social Security? If you have substantial income in addition to your Social Security, which of these is true: You will pay up to 85% of your Social Security in taxes, or up to 85% of your Social Security benefits will be taxable income?

### 7.3 Medicare: Income-Related Monthly Adjustment Amount (IRMAA)

The standard Medicare Part B monthly premium for 2017 is \$134. If you're single and file an individual tax return, or married and file a joint tax return, the following additional costs could apply to you. While these costs are not assessed as "taxes," that's what they are in everything but name:

*Fig 7.1 Medicare "Taxes," Single or Married Filing Jointly*

MODIFIED ADJUSTED GROSS INCOME (MAGI)	PART B MONTHLY PREMIUM AMOUNT	PRESCRIPTION DRUG COVERAGE MONTHLY PREMIUM AMOUNT
Individuals with a MAGI of \$85,000 or less Married couples with a MAGI of \$170,000 or less	2017 standard premium = \$134.00	Your plan premium
Individuals with a MAGI above \$85,000 up to \$107,000 Married couples with a MAGI above \$170,000 up to \$214,000	Standard premium + \$53.50	Your plan premium + \$13.30
Individuals with a MAGI above \$107,000 up to \$160,000 Married couples with a MAGI above \$214,000 up to \$320,000	Standard premium + \$133.90	Your plan premium + \$34.20
Individuals with a MAGI above \$160,000 up to \$214,000 Married couples with a MAGI above \$320,000 up to \$428,000	Standard premium + \$214.30	Your plan premium + \$55.20
Individuals with a MAGI above \$214,000 Married couples with a MAGI above \$428,000	Standard premium + \$294.60	Your plan premium + \$76.20

If you're married and lived with your spouse at some time during the taxable year but file a separate tax return, the following additional costs could apply to you:

*Fig 7.2 Medicare "Taxes," Married Filing Separately*

MODIFIED ADJUSTED GROSS INCOME (MAGI)	PART B MONTHLY PREMIUM AMOUNT	PRESCRIPTION DRUG COVERAGE MONTHLY PREMIUM AMOUNT
Individuals with a MAGI of \$85,000 or less	2017 standard premium = \$134.00	Your plan premium
Individuals with a MAGI above \$85,000 up to \$129,000	Standard premium + \$214.30	Your plan premium + \$55.20
Individuals with a MAGI above \$129,000	Standard premium + \$294.60	Your plan premium + \$76.20

## 7.4 Roth IRA

The tax code allows you or your employer to transfer earned income into your IRA, 401(k), 403(b), and similar types of accounts, without paying income taxes or payroll taxes—*for now*. The earnings or growth inside of these accounts is tax-deferred—*for now*. Ordinary income taxes must be paid when distributions are taken from your IRA. If you distribute your IRA before age 59½, an additional 10% penalty will be applied.

With a Roth IRA, you deposit after-tax earned income. Earnings or growth accumulate tax-free inside a Roth IRA. Distributions from your Roth IRA are tax-free during your lifetime, providing you leave the money in the Roth for at least five years.

It is possible, and might be to your advantage, to convert your traditional IRA to a Roth IRA. In doing so, you pay income taxes on your traditional IRA. Roth IRAs have no Required Minimum Distributions during your lifetime. For more on IRAs, see Module 4.

### Reading Check

Do you pay taxes on money in an IRA? If so, when?

## 7.5 How Are Different Types of Investment Income Taxed?

### **IRAs**

Tax-deferred until withdrawn. Taxed as ordinary income.

### **Roth IRAs**

Tax-free.

### **Life Insurance**

Cash value increases are tax-deferred until withdrawn, then taxed as ordinary income. Death benefits generally go to beneficiaries with taxes due on deferred gains.

### **Stocks Held Individually**

Capital gains tax is due on sale profits if the stock is held longer than 12 months. Dividends are taxed at capital gains rates.

### **Bonds Held Individually**

Interest is taxed as ordinary income. Capital gains tax is due on sale profits if the bond is held longer than 12 months.

### **Bank CDs Held Individually**

Interest is taxed as ordinary income.

### **Mutual Funds**

Income tax liability is passed through to the holder of the mutual fund. It's paid as ordinary income tax or capital gains tax.

### **Estate Taxes: “There Are Income Taxes Even in Death”**

The estate files an income tax return for the year in which the death occurred. Several considerations come into play, including “Income in respect of a decedent.”

## 7.6 Long-Term Care and Income Taxes

Nursing home and home health-care costs can be a deductible medical expense. Generally, you can deduct only the amount of your medical and dental expenses that exceed 10% of your adjusted gross income (AGI). We believe that smart planning is to use IRA money first to pay nursing home and home health care costs.

