POLARIS ADVISORS, LLC.

# THE Retirement Report

Retirement Transition Planning

508.481.2299 www.polarisadv.com Fourth Quarter 2016

## 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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## *Stress And Our Investment Results*

Our last quarterly letter warned about "voting with our shares." We shouldn't define our investment strategy around how we feel about a candidate. In this election, the market lost almost 1,000 points early on election night when it became clear Trump likely would win. By the next morning, that loss had disappeared, and it now looks like the year may end with a 2000 point advance instead. Sadly, some whose candidate lost on election night also lost a lot of money!

Happily, we are not part of that group. Depending on which risk profile we use, 2016 looks like it could end up a decent year. Perhaps high 5 to 6 percent returns. Much better than 2015, when we ended with a slight loss. So, if your rate of withdrawal was 5% or less, you've put some money "back in the bank!"

One of our articles this quarter talks about the "ups and downs" of retirement. The stock market is one, health care costs are another, and inflation is a third. Clearly, there are a lot of moving parts affecting our retirement prosperity. Most of them we can't control, but there are a couple we can, and may help lower our stress. One is how much we withdraw every year; hopefully nothing over 5%. Another is how we react to short-term events, such as the election. Maintaining a long-term perspective and a properly balanced portfolio should stabilize earnings and lower our stress level at the same time. We'll have more about this in our quarterly letter.

Stay Well,

*Ric and Trang*

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# Why Would You Take Your RMDs Sooner?

Is it time for you to begin taking required minimum distributions (RMDs) from your retirement plans? The rules for 401(k)s, other employer-sponsored plans, and traditional IRAs generally call for these payments to start after you reach age 70½ and to continue each year. But you don't actually have to begin RMDs until the "required beginning date" (RBD) of April 1 of the year *after* you turn 70½.

Nevertheless, you might bypass this respite. Why would you do that? Because you still must take another RMD later that year. Thus, you would be doubling up on payouts and have to pay more tax.

Although your savings in 401(k)s and traditional IRAs grow without being taxed along the way, you eventually must start receiving RMDs, taking one each year by December 31. These RMDs generally are taxed at ordinary income tax rates.

If you're still working and don't own the company you work for, you may be able to postpone withdrawals from an employer-sponsored plan with that company until you retire. But this exception doesn't apply to traditional IRAs.

The amount of the RMD is based on IRS life expectancy tables and the value of your accounts on the final day of the previous tax year. Your financial advisers or the financial company holding your account can provide assistance in computing the amount.

The penalty for failing to take an RMD is equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any smaller amount you did withdraw). For example, if you're required to take $20,000 and you're in the 28% tax bracket, the penalty for failing to withdraw is $10,000, plus you'll owe $5,600 in federal income tax on the distribution.

If you postpone your first RMD until the following year, you'll have to take two RMDs in that year. If you remain in the same tax bracket, that will double the tax you owe, or the extra payment may push you into a higher tax bracket. Going back to our example of an annual $20,000 RMD, you'll have to take two RMDs for a total of $40,000 in the following year. Suppose that $10,000 of the extra amount is taxed at the 33% rate. Your total tax bill on RMDs for that year comes to a whopping $11,700 (28% x $30,000 + $10,000 x 33%).

Furthermore, doubling up on RMDs increases the possibility you'll have to pay the federal surtax on "net investment income," and it could hike your state income tax liability as well.

As you approach your RBD, consider your options. In many cases, you'll be better off taking your first RMD in the year in which you turn age 70½, rather than the following year. ●

# This Type Of Trust Is A Failure

Trusts come in many shapes and sizes, but you could divide them into two broad groups—grantor trusts and non-grantor trusts. There's also a third type, however—the "intentionally defective grantor trust," or IDGT, that is designed to break tax rules for estate planning purposes.

