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INVESTMENTS | WEALTH MANAGEMENT

TAKING STOCK

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Ten Frequent Retirement Mistakes You Should Avoid

When your retirement finally arrives, you can take a deep breath and exhale. You made it! But that doesn't mean you may relax completely.

In fact, mistakes made in retirement can cause significant financial distress. Here are 10 common pitfalls to avoid:

Mistake 1. Going on a spending spree. It may be tempting to start spending freely, especially because you now have more time on your hands. But you don't want to burn through your savings in just a few years. It's still important to rely on a budget that helps you balance monthly income and expenses.

Mistake 2. Applying for Social Security right away. Most people are eligible to begin receiving Social Security benefits as early as age 62. Although that may be the best approach for some retirees, it's not recommended for everyone. You can ensure greater monthly benefits by waiting until full retirement age (FRA) to apply—age 66 for most Baby Boomers—or even longer. Starting your benefits at age 70 will give you the largest possible monthly benefit.

Mistake 3. Not taking income taxes into account. Even though you're retiring, taxes will continue to have an impact on your financial life in general and your investments in particular. You still can take advantage of investment losses to offset capital gains that otherwise would be taxed, while distributions from your employer-sponsored retirement plans and IRAs may add to your tax bill. If you have a Roth IRA, you may be able to take tax-free payouts—or pass them along to your heirs.

Mistake 4. Becoming too conservative in your investments. The traditional advice is to shift your portfolio to lower-risk investments during retirement. That makes sense as a general principle, but don't go too far. Consider your life expectancy and how long you will have to stretch the income from your savings. By avoiding investment risk you could increase another kind of risk—the risk of outliving your savings.

Mistake 5. Being handicapped by your biggest asset. It's often hard to give up the home in which you raised your children. However, at some point during retirement, it may become too expensive to live there. Even if you've paid off your mortgage, you'll still be responsible for real estate taxes, repairs, and utilities, which could add up to thousands of dollars a month. Selling the old homestead and then buying a smaller place could free up your equity while reducing your costs.

Mistake 6. Being victimized by a scam. Con artists frequently prey on the elderly, and today's schemes are increasingly sophisticated, putting almost everyone at risk. Imposters may create phony websites that mirror ones from reputable financial institutions and

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Harvard Study Says People Want Their Money Tied Up

If given the choice between accounts that restrict access to their money and one that doesn't (with the returns being equal) it is assumed that people would only choose the one that doesn't have restrictions. Not so, according to a study by professors at Harvard, Yale, and other prestigious schools. Apparently people not only prefer to have restrictions on some of their money, but they choose to allocate increasing percentages to accounts with greater restrictions. They even choose restricted accounts that pay lower interest rates.

This does explain why people seem drawn to whole life insurance so they can build up a savings account, even though it typically doesn't make any logical sense. Certain permanent policies can make sense for longer-term retirement-oriented goals, but the math and restrictions just don't add up for short-term savings. Nevertheless, lots of these policies are purchased with an accessible savings component in mind.

The academics that study this type of thing refer to these restricted accounts as "commitment devices". The whole thing sounds a little Fifty Shades of Grey to me, but if someone wants restrictions to avoid the temptation of squandering their money, we can easily find investments to accommodate that goal.

Ryan

Using RMDs To Buy Life Insurance

It's a fact of tax-deferred investing for retirement. Eventually—within a year of reaching the age of 70½—the Internal Revenue Service expects you to begin pulling your savings out of retirement accounts and paying income tax on your withdrawals. These "required minimum distributions" (RMDs) are mandated for 401(k)s and other employer-sponsored plans, as well as for traditional IRAs (but not Roth IRAs).

Yet while there's no way around taking these mandatory distributions, if you use the money to buy life insurance you may be able to provide substantial tax-free benefits to your family.

Although the money you contribute to tax-deferred retirement accounts can grow without current tax erosion, RMDs must begin by April 1 of the year after the year in which you turn 70½. Then you have to take an RMD by December 31 every year thereafter. These RMDs generally are taxed at ordinary income tax rates as high as 39.6%.

If you're still working full-time and don't own the company, you may be able to postpone withdrawals from a plan sponsored by that employer until retirement. But this exception doesn't apply to IRAs.

The amount of the RMD is based on life expectancy tables and the value of your accounts on the last day of the previous year. For example, if you're age 75, the value of all your accounts is $500,000, and your spouse, who is the sole beneficiary, isn't more than 10 years younger than you are, the RMD under the tables is $21,834.

