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Financial Planning Strategies

A Financial Planning Update

A Look at Tax Planning for Retirement

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After years of saving and planning for their golden years, many people nearing retirement fail to consider the tax burden they may face on income they receive after they stop working. While you will likely see a reduction in the amount of taxes you owe after the age of 65, you still need to plan ahead if you want to minimize your tax bill from the IRS.

Social Security Benefits

Depending upon your total income and marital status, a portion of your Social Security benefits may be taxable. For a rough estimate of your potential tax liability, add half of your Social Security benefits to your projected income from all other sources. This figure is your adjusted gross income (AGI), plus any tax-free interest income from municipal bonds or foreign-earned income. Up to half of Social Security benefits are taxable if this sum, which is called your provisional income, exceeds $25,000 for singles or $32,000 for married couples filing jointly. However, up to 85% of Social Security benefits are taxable if your provisional income is above $34,000 for single filers or $44,000 for married couples filing jointly.

Use the Social Security Benefits Worksheet in the instructions for IRS Form 1040 to calculate the exact amount of taxes owed. Rather than writing a large check once a year, you can arrange to have taxes withheld from your Social Security benefits checks by completing Form W-4V and filing it with the Social Security Administration.

Other Income Sources

In addition to collecting Social Security benefits, most retirees receive their income from a variety of sources, including distributions from 401(k) accounts and individual retirement accounts (IRAs); payouts from company pensions and annuities; and earnings from investments.

Contributions and earnings growth are tax deferred on 401(k)s and traditional IRAs; however, distributions from these accounts are fully taxable, but have no penalties if withdrawals are made after age 59½. If you have savings in 401(k) accounts or traditional IRAs, you must begin making withdrawals from these accounts—and paying taxes on the distributions—by April 1 of the year following the year in which you reach age 70½. If you are at least 59½ years old and have owned a Roth IRA or Roth 401(k) for at least five tax years, withdrawals are completely tax free. There are no minimum distribution requirements for Roth accounts.

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The Changing Face of America: Dual Income Families

The concept of the "traditional" American family is continually changing. The dual income family—with both spouses maintaining separate careers and contributing to the financial success of the household—has now become commonplace.

The economic challenges and opportunities of this century may often require two incomes to meet overall family expenses. Many families ask themselves, "How will we be able to plan for our retirement, save for our children's education, and perhaps help our aging parents deal with some of their financial burdens?" These concerns may be especially pressing given today's high cost of living and the current economic climate.

The Cost of Working

Although it may seem that dual income families will have more disposable income to afford life's necessities, this may not always be the case. Families with both spouses working often lose some portion of the second paycheck to extra expenses, such as unreimbursed childcare, domestic help, job-related transportation, business attire and dry cleaning, lunches and dinners at restaurants, and take-out meals. These additional, daily expenses all eat away at that second income.

When both parents work outside the home, childcare concerns are especially critical. Quality childcare is a major expense for many families

with working parents—after housing, food, and taxes. It is this cost that often reduces the income that could be used to help fund education or retirement.

As American businesses continue to restructure and downsize, some dual income families may face the possibility of living on a single or reduced income for an unspecified period of time. For those who need the additional income to help pay for basic expenses, a loss or reduction of one income could have a serious impact on the family finances.

Protecting Your Family's Future

How would your family protect its income if either working parent should die or become disabled? One solution may be to purchase a permanent life insurance policy that will pay a death benefit upon the death of the insured spouse. There are several advantages to life insurance plans: For example, policies bought at a younger age may have lower premiums, and some policies maintain level premiums and build cash value.

Generally, the cost for life insurance policies is lower when purchased relatively early in life. However, it is important to re-evaluate insurance coverage as time goes on and circumstances change. The protection that life insurance policies provide for dual income families can best be calculated by periodically analyzing all life insurance needs in order to determine the best plan for your family.

Now, what about loss of family income due to disability? This possibility is not as unlikely as you might think. According to the Social Security Administration*, studies show that just over 1 in 4 of today's 20 year-olds will become disabled before reaching age 67.

A debilitating illness or injury that eliminates or reduces your family's primary source of income can be financially devastating. An individual disability income insurance policy to help replace a portion of those lost dollars would be a worthwhile consideration.

Dual income families have become a fixture in today's society. Although individuals may have different motives for working, most families come to depend upon that second income, whether it is used to meet current or future needs. Thus, it is important to ensure that both spousal incomes are protected from loss with life and disability income insurance. $

* Source: Social Security Administration, 2018. http://www.ssa.gov/dibplan/

A Look at Tax Planning for Retirement

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Strategies to Minimize Taxes

Most retirees with nest eggs or pension income of any size will pay at least some taxes on their retirement income, but there are strategies to reduce the amount owed. While it usually makes sense to delay taking taxable distributions from retirement accounts until the funds are needed, or until distributions are required, you may want to withdraw more funds in tax years when claiming a large number of deductions temporarily lowers your tax rate. You may, for example, choose to take advantage of itemized deductions, such as the breaks for medical expenses or charitable gifts, in certain years, while taking the standard deduction in other years.