With a grantor trust, the grantor —the person who creates it—retains considerable power over how it's administered, including the rights to amend, revoke, or terminate the trust. The grantor also maintains control over the trust assets. Typically, the grantor is a beneficiary of the trust income and principal. For instance, the grantor could be the primary beneficiary, with other family members entitled to the remainder. The grantor also can act as the trustee responsible for administering the trust.

With non-grantor trusts, however, grantors give up all of those rights. They aren't entitled to the income or the principal and, usually, payouts from the trust go to other family members. Also, the grantor cannot be the trustee of a non-grantor trust.

Now consider the tax implications. Because grantors retain control over grantor trusts, they're taxed for the income the trusts produce. For grantors in higher tax brackets—including the top bracket, with its 39.6% tax rate—the income tax consequences can be significant. In contrast, income earned by a non-grantor trust is taxed to the trust itself, not to the grantor.

But that can be a problem because trusts pay comparatively high tax rates. For instance, that top 39.6% rate kicks in when trust income exceeds $12,400 in 2016. Compare that to the $466,950 threshold for the top rate for a married grantor who files a joint return, or $415,050 for a single filer. That can translate into very high taxes for a non-grantor trust.

But that's where an IDGT may

# Watch Out For These 7 Retirement Ups And Downs

Have you heeded the usual dire warnings about retirement? You may have made all of the necessary preparations, including saving enough to have a strong likelihood of living comfortably in your golden years. However, the economic and practical realities may be harsher than you expect. Consider these ups and downs that might hinder your plans:

**1. The stock market could go down.** People are quick to forget the hard lessons learned from previous stock market downturns—such as in 2008 and 2009, when the market lost about half of its value. Volatility in equities is inevitable and if the market drops while you're making withdrawals, the value of your retirement portfolio could plummet. Suppose you have a portfolio valued at $1 million and you anticipate withdrawing 5% a year, or $50,000, during retirement. If your holdings drop 25% next year, you'll be left with $750,000—and that same withdrawal amount rises to almost 7% of the portfolio, a withdrawal rate that would be very difficult to sustain.

**2. Your health care costs could go up.** Some people think they'll have it made when they reach age 65 and become eligible for Medicare. While Medicare may reduce your health insurance outlays, you'll still likely need supplemental insurance, and there will be out-of-pocket expenses. And what if you need long-term care? In 2016, the average cost of a private room in a U.S. nursing home was $7,698 per month, according to the Genworth Cost of Care survey. That's more than $92,000 a year.

**3. Inflation could go up.** Inflation has been negligible during the past decade. Nevertheless, steep price increases could return quickly, and even if inflation doesn't spiral dramatically like it did during the 1960s and '70s, it's safe to assume that your expenses are likely to go up during your retirement years, while your savings may lose value. If you withdraw the same amount from your portfolio each year, expect that money not to stretch as far as it once did.

**4. Your taxes could go up.** You may expect your tax bill to go down during retirement because you'll likely earn less than you did at the peak of your working career. But various factors could result in higher-than-expected taxes. The tax break you likely got when you were contributing to your 401(k) and IRAs will end, and now you'll have to pay income tax on the money coming from those accounts. Up to 85% of your Social Security benefits, too, will be subject to tax if your income exceeds relatively low thresholds.

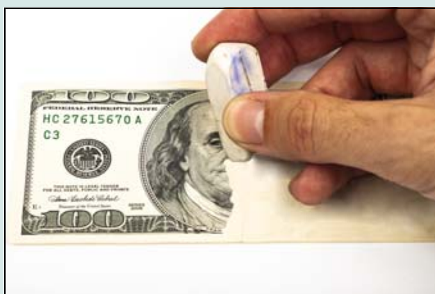
**5. Your work earnings could go down.** If you're like many soon-to-be retirees, you may plan to work at least part-time well into your 60s or perhaps your 70s and beyond. But there are no guarantees. The work you've been doing might dry up, or you may no longer be able to meet the physical or mental challenges of the job. And, even if you have been healthy until now, that too could change as you get older.

