CLICK HERE TO
INSERT LOGO

Retirement Planning: Never Too Soon…Or Too Late!

Authored By: Heather L. Schreiber, RICP® NSSA®

When should trusted financial professionals start discussing retirement planning with clients? If that conversation hasn't already begun, the answer is now.

Many of the decisions your clients will make as they navigate the road toward and through retirement will have tax implications both now and in the future; so financial professionals should encourage their clients to build a team of trusted tax and legal advisors to help them make decisions to maximize their retirement.

Suppose long-term clients John and Mary Smith have introduced you to their 25-year-old daughter, Pam. Her new employer offers a 401(k) plan, and Pam is eager to participate. Should she? Here's where you can provide valuable suggestions.

If there is an employer match, Pam should be encouraged to participate. Otherwise, free money is being left on the table. Beyond any match, a tax-deferred contribution should be considered cautiously. Early in her career, Pam might be in a low tax bracket. For example, this year, for single filers, the 12% rate applies to taxable income (after deductions) up to $47,150.[1]

If Pam is in that bracket, does it make sense to defer 12% in tax if that contribution might grow to a much larger amount over her career, perhaps taxed at a higher rate when withdrawn? Would Pam be better off deferring on a Roth basis if the plan permits? If she also participates in a high deductible healthcare plan, should she contribute to the Health Savings Account for superior tax benefits instead (over and above the match)?

Virtually all workers and pre-retirees (the younger, the better!) would gain from such a discussion and a thorough explanation of the tax treatment of their choices early on and the potential impact those choices can have later in retirement. With this in mind, it's useful to think of retirement planning in stages, where you are a much-needed guide to get your clients to the finish line.

I. Early-Stage Planning, Before Age 59 1/2

1. **Don't Leave Free Money on the Table:**
   As explained above, encourage clients to maximize contributions to employer-sponsored retirement plans up to any company match.

2. **Take Advantage of The Big 5-0:**
   If practical, workers aged 50 or older can boost retirement plan contributions by "catch-up" amounts. In 2024, that can add up to $7,500 to the normal contribution limit for 401(k), 403(b), and TSP accounts, $3,500 to SIMPLE IRAs and SIMPLE 401(k)s, and $1,000 to IRAs.[2]

3. **Under-Age Withdrawals Beware:** Before age 59-1/2, retirement account withdrawals should be considered carefully. Unless an exception applies, the 10% early withdrawal penalty and the relevant federal and probably state income tax may be triggered.

4. **HSA Trifecta: Maximize Health Savings Account contributions.** As noted, HSAs offer unique tax treatment: deductible contributions, untaxed accumulation of any investment gains inside the account, and tax-free qualified distributions for health care. A high-deductible health insurance plan is necessary, but contributions do not require earned income. Typically, contributions generate tax benefits until enrollment in Medicare, often at age 65.[3]

II. Planning In Early Retirement

1. **Don't Forget the Age 55 Rule:** Regardless of whether someone's early exit from the workforce is planned or unexpected, often his or her biggest source of income may be the existing account in an employer-sponsored retirement plan. An often-overlooked opportunity to solve an income need without incurring the dreaded 10% early withdrawal penalty is the separation-from-service-at-age 55 rule. If an employee leaves an employer during or later than the year of attaining age 55 (age 50 for many public safety employees), he or she may withdraw money from that employer's retirement plan without incurring the 10% penalty. This strategy often works better than the SEPP approach—taking Substantially Equal Periodic Payments over the longer of 5 years or until age 59-1/2—which is another way to avoid the 10% penalty. SEPPs may not satisfy the need because of (a) the strict guidelines imposed under IRS Notice 2022-6 or (b) the requirement that payments continue longer than the need for income, thereby depleting retirement assets earlier and leaving less cash flow for later.[4]

2. **Diversify! Diversify! Diversify!** If you haven't already, now is the time to discuss opportunities to diversify the tax character of retirement savings. For example, carefully measured Roth conversions may deliver later cash flow that is tax-free during retirement. Cash value life insurance might be a source of tax-free withdrawals and loans in retirement and a tax-free death benefit to heirs. Home equity loans, including reverse mortgages, can also provide income that's not taxable.

3. **Phased Retirement:** Working part-time might be a viable option. People approaching retirement with less than 35 years of earnings often can boost future Social Security benefits by closing this gap with part-time work. An individual's Primary Insurance Amount (the Social Security benefit due with a claim at full retirement age) is based upon the highest 35 years of earnings history, indexed to inflation. Those without 35 years of earnings will have zeros substituted for those years.[5] Changing any zeros to positive numbers may be particularly impactful for people often called the "sandwich generation" or those who stayed home to raise children and then left the workforce again to care for aging parents. Filling any gaps in work history could significantly impact Social Security benefit amounts, so even part-time work could positively increase future income.