The penalty for *not* taking RMDs is equal to 50% of the amount you should have withdrawn (or the difference between the required amount and any lesser amount you did withdraw). For instance, if you failed to take any distribution in the example above, the penalty is $10,917, plus regular income tax. In addition, taking an RMD can trigger other tax complications. You might be subject to the 3.8% "net investment income" (NII) tax.

But what if you were to use the money to buy life insurance? Suppose that, in our example, you use the RMD amount, after paying tax on the withdrawal, to acquire a life insurance policy with a death benefit of $500,000. Further suppose that you pay a total of $200,000 in premiums before you die. Your family still comes out ahead by $300,000, and none of the $500,000 in proceeds from the life insurance is subject to income tax.

Choose the policy carefully to reduce the risk that your family will have less money with life insurance than if you invested the premiums somewhere else.

You could sweeten the deal by transferring ownership of the policy to an irrevocable life insurance trust, thus removing the value of the life insurance proceeds from your taxable estate. That could save your family from federal estate tax as well. ●

IRS Adjusts Retirement Plan Limits

Every year, the Internal Revenue Service (IRS) adjusts the amounts you can contribute to employer retirement plans and IRAs, based on inflation indexing. For 2017, the limits are slightly higher in some cases, while others stay the same. Here's a rundown on the key limits for participants:

Limits that will change for 2017

Defined contribution plans – The limit on total annual additions to 401(k), profit-sharing plans, and other such vehicles is increased to $54,000 for 2017 (up from $53,000).

Defined benefit plans – The maximum size of the annual benefit for traditional pensions and related retirement plans increases to $215,000 for 2017 (up from $210,000).

Annual compensation – The maximum amount of compensation that can be taken into account for most employer retirement plan calculations increases to $270,000 (up from $265,000).

Deductible IRA contributions – Phase-outs in 2017 for deductible IRA contributions will reflect the following changes:

- For single filers participating in an employer plan, the phase-out range increases to between $62,000 and $72,000 for 2017 (up from $61,000 and $71,000).
- For an IRA contributor filing jointly who participates in an employer plan, the phase-out range increases to between $99,000 and $119,000 (up from $98,000 through $118,000).
- For an IRA contributor filing jointly whose spouse participates in an employer plan, the phase-out range increases to between $186,000 and $196,000 for 2017 (up from a range of $184,000 to $194,000).

Roth IRA contributions – For single filers, phase-outs for the ability to make contributions increase to a range of from $118,000 to $133,000 for 2017 (up from $117,000 to

Roth IRA Conversions: The Time May Be Right

Perhaps you've thought about converting part of your traditional IRAs to a Roth IRA in the past, but you didn't pull the trigger. For instance, you might not have had the money available to pay the tax on a conversion without diluting your retirement assets. Or you may not have wanted pay that tax in a year in which you were in a high tax bracket.

Now, however, with the incoming Congress promising to enact significant tax cuts, the time may be right to convert to a Roth.

With a traditional IRA, contributions may be deductible from your taxable income, but not if you also participate in a retirement plan at work or earn too much to qualify for a deductible IRA. When you take distributions from a traditional IRA, usually during retirement, you're taxed at the rates for ordinary income on the portion representing tax-deductible contributions and earnings. Under current law, the top ordinary income tax rate is 39.6%. In addition, if you withdraw from an IRA before you reach age 59½, you must pay a 10% penalty tax unless you qualify for a special exception.

Suppose you're age 55 and you take a fully taxable distribution of $100,000 from your traditional IRA. If you're in the top 39.6% bracket, you'll owe tax of $39,600, plus a penalty of $10,000, for a total tax bill of $49,600. Withdrawing that money also could have other adverse tax consequences, such as making you liable for a 3.8% surtax on net investment income.

Contributions to a Roth IRA, meanwhile, are never tax-deductible, but when you take a distribution from a Roth you've had for at least five years that income is completely tax-free and also exempt from the 10% tax penalty. The lure of future tax-free payouts is usually the driving force behind converting a traditional IRA to a Roth.

The downside of a conversion is that you're taxed on at least part of the amount you convert, just as if it were a distribution from a traditional IRA. If you're in the peak of your earning years and in the top 39.6% tax bracket, or close to it, you may owe a hefty tax for the conversion. Even if you spread out the conversion over several years, the cost may be too high to stomach. (If most of your contributions to the traditional IRA were not deductible, however, the tax hit of a conversion could be reduced considerably.)

