Retirement Strategies Tax Estimator methodology document

This calculator is for illustrative purposes only and is meant to demonstrate how certain tax-planning strategies may impact the amount of taxable income and the estimated federal tax liability for the selected year. The calculations and other output generated by this calculator are hypothetical in nature and are estimates based on the information you provided, assumptions made by this calculator, and the Internal Revenue Code and Treasury regulations. The results do not represent actual tax liabilities or benefits. The calculator does not provide recommendations and therefore should not be used as the primary basis for any tax-planning decisions or for tax-reporting purposes. You should always consult a tax advisor prior to implementing a specific tax strategy or to answer questions specific to your tax situation. Your unique circumstances may not be accounted for in this calculator.

Fidelity does not provide legal or tax advice. The information herein is general and educational in nature and should not be considered legal or tax advice. Tax laws and regulations are complex and subject to change, which can materially impact the outcome of certain tax-planning strategies. Fidelity cannot guarantee that the information herein is accurate, complete, or timely. Fidelity makes no warranties with regard to such information or results obtained and disclaims any liability arising out of your use of, or any tax position taken in reliance on, such information.

Calculations

The calculator performs 2 separate calculations to provide 2 sets of hypothetical results; one where the tax-planning strategy inputs are included and the other where they are excluded. This establishes what the estimated federal tax liability might be if strategies are applied and what the estimated federal tax liability might be if no strategies are applied.

Using the inputs you provide, the calculator will perform the following calculations to estimate federal tax liability and related information for both scenarios:

- Adjusted gross income (AGI)
- Deductions and taxable income
- Ordinary income tax liability
- Capital gains tax liability
- Total federal tax liability
- MAGI and related tax calculations
- Tax Bracket Headroom
- Tax Brackets

Details regarding these calculations can be found below.

Calculating adjusted gross income (AGI)

The calculator starts by calculating total income as the sum of all income received by the individual or household, depending on the selected tax-filing status provided in the inputs entered by you. No above-the-line deductions are considered in the calculator, thus adjusted gross income (AGI) in this calculator is equivalent to total income. To calculate the total income amount, the calculator begins by summing the following inputs:

- Taxable income from salaries and wages
- Annual pension
- Social Security income
- Other ordinary income for the tax year
- Net realized long-term capital gains or losses
- Net realized short-term capital gains or losses
- Ordinary dividends
- Qualified dividends
- Taxable interest
- Required minimum distributions (RMDs)

Applying tax strategies: Adjustments to total income

In the calculation where tax-planning strategies are applied, adjustments to the total income amount are made for each of the strategies, as described below:

Roth conversion

The Roth conversion "amount to convert" input is added to the total income amount. The input is assumed to be the gross withdrawal, inclusive of any withholding amount. Roth conversions do not qualify toward the required minimum distribution (RMD) for the year.

Charitable giving

The "amount of qualified charitable distributions (QCD)" input reduces the reportable amount of the RMD and thus the total income amount. A QCD is not tax-deductible and does not impact itemized deductions. A QCD can reduce the reportable amount of the RMD regardless of whether itemizing or claiming the standard deduction. If the QCD is greater than the RMD, the amount that is greater is not deducted from the total income amount and that portion of the QCD does not have any further impact on the tax calculations.

To understand how the "amount of tax-deductible charitable donations" input impacts the calculations, see "Calculating deductions and taxable income" below.

Targeting withdrawals by account type

The "withdrawals from tax-deferred accounts" input is added to the total income amount. Tax-deferred account withdrawals do not qualify toward the RMD for the year for purposes of these calculations.

The "withdrawals from tax-exempt accounts" input is treated as a nontaxable withdrawal and does not impact the total income amount.