**6. Your retirement assets could go down.** Just because you figure that you have enough on hand to ensure a comfortable retirement doesn't mean that your nest egg won't be eroded. For one thing, you must start taking required minimum distributions (RMDs) from qualified plans and traditional IRAs after you reach age 70½. (RMD rules don't apply to Roth IRAs.) The amount of your distribution is based on your account balance in the prior year and your life expectancy. There's no way to get around this, but you can postpone RMDs from an employer-sponsored retirement plan until you retire if you're still working for the company with the plan and you don't own more than 5% of the business.

**7. Your stress level could go up.** Any or all of these pitfalls could give you a lot more to worry about than you expected. What's more, you now may have to take on more decisions about how to invest your assets and how to structure your withdrawals.

However, you don't have to shoulder these responsibilities alone. Your financial advisors can work with you to help you overcome potential problems. ●

come to the rescue. As long as the grantor retains certain powers, the grantor, rather than the trust, will be taxed on trust income—even if none of that income goes to that person. An IDGT trust is set up so that it will purposely fail to qualify as a non-grantor trust, thus avoiding the higher taxes that come with the non-grantor designation.




What about estate and gift taxes? Money you transfer to an IDGT is treated as a taxable gift, but there's a current individual exemption of $5.45 million in 2016 that could reduce or eliminate your tax liability for the gift. (There also are other ways to structure this transfer so that it's not considered a gift at all.) In addition, the assets you transfer into the trust are no longer in your taxable estate, whose value will be reduced further by the annual taxes you pay on trust assets.

But IDGTs are complex arrangements, and you'll need the help of an experienced estate planning professional to create a trust that fits your needs. Seek expert assistance. ●

# Easier Rules On IRA Rollover Waivers

A new IRS ruling may provide tax relief on late rollovers by some IRA owners.

Normally, if you take money out of your IRA, you're responsible for tax on the distribution, plus a potential 10% penalty if you make an early withdrawal – before you reach age 59½. But you can avoid current tax liability if you roll over funds from the IRA into another IRA within 60 days.

The surest way to do that is to make a "trustee to trustee" transfer, from one financial company to another. If the money never touches your hands, none of it will be withheld for possible taxes. However, if you have an immediate but temporary need for money, you could use the rollover process to give yourself a short-term loan—you can have funds paid to you and then redeposit the same amount in an IRA within 60 days. Yet while you won't ultimately be taxed on the rollover, 20% of the amount that you withdraw will be withheld for taxes; you'll need to recoup the money when you file your tax return.

It's easy to miss the 60-day deadline. You simply might forget about it or you could be distracted by other circumstances. And if you do fail to redeposit your withdrawal amount on time, you'll be taxed on the distribution at your full income tax rate.

Is there anything you can do to avoid that tax if you inadvertently fail to meet the deadline? The IRS has been notoriously tough about handing out waivers to tardy taxpayers. Normally, a waiver will be granted only if you suffer a casualty, disaster, or another event beyond your reasonable control.

The IRS has established several factors to be used in waiver determinations, including the time elapsed since the distribution and whether the inability to complete the rollover was because of death, disability, hospitalization, incarceration, restrictions imposed by foreign countries, or postal error. If you miss the 60-day deadline because of a mistake by a financial institution, you can get an automatic waiver.

Now the IRS is going one step further. It says, in Revenue Procedure 2016-47, that a taxpayer can "self-certify" a waiver by sending a letter to a plan administrator or an IRA trustee, custodian, or issuer. The IRS has developed a model letter for this purpose.

To qualify for the waiver:

- The IRS can't have previously denied a waiver request with respect to all or part of the same rollover.
- The deadline has to have been missed because of one or more of the reasons described above.
- The rollover must be completed within 30 days after the problem that resulted in missing the deadline has been resolved. ●

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### Retirement Mistakes To Avoid

*(Continued from page 1)*

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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