Independent Investor

July 2015

Planning for the Changing Phases of Retirement

Today many Americans plan for a retirement of up to 20 years, yet in reality, your retirement may last much longer.

Believe it or not, living nearly a century may someday be commonplace. As a result, rather than thinking of retirement as the final stage of life, a more realistic approach may be to view it as a progression of phases. This involves taking a fresh look at retiree expenses and income, as well as withdrawal and estate planning strategies.

The Need for Flexible Planning

Traditionally, retirees were advised to project income needs over the length of their retirement, add on an annual adjustment for inflation, and then identify any potential income shortfall. But the planning required may not be that linear. For example, research suggests that some retirees' expenses--other than health care--may slowly decrease over time.

That means some retirees--depending on personal expenses--may need more income early in their retirement than later. That's why it's critical not just to determine a sustainable withdrawal rate at the outset of retirement but also to periodically evaluate that withdrawal rate.

Or consider another trend: The desire to remain active means many people are continuing to work part time or starting new businesses in retirement. In fact, some psychologists and gerontologists believe that many people don't really want to retire, but instead want to reinvent themselves through a mixture of work and leisure. As a result, some older men and women may be inclined to jump back into the workforce--and possibly enjoy the most productive years of their lives.

Early Years: Income and Tax Decisions

Keep in mind that adding employment earnings to your retirement "paycheck" requires careful planning because it may impact other sources of retirement income or bump you into a higher tax bracket. For example, in 2015 retirees who collect Social Security before the year of their full retirement age will see their benefits cut $1 for every $2 earned above $15,720. Also, depending on adjusted gross income, you might have to pay taxes on up to 85% of benefits, according to the Social Security Administration.

The need to potentially stretch out income over a longer period than previous generations also means that some people may not want to tap Social Security when they're first eligible. Consider that for each year you delay taking Social Security beyond your full retirement age until age 70, you'll receive a benefit increase of 6% to 8%. One caveat: If you do decide to delay collecting Social Security, you may want to sign up for Medicare at age 65 to avoid possibly paying more for medical insurance later. For additional information, please visit the Social Security website at www.ssa.gov.

Also plan ahead for health care costs not covered by Medicare. Remember that Medicare does not pay for ongoing long-term care or assisted living expenses, and that qualifying for Medicaid requires spending down your assets.

If you have accumulated assets in qualified employer-sponsored retirement plans, now may be the time to determine if rolling that money into a tax-deferred IRA would make managing your investments easier. A tax and/or financial advisor can help you go over your retirement account options, and decide which accounts to tap first at this point in your post-retirement planning--a decision that could significantly affect your financial situation.

Finally, don't overlook any pension assets in which you may be vested, especially if you changed employers over the course of your career. Pensions can supply you with regular income for life. Fixed annuities may also play a role in helping you generate steady income.[1]

Middle Years: Distributions and Lifestyle Realities

By April 1 of the year after you reach age 70½, you'll generally be required to begin taking annual withdrawals from traditional IRAs and employer-sponsored retirement plans (except for assets in a current employer's retirement plan if you're still working and do not own more than 5% of that business). The penalty for not taking your required minimum distribution (RMD) can be steep: 50% of what you should have withdrawn. Withdrawals from Roth IRAs, however, are not required during the owner's lifetime. If money is not needed for income and efficient wealth transfer is a goal, a Roth IRA may be an attractive option. Be sure to seek out the advice of a qualified tax or financial advisors to discuss the tax implications of converting a traditional IRA or employee sponsored retirement plan to a Roth IRA.[2]

Also, consider reviewing the asset allocation of your investment portfolio. Does it have enough growth potential to keep up with inflation? Is it adequately diversified among different types of stocks and income-generating securities?[3]

Later Years: Your Legacy

Review your financial documents to make sure they are true to your wishes and that beneficiaries are consistent. Usually, these documents include a will and paperwork governing brokerage accounts, IRAs, annuities, pensions, and in some cases, trusts. Many people also draft a durable power of attorney (someone who will manage your finances if you're not able) and a living will (which names a person to make medical decisions on your behalf if you're incapacitated).

You'll still need to stay on top of your investments. For example, an annual portfolio and asset allocation review are important.

Keep in mind that a financial advisor may be able to set up an automatic rebalancing program for you. And finally, be aware that some financial companies require that you begin taking distributions from annuities once you reach age 85.

Preparing for a retirement that could encompass a third of your life span can be challenging. Regularly review your situation with financial and tax professionals and be prepared to make adjustments.

[1]Withdrawals from annuities before age 59½ are taxed as ordinary income and may be subject to a 10% federal penalty tax. In addition, the issuing insurance company may have its own set of surrender charges for withdrawals taken during the initial years of the contract. Fixed annuities are long-term investment vehicles designed for retirement purposes. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal. Guarantees are based on the claims paying ability of the issuing company.

[2]The Roth IRA offers tax deferral on any earnings in the account. Withdrawals from the account may be tax free, as long as they are considered qualified. Limitations and restrictions may apply. Withdrawals prior to age 59 may result in a 10% IRS penalty tax. Future tax laws can change at any time and may impact the benefits of Roth IRAs. Their tax treatment may change. Traditional IRA account owners should consider the tax ramifications, age and income restrictions in regards to executing a conversion from a Traditional IRA to a Roth IRA. The converted amount is generally subject to income taxation.

[3]There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification and asset allocation do not protect against market risk.