



April 2017 Newsletter

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Clients and Friends:

The focus of this newsletter is on issues that commonly come up with "pre-retirees," those people not yet retired, but thinking about it.

The first article is a quiz (with answers) about common questions on Social Security.

The second article discusses whether it is wise to trade your pension for a lump sum. Many companies have been making these type of offers lately, and likely will into the future.

The third article talks about how you convert the money you have saved over the years into a retirement income stream.

Finally, the articles on page four discuss the tax implications of the sale of your home, and the age old question of "when can I retire?"

As always, feel free to contact me if you have any questions, or I can be of assistance.

Eric

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Is It Wise to Trade Your Pension for a Lump Sum?

Converting Retirement Savings to Retirement Income

Will I owe income taxes when I sell my home?

Are you ready to retire?

Quiz: How Much Do You Know About Social Security Retirement Benefits?



Social Security is an important source of retirement income for millions of Americans, but how much do you know about this program? Test your knowledge, and learn more about your retirement benefits, by answering the following questions.

Questions

1. Do you have to be retired to collect Social Security retirement benefits?

- a. Yes
- b. No

2. How much is the average monthly Social Security benefit for a retired worker?

- a. \$1,360
- b. \$1,493
- c. \$1,585
- d. \$1,723

3. For each year you wait past your full retirement age to collect Social Security, how much will your retirement benefit increase?

- a. 5%
- b. 6%
- c. 7%
- d. 8%

4. How far in advance should you apply for Social Security retirement benefits?

- a. One month before you want your benefits to start.
- b. Two months before you want your benefits to start.
- c. Three months before you want your benefits to start.

5. Is it possible for your retirement benefit to increase once you start receiving Social Security?

- a. Yes
- b. No

Answers

1. b. You don't need to stop working in order to claim Social Security retirement benefits. However, if you plan to continue working and you have not yet reached full retirement age (66 to 67, depending on your year of birth), your Social Security retirement benefit may be reduced if you earn more than a certain annual amount. In 2017, \$1 in benefits will be deducted for every \$2 you earn above \$16,920. In the calendar year in which you reach your full retirement age, a higher limit applies. In 2017, \$1 in benefits will be deducted for every \$3 you earn above \$44,880. Once you reach full retirement age, your earnings will not affect your Social Security benefit.

2. a. Your benefit will depend on your earnings history and other factors, but according to the Social Security Administration, the average estimated monthly Social Security benefit for a retired worker (as of January 2017) is \$1,360.¹

3. d. Starting at full retirement age, you will earn delayed retirement credits that will increase your benefit by 8% per year up to age 70. For example, if your full retirement age is 66, you can earn credits for a maximum of four years. At age 70, your benefit will then be 32% higher than it would have been at full retirement age.

4. c. According to the Social Security Administration, you should ideally apply three months before you want your benefits to start. You can generally apply online.

5. a. There are several reasons why your benefit might increase after you begin receiving it. First, you'll generally receive annual cost-of-living adjustments (COLAs). Second, your benefit is recalculated every year to account for new earnings, so it might increase if you continue working. Your benefit might also be adjusted if you qualify for a higher spousal benefit once your spouse files for Social Security.

For more information, visit the Social Security Administration website, ssa.gov.

¹ Social Security Fact Sheet, 2017 Social Security Changes



Is It Wise to Trade Your Pension for a Lump Sum?



About 41 million people are participants (active, retired, or separated vested) of PBGC-insured corporate pension plans.

Source: Congressional Budget Office, 2016

Most private employers have already replaced traditional pensions, which promise lifetime income payments in retirement, with defined contribution plans such as 401(k)s. But 15% of private-sector workers and 75% of state and local government workers still participate in traditional pensions.¹ Altogether, 35% of workers say they (and/or their spouse) have pension benefits with a current or former employer.²

Many pension plan participants have the option to take their money in a lump sum when they retire. And since 2012, an increasing number of large corporate pensions have been implementing "lump-sum windows" during which vested former employees have a limited amount of time (typically 30 to 90 days) to accept or decline buyout offers.³ (Lump-sum offers to retirees already receiving pension benefits are no longer allowed.)

By shrinking the size of a pension plan, the company can reduce the associated risks and costs, and limit the impact of future retirement obligations on current financial performance. However, what's good for a corporation's bottom line may or may not be in the best interests of plan participants and their families.

For many workers, there may be mathematical and psychological advantages to keeping the pension. On the other hand, a lump sum could provide financial flexibility that may benefit some families.

Weigh risks before letting go

A lump-sum payout transfers the risks associated with investment performance and longevity from the pension plan sponsor to the participant. The lump-sum amount is the discounted present value of an employee's future pension, set by an IRS formula based on current bond interest rates and average life expectancies.

Individuals who opt for a lump-sum payout must then make critical investment and withdrawal decisions, and determine for themselves how much risk to take in the financial markets. The resulting income is often not enough to replace the pension income given up, unless the investor can tolerate exposure to stock market risk and is able to achieve solid returns over time.