III. Planning For Those Still Working, Age 59 ½ to 70

1. **Discuss Social Security claiming strategies:** People who continue to work should understand that starting Social Security is generally not advisable until the paychecks stop, particularly before full retirement age. Those who work and file prior to FRA are subject to a limit on how much they may earn and collect a full monthly benefit. In 2024, that limit is $22,320 for someone under FRA for the entire year. Excess earnings would

cause the SSA to withhold $1 of benefits for every $2 over the limit. The limit is more generous in the year of reaching FRA: over $59,520, with $1 of benefits withheld for every $3 earned. Once FRA is reached, no earnings limit applies. Even still, earnings may cause a portion of Social Security benefits to be taxable, so ensuring clients know how their Social Security cash flow can be impacted is important before they hit the "on" button.

2. **Revisit pulling money from qualified plans.** Generally, even employer-sponsored retirement plans without a hardship in-service withdrawal provision may allow withdrawals to occur to active employees at or beyond age 59 1/2. With qualified plans, active employees cannot take elective deferrals before 59-1/2 unless a hardship withdrawal is allowed under the plan's terms. Moreover, hardship in-service withdrawals are not eligible for rollover. After 59-1/2, though, in-service non-hardship withdrawals may be rolled over to an IRA or another qualified plan.

3. **At age 63, be mindful of "Aunt IRMAA."** Medicare enrollees may know the importance of age 65 when enrollment usually begins, but few are aware of the importance of age 63. Medicare Part B and Part D premiums for the current calendar year generally are based on Modified Adjusted Gross Income (MAGI) two years before. Thus, for an individual who enrolls in Medicare when first eligible at age 65, income two years prior at age 63 will determine whether they pay the standard Part B and Part D premiums or whether an income-related monthly adjustment amount (IRMAA) surcharge will be imposed on high-income earners. Seniors facing IRMAA may owe more than three times the standard amounts for the same coverage, so income planning for age 63 and older may be needed. Certain qualifying life-changing events are grounds for requesting an IRMAA reconsideration, such as work stoppage, death of a spouse, marriage or divorce, etc. Other boosts in income are not, such as Roth conversions, taxable inheritances from qualified accounts, or the sale of property.[6] IRMAA premiums are redetermined each year, so if an increase in income is a one-time windfall, premiums may return to normal the following year. For more information about 2024 Part B premium surcharges, click here: https://www.cms.gov/newsroom/fact-sheets/2024-medicare-parts-b-premiums-and-deductibles

4. **65: Medicare or Work-Based Health Plan?** Remind clients to determine whether they should enter Medicare during their initial enrollment period (IEP), a 7-month span bracketing their 65th birthday, or stay on their (or their spouse's) employer plan. Generally, an employer plan is considered creditable coverage if the employer employs 20 or more people.[7] It is always good practice to encourage clients to check with their employer to avoid paying lifelong late enrollment penalties.

IV. Planning For Those Who Have Retired

1. **Age 60 and survivor benefits.** Age 60 generally is the age at which widow(er) benefits are available to those who have lost a spouse, although widow(er)s as young as age 50 are eligible if they were disabled or become disabled within 7 years of the death of their spouse. Although retirement isn't required to collect widow's benefits, the limitation on earnings, discussed previously, applies to widow's benefits claimed before full retirement age. Survivor benefits also might be payable to former spouses who were married for at least ten years; remarriage at age 60 or later does not prevent either a widow or a former spouse from claiming a survivor benefit from a late spouse. An often-overlooked opportunity

to leverage a survivor's retirement benefit and the widow's benefit is to claim the smaller benefit first and collect the higher one later. For more information, visit https://www.ssa.gov/benefits/survivors/ifyou.html.

2. **Age 62 Earliest Claim Age.** Age 62 is the earliest someone can claim Social Security retirement benefits, so this may seem to be the natural next step to replace cash flow after leaving the workforce. Helping clients make this important decision is critical to ensuring that ongoing cash flow can meet their needs in retirement. Nevertheless, starting early comes at a cost. For someone with a full retirement age of 67, a claim at age 62 reduces monthly benefits by 30%, lifelong, which will also produce a smaller cost-of-living adjustment on that monthly income to keep pace with inflation throughout retirement. Waiting to full retirement age generates more cash flow once payments begins. Methods of bridging income in order to postpone Social Security well beyond age 62 include efficiently tapping retirement accounts, continuing earned income, borrowing against home equity, etc.

3. **Age 65: Don't forget to Enroll.** Discuss whether to enroll in Medicare during the IEP, as discussed previously. People already collecting Social Security automatically will be enrolled in Parts A and B. Once on Medicare, HSA contributions must cease.