The "withdrawals from taxable accounts" input is assumed to be comprised of cost basis and capital gains or losses, based on the "amount of taxable withdrawals that are long-term capital gains or losses" and the "amount of taxable withdrawals that are short-term capital gains or losses" inputs. The positive portion of long-term capital gains, if applicable, and the positive portion of short-term capital gains, if applicable, is added to the total income amount. The remaining portion of the withdrawals from taxable accounts input is assumed to be cost basis and is treated as a nontaxable withdrawal that does not impact the total income amount. If either short-term or long-term capital losses are entered or the inputs are zero, there is no impact on the total income amount.

Taxable portion of Social Security

Not all income is fully taxable. To calculate AGI, the calculator takes the total income defined above and calculates the taxable portion of Social Security income. This calculation takes the total income amount less Social Security, adds back one-half of the Social Security income, and adds non-taxable interest from the "tax-exempt interest input" and the "Savings bond interest used for higher education expenses" input to arrive at the combined income. Based on the filing status, the combined income determines the amount of the Social Security income that is taxable (under federal tax rules) up to a maximum of 85% of the benefit received. Social Security income less the amount of the Social Security income that is taxable equals the nontaxable portion of Social Security income. Note that the taxable and nontaxable portions are estimated separately for the 2 scenarios, when strategies are and are not applied.

The nontaxable portion of Social Security income is subtracted from the total income amount to arrive at total income, and AGI, for federal income tax purposes.

Calculating deductions and taxable income

Once AGI is determined, then the tool calculates deductions. The standard deduction amount is assumed based on your tax-filing status and your birthday and your spouse's, if applicable. If either you or your spouse are age 65 or older, an increase to the standard deduction is considered.

Applying tax strategies: Adjustment to total itemized deductions

Charitable giving

For the scenario where tax-planning strategies are applied, the "amount of tax deductible charitable donations" input is added to the "itemized deductions" input to determine the total itemized deductions amount.

To determine the amount of the deduction used to calculate taxable income, the standard deduction amount is compared to the total itemized deductions amount. If the total itemized deductions amount is greater than the standard deduction amount, the total itemized deductions amount is subtracted from AGI to estimate taxable income. If not, the standard deduction is subtracted from AGI to estimate taxable income. Taxable income is comprised of ordinary taxable income and taxable net capital gains or losses.

To arrive at ordinary taxable income, the calculations start with total ordinary income which, for the purposes of these calculations, is defined as the portion of AGI that is not comprised of net capital gains and qualified dividends, after netting short-term and long-term net realized capital gains or losses and the amount of taxable withdrawals that are capital gains or losses. Deductions are first applied to total ordinary income to estimate ordinary taxable income. If deductions exceed total ordinary income, then they are applied against net capital gains and qualified dividends to arrive at taxable net capital gains or losses. Remaining deductions are not refundable and do not carry forward to future years.

If applicable, up to $3,000 of net capital losses may be applied against ordinary income first and then against qualified dividends in the same manner deductions are applied. Any unused net capital losses are carried forward to future years and have no impact on the results generated by the calculator.

Calculating ordinary income tax liability

The taxable portion of income attributable to total ordinary income is taxed according to the applicable federal income tax rates and brackets to arrive at the estimated ordinary income tax liability. The estimated marginal tax rate on ordinary income is defined in this calculator as the amount of ordinary income tax paid for every additional dollar of ordinary income.

Calculating capital gains tax liability

The taxable portion of income attributable to net capital gains and qualified dividends is taxed at the applicable long-term capital gains rate to arrive at the estimated capital gains tax liability. The estimated marginal tax rate on capital gains is defined in this calculator as the amount of capital gains tax paid for every additional dollar of net capital gains or qualified dividend income.

Calculating total federal tax liability

To estimate the total federal tax liability, the calculator sums the capital gains tax liability and the ordinary income tax liability together. The estimated effective tax rate is defined as the total federal tax liability divided by adjusted gross income (AGI).

MAGI and related tax calculations

MAGI and related tax calculations do not impact your federal tax liability as presented on the output page and illustrated in the visuals. The results of these calculations are presented independently.