Fig 7.3

TYPE OF TAXPAYER	PREMIUM DEDUCTION (TRADITIONAL POLICIES)	TAXATION OF BENEFITS												
<p><b>Individual taxpayer who itemizes deductions</b> (Schedule A)</p>	<p>Treated as accident and health insurance. IRC §7702B(a)(1)                      Limited to lesser of actual premium paid or eligible LTCI premium.                      IRC §§213(d)91)9D0, 213(d)(10)                      Eligible LTC premium in 2017 (indexed):</p> <table border="1" data-bbox="391 780 776 1045"> <thead> <tr> <th>Attained age in tax year</th> <th>Deductible premium limit</th> </tr> </thead> <tbody> <tr> <td>Age 40 or less</td> <td>\$410</td> </tr> <tr> <td>Age 41–50</td> <td>\$770</td> </tr> <tr> <td>Age 51–60</td> <td>\$1,530</td> </tr> <tr> <td>Age 61–70</td> <td>\$4,090</td> </tr> <tr> <td>Age 71 or older</td> <td>\$5,110</td> </tr> </tbody> </table> <p>Medicare expense deduction is allowable to extent that such expenses (including payment of Eligible LTCI premium) exceed 10% of AGI (7.5% if age 65 or older). IRC§ 213(a), 213(f)</p>	Attained age in tax year	Deductible premium limit	Age 40 or less	\$410	Age 41–50	\$770	Age 51–60	\$1,530	Age 61–70	\$4,090	Age 71 or older	\$5,110	<p><b>Reimbursement</b> benefits are not included in income.                      IRC§ §104(a)(3), 7702B(a)(2)  <b>Per diem (or indemnity)</b> benefits are not included in income except amounts that exceed the <u>greater of</u>:</p> <ul style="list-style-type: none"> <li>• \$360 per day (2017 indexed), <u>or</u></li> <li>• Total qualified LTC expenses.</li> </ul> <p>IRC §§104(a)(3), 7702B(a)(2), 7702B(d)</p>
Attained age in tax year	Deductible premium limit													
Age 40 or less	\$410													
Age 41–50	\$770													
Age 51–60	\$1,530													
Age 61–70	\$4,090													
Age 71 or older	\$5,110													

LINKED-BENEFIT LTCI
<p>LTC benefits paid from a Tax-Qualified (7702B) annuity or life insurance “linked benefit” plan are tax-free as noted above.                      IRC§7702B(e)</p>
<p>Cash surrenders from a LTCI linked-benefit plan that paid LTCI benefits may have a reduced cost-basis. IRC§72(e)(11)</p>
<p>Premium payments for annuity or life insurance linked-benefit LTCI plans are NOT deductible. (Separately-billed TQ LTCI riders may be deductible.)</p>

## 7.7 Income Tax Rates

The tables below show the 2017 personal income tax rates, depending on your filing status.

Fig 7.4

<b>Taxable Income Brackets for 2017 Ordinary Income Tax Rates</b>		
<b>Marginal Tax Rate</b>	<b>Married Filing Joint</b>	<b>Single</b>
39.6% *	Over \$470,700	Over \$418,400
35%	\$416,701 – \$470,700	\$416,701 – \$418,400
33%	\$233,351 – \$416,700	\$191,651 – \$416,700
28%	\$153,101 – \$233,350	\$91,901 – \$191,650
25%	\$75,901 – \$153,100	\$37,951 – \$91,900
15%	\$18,651 – \$75,900	\$9,326 – \$37,950
10%	\$0 – \$18,650	\$0 – \$9,325

\* The top rate is effectively 43.4% for those subject to the 3.8% Medicare surtax on net investment income

<b>Taxable Income Brackets for 2017 Long Term Capital Gains and Qualified Dividends Tax</b>		
<b>Long Term Capital Gains Rate</b>	<b>Married Filing Joint</b>	<b>Single</b>
20% *	Over \$470,700	Over \$418,400
15% **	\$75,901 – \$470,700	\$37,951 – \$418,400
0%	\$0 – \$75,900	\$0 – \$37,950

\*The top rate is effectively 23.8% for those subject to the 3.8% Medicare surtax on net investment income

\*\*Clients in the 15% LTCG tax bracket with MAGI over their 3.8% threshold (\$250,000 joint filers/\$200,000 single filers) will pay an effective rate of 18.8%

**PLANNING FOR INCOME TAXES**

**Locate your prior year's tax return(s).**

Your adjusted gross income (AGI) from line ..... on your form 1040 =

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