



MAXIMIZING RETIREMENT INCOME: Leveraging the New Senior Deduction to Reduce Voluntary Taxation

As a follow up to our article in July and our OBBB Act Gateway presentation in October, we want to reiterate the importance of talking to retirees about the new temporary senior deduction. For those of you helping clients with retirement income planning, you know that it is not enough to just ensure your clients have money to cover their monthly living expenses. Efficient planning is more than that — it is about making strategic decisions to preserve a client's wealth, minimize their tax liability and maximize their financial well-being.

Retirees and those approaching retirement have a unique opportunity to enhance their tax efficiency over the next four years. So, we are going to briefly review the new senior deduction and consider how it can be integrated with other tax management strategies to reduce your client's tax and longevity risk during retirement.

Understanding the OBBB's Senior Deduction

Eligibility

The new senior deduction allows eligible taxpayers aged 65 and older to claim an additional \$6,000 deduction (could be \$12,000 for married filers) from their taxable income, even if they itemize their deductions. This time-limited opportunity is effective for tax years 2025 through 2028. The deduction though will phase out at a 6% rate (\$60 reduction for every \$1,000 over the threshold) when MAGI exceeds \$75,000 for singles and \$150,000 for joint filers, and it is fully phased out at \$175,000 for singles and \$250,000 for joint filers.

Tax Management Strategies in Retirement

Coordinating Income Sources

Retirees often draw income from multiple sources: Social Security, pensions, retirement accounts and investments. Coordinating withdrawals and distributions can help manage taxable income and optimize the use of available deductions.

Timing Withdrawals

Strategic timing of withdrawals from retirement accounts (such as tax deductible IRAs and pretax 401(k)s) as well as tax-free accounts (such as cash value life insurance or Roth IRAs and Roth 401(k)s) can prevent income spikes that push clients into higher tax brackets or cause more of their Social Security income or long-term capital gains (LTCG) income to be taxed. And spreading taxable withdrawals across several years, if possible, especially while the new senior deduction is available, is a smart approach.

Deduction Utilization

To maximize the new senior deduction, retirees should aim to synchronize their income streams so that they can fully utilize the \$6,000 deduction each year and take advantage of reducing the potential taxation of Social Security and LTCG income. If possible, this would involve adjusting the amounts withdrawn from various taxable accounts or realizing long term capital gains income in a controlled manner to not only control the "voluntary" taxes paid on those income streams, but also take full advantage of this time-limited senior deduction.

Thresholds and Planning Opportunities

For the 2025 tax year, Social Security taxation begins when provisional income exceeds \$25,000 for single filers. For joint filers, the threshold is \$32,000. Keeping a client's combined income below these thresholds should be a key planning goal. One of the easiest ways to do this, other than drawing less income from taxable accounts, is to consider withdrawals from a client's cash value life insurance or Roth accounts. The client will receive the distribution tax free and therefore not increase the likelihood of exceeding the taxation threshold.

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Another tax management opportunity is considering a client's ability to take advantage of their 0% LTCG rate. The 0% rate generally applies to taxable income up to \$44,625 for single filers and \$89,250 for joint filers in 2025. Similar to Social Security taxation planning, retirees should consider drawing income from available Roth accounts or cash value life insurance to harvest capital gains strategically, especially over the next four years. By timing withdrawals and keeping reportable income below the 0% LTCG thresholds, they can minimize or eliminate capital gains taxes and take full advantage of the senior deduction.

Integrating the Senior Deduction with Income Planning

Case Example

Consider a single retiree who plans to receive \$100,000 of retirement income — \$10,000 from a pension, \$40k from Social Security and \$50,000 in long-term capital gains. He may not understand that his taxable income is currently above taxable thresholds for Social Security and LTCG taxation. He also may not understand that because he is recognizing income above \$75k, he is not able to take advantage of the full \$6,000 senior deduction in 2025.

After reviewing his retirement portfolio, you realize that he has an IUL policy and a Roth 401(k). You now have the perfect opportunity to help coordinate strategic withdrawals from your client's tax-free accounts to reduce his taxable income below both the Social Security and LTCG tax thresholds, and below \$75k of MAGI, resulting in substantial tax savings and also allowing your client to receive the full \$6k senior deduction (rather than only a portion of the deduction due to the phaseout).

Keeping Income Below Key Thresholds

The combination of the senior deduction and coordinated income planning from tax-free assets helps retirees meet their income needs, stay under critical thresholds to maximize tax deductions and minimize the voluntary tax on Social Security and capital gains income. This kind of proactive strategy not only preserves wealth to hedge longevity risk but also provides peace of mind to clients during retirement.

Conclusion

The new temporary senior deduction from the One Big Beautiful Bill offers retirees a powerful tool for managing taxes over the next four years. By integrating this deduction into a comprehensive retirement income plan and considering the taxation of Social Security and LTCG income, advisors can maximize a retiree's tax efficiency and ensure a more secure financial future. Now is the time for financial planners to assess their client's income strategies and make the most of this unique opportunity for tax savings.

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