- MAGI for public marketplace health insurance premium tax credits is the sum of:
    - AGI
    - The non-taxable portion of Social Security income
    - The “Tax-exempt interest” input
    - The “Exclusions and deductions from foreign earned income tax” input
    - The “Savings bond interest used for higher education expenses” input

  MAGI is an input used in determining applicable public marketplace health insurance premium tax credits. The estimated tax credit is not calculated.

- MAGI for future Medicare Part B and Part D surcharges is the sum of:
    - AGI
    - The “Tax-exempt interest” input
    - The “Exclusions and deductions from foreign earned income tax” input
    - The “Savings bond interest used for higher education expenses” input
    - The “Untaxed earned income from sources within US territories” input

  MAGI is an input used in determining applicable future Medicare Part B and Part D surcharges. The estimated surcharges are not calculated.

- MAGI for the net investment income tax (NIIT) is the sum of:
    - AGI
    - The “Foreign earned income exclusion (adjusted)” input

  MAGI is an input used in determining applicable NIIT. Estimated NIIT is calculated using the MAGI for NIIT, taxable investment income, and applicable federal NIIT tax rates and brackets. Taxable investment income in this calculator is determined by first taking the sum of "Other ordinary income for the tax year" input, the taxable net capital gains amount calculated when determining taxable income, the "Ordinary dividends" input, the "Qualified dividends" input, and the "Taxable Interest" input. The "Investment expenses" input is subtracted from this amount to arrive at taxable investment income.

Tax Bracket Headroom

Above the “Ordinary taxable income” chart, figures are presented indicating how far into the federal income tax bracket for the selected year the resulting ordinary taxable income is and how far until the next federal income tax bracket the resulting ordinary taxable income is. The amount “into” the bracket for the selected year is determined by subtracting the resulting ordinary taxable income from the beginning of the bracket for the selected year. The amount “until” the next bracket is determined by subtracting the resulting ordinary taxable income from the beginning of the next bracket. In the case the next tax bracket is the lowest tax bracket, only the figure showing the amount “until” the next bracket will be displayed. In the case the tax bracket for the selected year is the highest tax bracket, only the figure showing the amount “into” the bracket for the selected year will be displayed. The calculation is performed separately for the 2 scenarios, when strategies are and are not applied.

Above the “Taxable income” chart, figures are presented indicating how far into the federal capital gains tax bracket for the selected year the resulting taxable income is and how far until the next federal capital gains tax bracket the resulting taxable income is. The calculations determining the amount “into” the bracket for the selected year and “until” the next bracket is the same as described for the “Ordinary taxable income” chart, substituting taxable income for ordinary taxable income.

Tax Brackets

When clicking on the tax rates on the axis of the “Ordinary taxable income” chart, the beginning dollar amount of the corresponding federal income tax bracket will appear. When clicking on the tax rates on the axis of the “Taxable income” chart, the beginning dollar amount of the corresponding federal capital gains tax bracket will appear. Two tax rates will typically appear on the axis of the "Ordinary taxable income" graph. Depending on the Inputs provided, one or two tax rates will appear on the axis of the "Taxable income" graph.

Limitations and assumptions

While reasonable efforts are made to use and maintain the most updated tax rates, income tax brackets, and other tax rules for estimating taxes, there may be a delay between when any new tax rates, brackets, and other rules become effective and when this calculator is updated to reflect them.

This calculator estimates federal tax liability given the various strategies by evaluating the inputs provided under 2 scenarios: One where tax-planning strategies are applied and one where tax-planning strategies are not applied. The calculator does not account for the treatment of any FICA taxes, state, local, and foreign taxes, or tax credits. You should consult your tax advisor regarding the impact these taxes and tax credits could have on your tax liability.

The calculator does not allow all tax filing statuses to be entered. The calculator can only accommodate single and married filing jointly tax filing statuses. If you have a different tax filing status, the calculator should not be used. If you are self employed, the ability to deduct a portion of self employment taxes paid is not considered in this calculator.