Gender is not considered when calculating lump sums, so a pension's lifetime income may be even more valuable for women, who tend to live longer than men and would have a greater chance of outliving their savings.

In addition, companies might not include the value of subsidies for early retirement or spousal benefits in lump-sum calculations.⁴ The latter could be a major disadvantage for married participants, because a healthy 65-year-old couple has about a 73% chance that one spouse will live until at least 90.⁵

When a lump sum might make sense

A lump-sum payment could benefit a person in poor health or provide financial relief for a household with little cash in the bank for emergencies. But keep in mind that pension payments (monthly or lump sum) are taxed in the year they are received, and cashing out a pension before age 59½ may trigger a 10% federal tax penalty.⁶ Rolling the lump sum into a traditional IRA postpones taxes until withdrawals are taken later in retirement.

Someone who expects to live comfortably on other sources of retirement income might also welcome a buyout offer. Pension payments end when the plan participant (or a surviving spouse) dies, but funds preserved in an IRA could be passed down to heirs.

IRA distributions are also taxed as ordinary income, and withdrawals taken prior to age 59½ may be subject to the 10% federal tax penalty, with certain exceptions. Annual minimum distributions are required starting in the year the account owner reaches age 70½.

It may also be important to consider the health of the company's pension plan, especially for plans that don't purchase annuity contracts. The "funded status" is a measure of plan assets and liabilities that must be reported annually; a plan funded at 80% or less may be struggling. Most corporate pensions are backstopped by the Pension Benefit Guaranty Corporation (PBGC), but retirees could lose a portion of the "promised" benefits if their plan fails.

The prospect of a large check might be tempting, but cashing in a pension could have costly repercussions for your retirement. It's important to have a long-term perspective and an understanding of the tradeoffs when a lump-sum option is on the table.

¹ U.S. Bureau of Labor Statistics, 2016

² Employee Benefit Research Institute, 2016

^{3, 4} *The Wall Street Journal*, June 5, 2015

⁵ Society of Actuaries, 2017

⁶ The penalty doesn't apply to employees who retire during or after the year they turn 55 (50 for qualified public safety employees).



Converting Retirement Savings to Retirement Income



Regardless of which path you choose with your retirement accounts, keep in mind that generally, you'll be required to begin taking minimum distributions from employer-sponsored plans and traditional IRAs in the year you reach age 70½; you can delay your first distribution as late as April 1 of the following year.

Taxable distributions from traditional employer-sponsored plans and IRAs prior to age 59½ may be subject to a 10% penalty tax, unless an exception applies.

Different rules apply to Roth accounts. For information on how Roth accounts may fit into your retirement income picture, talk to a financial professional.

You've been saving diligently for years, and now it's time to think about how to convert the money in your traditional 401(k)s (or similar workplace savings plans) into retirement income. But hold on, not so fast. You may need to take a few steps first.

Evaluate your needs

If you haven't done so, estimate how much income you'll need to meet your desired lifestyle in retirement. Conventional wisdom says to plan on needing 70% to 100% of your annual pre-retirement income to meet your needs in retirement; however, your specific amount will depend on your unique circumstances. First identify your non-negotiable fixed needs — such as housing, food, and medical care — to get clarity on how much it will cost to make basic ends meet. Then identify your variable wants — including travel, leisure, and entertainment. Segregating your expenses into needs and wants will help you develop an income strategy to fund both.

Assess all sources of predictable income

Next, determine how much you might expect from sources of predictable income, such as Social Security and traditional pension plans.

Social Security: At your full retirement age (which varies from 66 to 67, depending on your year of birth), you'll be entitled to receive your full benefit. Although you can begin receiving reduced benefits as early as age 62, the longer you wait to begin (up to age 70), the more you'll receive each month. You can estimate your retirement benefit by using the calculators on the SSA website, ssa.gov. You can also sign up for a *my* Social Security account to view your Social Security Statement online.

Traditional pensions: If you stand to receive a traditional pension from your current or a previous employer, be sure to familiarize yourself with its features. For example, will your benefit remain steady throughout retirement or increase with inflation? Your pension will most likely be offered as either a single life or joint-and-survivor annuity. A single-life annuity provides benefits until the worker's death, while a joint-and-survivor annuity generally provides reduced benefits until the survivor's death.¹

If it looks as though your Social Security and pension income will be enough to cover your fixed needs, you may be well positioned to use your other assets to fund those extra wants. On the other hand, if your predictable sources are not sufficient to cover your fixed needs, you'll need to think carefully about how to tap your

retirement savings plan assets, as they will be a necessary component of your income.