A desire to leave a portion of your assets to your family may also influence how you handle withdrawals from tax-deferred accounts. Keep in mind that, if you leave behind funds in a traditional IRA, the rules for inheritance can be complex. To avoid these issues and make it easier to pass on your estate to family members, consider converting traditional IRAs to Roth IRAs. While you will have to pay taxes on the funds converted, moving to a Roth IRA eliminates future tax liabilities, regardless of whether you use the funds in retirement or pass the money on to your heirs. Alternatively, you may wish to consider cashing in your traditional IRAs and using the funds to purchase tax-free bonds or a life insurance policy that will provide your heirs with a tax-free inheritance.

If you are planning to retire soon, consider the tax implications of your income to avoid an unexpected bill from the IRS. For more information, consult your tax professional. $

Sharing Your Financial Information with Loved Ones

Suppose you're in the middle of your workday and you receive an urgent telephone call from the local hospital. The caller informs you that your spouse has been involved in a serious car accident and is unconscious. The shock of such a situation can be extremely difficult.

What if your loved one, who has always handled the family finances, were to die as the result of the accident? While you're grieving, it could be difficult to gather important financial records and documents. Would you be able to quickly identify bank account numbers and **insurance** policies, or locate **wills** and other key documents?

Unfortunately, this situation is not uncommon. To avoid such a predicament, it's important to take the time to sit down with your spouse and prepare an inventory of pertinent financial information. Update it regularly as changes occur, and share this information with family members or other trusted associates who may need to know where all the paperwork is located. This type of inventory can prove invaluable to a surviving spouse, another family member, or a close friend who must then manage the financial assets.

Be sure to include the following information in your inventory:

- **Basic Data.** Note your full name, maiden name, date of birth, and Social Security number.
- **Financial Contacts.** List the names of your lawyer, accountant, insurance agent, and other financial representatives, along with their contact information.
- **Financial Assets, Liabilities, and Account Numbers.** Identify all assets, including bank accounts, insurance policies, and company benefits, along with relevant account numbers. Also, note any outstanding liabilities, such as mortgages, loans, and credit card debt.
- **Location of Key Documents.** Finally, list the location of your will, **trust** documents, tax returns, and insurance policies.

The unexpected death of a loved one is never easy. However, an updated inventory with important financial information could help ease the burden on your spouse and expedite the resolution of your financial matters. $

Dividing Your Estate: A Practical Approach

When planning the division of your assets, you may believe in a policy of "share and share alike." This is perhaps the easiest method to avoid conflicts or complaints of favoritism. But does *equality* necessarily equate with *fairness*? Especially when you consider such factors as age, talents, skills, interests, needs, and degrees of material success.

An alternate approach to estate equalization is a division of assets that recognizes and supports the uniqueness and differences in the abilities and needs of your children, even at the risk of creating conflict. Through your estate plan, you have a chance to provide a degree of thoughtful and calculated support that your children may not otherwise experience.

Let's look at the following scenarios:

1. **Disparity in Age:** Assume you have two children, ages 22 and 14. Should you split your estate in half, even though your 22-year-old son has a private school education and college degree, while your 14-year-old son has just started high school?
2. **Income and Net Worth:** Your daughter becomes a partner in an investment banking firm and quickly builds up significant assets, while your son becomes an artist who is dependent on the sale of his artwork to make a living. Should you leave your estate in equal parts to your son and daughter?
3. **Previous Giving:** You have given your 24-year-old daughter $100,000 worth of stock in your business as an inducement for her to work with you. You have not, however, given your 18-year-old daughter a similar gift. Should you still divide the assets in your estate equally?
4. **Investments Given to Children:** You have given one child stock in Company ABC that has risen in value to $300,000, and another child stock in Company XYZ, which has gone bankrupt. How should you then allocate the balance of your assets?

In all of the above examples, an equal division of property has the potential to create or perpetuate unequal results. Of course, you may choose to divide your assets equally; however, it's important to be aware of all your options in estate planning.

Listen First

There are ways for you to achieve more equitable results. First, communicate with your children. You may choose to speak with each child individually or hold a family meeting. (You may serve as proxy for your young children.) Help them to express their hopes, dreams, and expectations, as well as their concerns and frustrations. By listening, you may gain the valuable insight needed to divide your estate without causing undue conflict or resentment. The decisions may be difficult, but in the long run, your estate plan may provide a certain degree of thoughtful support for your children. $

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