The calculator will only estimate federal tax liability for the selected year with and without tax-planning strategies applied. Subsequent years are not modeled; therefore, potential long-term tax benefits and long-term tax costs are not modeled. In some instances where tax-planning strategies are applied, the estimated federal tax liability will increase in the selected year with potentially offsetting benefits in future years. For example, this may be applicable to Roth conversions, where the potential tax benefit isn't realized until withdrawals are taken in future years, or to carryforward net capital losses, among other potential future tax benefits.

Not all tax-planning strategies may be applicable to your individual tax situation. By providing an input to a specific strategy, you are modeling a hypothetical situation that assumes you are eligible to execute the strategy without penalty or limitation. Any penalties incurred as a result of executing a strategy when you are not fully eligible are not modeled in this calculator. For example, withdrawing from a Roth IRA prior to meeting the IRS's waiting period imposed on certain Roth IRA withdrawals, known as the 5-year rule, may result in tax penalties. Any potentially applicable limitations in executing a strategy are not modeled in this calculator. For example, the amount of QCDs a taxpayer can make each year is limited.

Income from salaries and wages in this calculator is assumed to be after deductions for elective deferrals to retirement plans, HSAs, other pre-tax benefits, or payroll deductions. Entering income before reducing the amount for deductions may lead to an overestimation of the federal tax liability.

The calculator does not consider all potential increases to the standard deduction (e.g., if you or your spouse are legally blind). Additionally, the calculator does not check nor alter all inputs for the limits on individual deductions, where applicable. For example, the calculator does not limit the deductibility of mortgage interest paid nor apply charitable deduction limitations based on income. The exceptions to this are within the "itemized deductions" entry form, where the calculator will calculate the deductible portion of the "Medical, vision, and dental expenses" input as the amount in excess of 7.5% of your AGI and calculate the deductible portion of the the "State and local taxes paid" input up to a $10,000 limit. To the extent you may receive tax credits, or you are subject to the Alternative Minimum Tax, this calculator may significantly over - or underestimate your federal tax liability.

If using either the “Salaries and wages” entry form, the “Itemized deduction” entry form, or the “Additional income sources affecting taxes, credits, and adjustments” entry form, note that none are fully representative of the comparable tax forms. On the “Salaries and wages” entry form, considerations for some pre-tax deductions or other adjustments to income for federal income tax purposes may be omitted. The calculations take your entered earned income less aggregate pre-tax deductions to determine taxable income from salaries and wages. On the “Itemized deduction” entry form, not all possible itemized deductions are included. The calculations aggregate your entered itemized deductions and calculate deductibility, where applicable, to determine total itemized deductions (excluding charitable donations). On the “Additional income sources affecting taxes, credits, and adjustments” entry form, values are defaulted to zero unless an entry is made. For each MAGI calculation, inputs are not exhaustive and may omit inputs used by the IRS. For the taxable investment income used to determined NIIT calculation, the "Other ordinary income for the tax year" input may include income sources that are not considered investment income such as qualified annuities. If these income sources are included, the estimated NIIT may be overstated.
Not all aspects of income taxability are considered in this calculator. Certain income types may only be partially taxable or not taxable at all. The calculator treats the “tax-exempt interest” input and the “Savings bond interest used for higher education expenses” input as non-taxable. The calculator treats all other income, aside from Social Security income, as fully taxable; therefore, this calculator may overestimate your federal tax liability. Net capital gains and qualified dividends are assumed to be taxed at the long-term capital gains rate. Taxable interest and ordinary dividends from investments are assumed to be fully taxable as ordinary income.

All withdrawals from tax-deferred accounts, including required minimum distributions, are considered fully taxable and assumed to have zero basis. All tax-exempt withdrawals are assumed to be qualified and thus not subject to taxes.

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