Understand your savings plan options

A key in determining how to tap your retirement plan assets is to understand the options available to you. According to the Government Accountability Office (GAO), only about one-third of 401(k) plans offer withdrawal options, such as installment payments, systematic withdrawals, and managed payout funds.² And only about a quarter offer annuities, which are insurance contracts that provide guaranteed income for a stated amount of time (typically over a set number of years or for the life expectancy of the participant or the participant and spouse).³

Plans may allow you to leave the money alone or require you to take a lump-sum distribution. You may also choose to roll over the assets to an IRA, which might offer a variety of income and investment opportunities, including the purchase of annuity contracts. If you choose to work part-time in retirement, you may be allowed to roll your assets into the new employer's plan.

Determining the right way to tap your assets can be challenging and should take into account a number of factors. These include your tax situation, whether you have other assets you'll use for income, and your desire to leave assets to heirs. A financial professional can help you understand your options.

¹Current law requires married couples to choose a joint-and-survivor annuity unless the spouse waives those rights.

²"401(k) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants," GAO Report to Congressional Requesters, August 2016

³Generally, annuity contracts have fees and expenses, limitations, exclusions, holding periods, termination provisions, and terms for keeping the annuity in force. Most annuities have surrender charges that are assessed if the contract owner surrenders the annuity. Qualified annuities are typically purchased with pre-tax money, so withdrawals are fully taxable as ordinary income, and withdrawals prior to age 59½ may be subject to a 10% penalty tax. Any guarantees are contingent on the claims-paying ability and financial strength of the issuing insurance company. It is important to understand that purchasing an annuity in an IRA or an employer-sponsored retirement plan provides no additional tax benefits other than those available through the tax-deferred retirement plan.

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Will I owe income taxes when I sell my home?

In general, when you sell your home, any amount you receive over your cost basis (what you paid for the home, plus capital improvements, plus the costs of selling the home) is subject to capital gains taxes. However, if you owned and used the home as your principal residence for a total of two out of the five years before the sale (the two years do not have to be consecutive), you may be able to exclude from federal income tax up to \$250,000 (up to \$500,000 if you're married and file a joint return) of the capital gain when you sell your home. You can use this exclusion only once every two years, and the exclusion does not apply to vacation homes and pure investment properties.

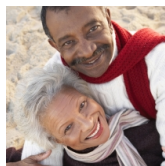
For example, Mr. and Mrs. Jones bought a home 20 years ago for \$80,000. They've used it as their principal residence ever since. This year, they sell the house for \$765,000, realizing a capital gain of \$613,000 (\$765,000 selling price minus a \$42,000 broker's fee, minus the original \$80,000 purchase price, minus \$30,000 worth of capital improvements they've made over the years). The Joneses, who file jointly and are in the 28% marginal tax bracket, can

exclude \$500,000 of capital gain realized on the sale of their home. Thus, their tax on the sale is only \$16,950 (\$613,000 gain minus the \$500,000 exemption, multiplied by the 15% long-term capital gains tax rate).

What if you don't meet the two-out-of-five-years requirement? Or you used the capital gain exclusion within the past two years for a different principal residence? You may still qualify for a partial exemption, assuming that your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances.

Special rules may apply in the following cases:

- You sell vacant land adjacent to your residence
- Your residence is owned by a trust
- Your residence contained a home office or was otherwise used for business purposes
- You rented part of your residence to tenants
- You owned your residence jointly with an unmarried taxpayer
- You sell your residence within two years of your spouse's death
- You're a member of the uniformed services



Are you ready to retire?

Here are some questions to ask yourself when deciding whether or not you are ready to retire.

Is your nest egg adequate?

It may be obvious, but the earlier you retire, the less time you'll have to save, and the more years you'll be living off your retirement savings. The average American can expect to live past age 78.* With future medical advances likely, it's not unreasonable to assume that life expectancy will continue to increase. Is your nest egg large enough to fund 20 or more years of retirement?

When will you begin receiving Social Security benefits?

You can receive Social Security retirement benefits as early as age 62. However, your benefit may be 25% to 30% less than if you waited until full retirement age (66 to 67, depending on the year you were born).

How will retirement affect your IRAs and employer retirement plans?

The longer you delay retirement, the longer you can build up tax-deferred funds in traditional IRAs and potentially tax-free funds in Roth

IRAs. Remember that you need taxable compensation to contribute to an IRA.

You'll also have a longer period of time to contribute to employer-sponsored plans like 401(k)s — and to receive any employer match or other contributions. (If you retire early, you may forfeit any employer contributions in which you're not fully vested.)

Will you need health insurance?

Keep in mind that Medicare generally doesn't start until you're 65. Does your employer provide post-retirement medical benefits? Are you eligible for the coverage if you retire early? If not, you may have to look into COBRA or an individual policy from a private insurer or the health insurance marketplace — which could be an expensive proposition.

Is phasing into retirement right for you?

Retirement need not be an all-or-nothing affair. If you're not quite ready, financially or psychologically, for full retirement, consider downshifting from full-time to part-time employment. This will allow you to retain a source of income and remain active and productive.

* NCHS Data Brief, Number 267, December 2016