Roth Conversions
Taxation of Roth IRA Distributions - Summary

	Distribution within 5 years	Distribution beyond 5 years
Age < 59½	Income Tax: Yes (earnings only)	Income Tax: Yes (earnings only)
	10% Penalty : Yes (earnings & taxable portion of prior conversion amounts)	10% Penalty: Yes (earnings only)
Age ≥ 59½	Income Tax: Yes (earnings only)	Income Tax: No
	10% Penalty: No	10% Penalty: No

But if tax rates indeed are reduced in 2017, a conversion might become more palatable. For example, if a three-tier structure of 12%, 25%, and 33% were adopted, someone who had been in the 39.6% bracket might save tens of thousands of dollars in taxes on a large conversion. This may be enough to convince you to convert this year, especially if you believe that tax rates might rise again in the future.

Of course, there's no guarantee that a tax cut will be enacted, and if you made a conversion assuming taxes would go down, you could be disappointed. In that case, though, you could decide to "recharacterize" your new Roth IRA back into a traditional IRA. With this technique you simply undo the conversion. As far as the IRS is concerned, it's as if it never had occurred.

What's more, you have plenty of time to decide if you want to recharacterize. The deadline is the tax return due date for the year of the conversion plus extensions. In other words, if you convert in 2017, you have until October 15, 2018, to complete a recharacterization.

And there's nothing that says you couldn't choose to convert to a Roth IRA all over again. But the earliest you could do that is the beginning of the tax year following the tax year of the conversion or the end of a 30-day period beginning on the day of the recharacterization, whichever is later.

Yet while it's possible to undo a Roth conversion—and then to reconvert back to a Roth—it's better not to proceed based just on what you think is going to happen in Washington. We can help you weigh the factors of your situation as you weigh the pros and cons of a Roth conversion now or later. ●

$132,000). For joint filers, the phase-out range increases to between $186,000 and $196,000 for 2017 (up from $184,000 to $194,000 for 2016).

Limits that won't change in 2017

Elective deferrals – The deferral limit for those who participate in a 401(k), 403(b), most 457 plans, and the government's thrift savings plan remains at $18,000 for 2017. The limit for catch-up contributions to these plans for participants age 50 or over remains at $6,000.

SIMPLE plan deferrals – The limit on earnings deferrals to a SIMPLE plan remains at $12,500 for 2017. The limit for catch-up contributions for participants age 50 or over holds steady at $3,000.

Highly compensated employees – The dollar limit used to define highly compensated employees (HCEs) for employer plans stays at $120,000 for 2017.

IRA and Roth contributions – The maximum amount you can contribute to traditional and Roth IRAs stays at $5,500 for 2017. The $1,000 limit on catch-up contributions for participants 50 or over isn't subject to inflation indexing. ●

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Retirement Mistakes To Avoid

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pretend that the information they're seeking is crucial. Be very careful about working with anyone you don't know personally.

Mistake 7. Continuing to support your adult children. No matter how old you are, you never stop being a parent. Nevertheless, there comes a point when you must realize that you're living on a fixed income and can't support your children in the same manner as you could during your peak earning years. Worry about paying your own expenses first. Then, if there are assets left over, you can follow your parental inclinations.

Mistake 8. Underestimating health-care costs. Just because you're eligible to receive Medicare at age 65 doesn't mean all of your expenses will be paid. You'll probably need other coverage to supplement Medicare, and if you or your spouse encounter serious health issues, you could run up extremely high costs for care in a nursing home or care in your home. Long-term care insurance, when purchased early enough, can provide affordable protection. Alternatively, you might need to set aside funds to pay for potential care expenses.

Mistake 9. Leaving work too soon. Sure, some people would like to call it quits as early as possible, but it's important to be realistic. Go back to your budget and consider it in terms of how long you're likely to live. Although it may not be your first choice, the option of working for a year or two longer could help in two ways, adding to your nest egg and shortening the length of time you'll need it to fund retirement expenses. Coordinate this decision with your choices for Social Security benefits.

Mistake 10. Not seeking professional guidance. Instead of trying to do it all on your own, or relying on the advice of friends or family, sit down with your financial adviser to map out a plan. This last step may help you avoid many of the other mistakes and improve your chances of a comfortable retirement. ●

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