4. **Full retirement age to Age 70: delaying Social Security.** Encourage clients to wait until at least FRA (age 66 to 67, depending upon birth year) to claim Social Security benefits in order to avoid a reduction in benefits. Waiting beyond age 70 provides no additional benefit because delayed retirement credits stop accruing then. When working with couples, consider encouraging the higher-wage earner to wait as long as possible to secure the highest lifetime cash flow and survivor income, with the lower-earning spouse filing sooner if cash flow is desired earlier.

IV. Planning For Those Age 70 ½ and Beyond

1. **Age 70 ½ and the QCD Pivot.** Qualified Charitable Distributions (QCDs) were created almost 20 years ago as part of the Pension Protection Act of 2006 to allow individuals aged 70 ½ and older to contribute tax-free directly to a qualified charity from their IRA. This strategy may not have been intended to be permanent, but it was extended several times until it became permanent in 2015.[8] In the wake of expanded standard deductions and the consequent reduction in itemized deductions under the Tax Cuts and Jobs Act of 2017, the QCD strategy may be one of the best ways for IRA owners to reap tax benefits while fulfilling charitable intent. In 2024, IRA owners may contribute up to $105,000 directly from a traditional IRA to a qualified charitable organization tax-free, beginning at age 70 ½.[9] Unlike other charitable donations, which require taxpayers to itemize deductions, a QCD does not. Further, once an IRA owner reaches RMD age, a QCD may be used to fully or partially offset an RMD for the year.[10] QCDs reduce taxable RMDs without generating taxable income, reducing the IRA's owner's exposure to taxes on social security benefits and the potential for higher Medicare premiums.

2. **At age 73 (or 75), know the RMD rules.** The original SECURE Act delayed the longstanding age for starting RMDs from 70 ½ to 72. Secure 2.0 moved the beginning age to 73 for those born between 1951 and 1959 and 75 for those born in 1960 or later. Prior to SECURE 2.0, missing an RMD resulted in a 50% excise tax on the shortfall; the follow-up legislation reduced the penalty to 25% and to as low as 10% if corrected within the correction window, generally two years from the year it was due. Even with reduced

penalties, it makes sense for clients to set their IRAs on an automatic RMD payment plan to ensure no penalties are triggered.

V. Planning For Later Years

As seniors move through their 60s and 70s, planning should continue. Life expectancy is increasing, so many retirees will approach and even reach triple figures. Some planning points:

1. **Hedge long-term cash flow.** Retirees may spend aggressively, while relatively young and healthy, on travel, entertainment, and recreation. The risk of a cash shortfall down the road can be reduced by moving money from a traditional IRA to a Qualified Longevity Annuity Contract (QLAC), where payments can be delayed until age 85. In 2024, the upfront payment can be as high as $200,000 per person; money going into a QLAC won't count for RMD purposes until payouts begin.[11]
2. **Late in life, planning should begin at home.** Many retirees eventually may want to relocate for better weather, lower living costs, or easier household management. Married couples with considerable home appreciation may want to sell while the full $500,000 capital gain exception applies. Another option is to hold onto the home indefinitely, passing along an appreciated residence with a full basis step-up to the next generation.
3. **Passing Wealth to the Next Generation.** As the need for retirement planning wanes, the need for savvy estate planning may be on the rise. Suppose a daughter is to inherit the family business and a son with a large family is to inherit the principal residence. What might be left to other children or additional heirs? Assuming at least one retiree is able to qualify, a sizable life insurance policy might be acquired to ultimately deliver income tax-free death benefits structured to provide a welcome legacy for everyone.

As financial professionals, you have a critical role in your clients' lives – one of trust and valuable insight that many rely on to navigate the waters of retirement with a greater sense of confidence. The conversations can never start too early, nor can they ever get stale. Perhaps they will transition to the next generation. That is what your goal should be. The point is to keep educating and finding reasons to reach out to your clients through the journey leading up to and through retirement.

Sources:

[1]https://taxfoundation.org/data/all/federal/2024-tax-brackets/

[2]https://www.irs.gov/pub/irs-tege/cola-table.pdf

[3]https://www.irs.gov/pub/irs-pdf/p969.pdf

[4]https://www.irs.gov/irb/2022-05_IRB#NOT-2022-6

[5]https://www.ssa.gov/myaccount/assets/materials/eligibility-for-benefits.pdf

[6]https://www.ssa.gov/forms/ssa-44.pdf

[7]https://www.medicare.gov/supplements-other-insurance/how-medicare-works-with-other-insurance

[8]https://crsreports.congress.gov/product/pdf/IF/IF11377/2

[9]https://www.irs.gov/newsroom/401k-limit-increases-to-23000-for-2024-ira-limit-rises-to-7000

[10]https://www.irs.gov/newsroom/qualified-charitable-distributions-allow-eligible-ira-owners-up-to-100000-in-tax-free-gifts-to-charity

[11]https://www.irs.gov/pub/irs-drop/n-23-75.pdf