Kiplinger's
RETIREMENT REPORT
Your Guide to a Richer Retirement
SAMPLE ISSUE | MAY 2018

Withhold on RMD to **Simplify Paying Taxes**

FOR MANY RETIREES, PAYING TAXES ISN'T A ONE-TIME-A-YEAR task. Instead, many have to pay estimated taxes four times a year. The first quarterly payment is due in April, the same day as your tax return for the prior year.

If you're still working, you probably don't need Form 1040-ES, which you use to figure estimated taxes. Withholding on your paychecks should ensure compliance with the tax system's pay-as-you-earn demands. But if you're retired, chances are you need to make estimated payments. Don't assume payments are due every three months. The payment deadlines typically fall in April, June, September and the following January. You're basically supposed to figure how much tax you'll owe for the current tax year and send it along to the IRS in four equal installments.

Pay at least 90% of your current tax year's liability or 100% of what you owed the previous tax year, and you will have done your duty and be protected from an underpayment penalty. (That 100% of last year's taxes rises to 110% if your prior year adjusted gross income was more than $150,000.)

Not only can making those estimates be a pain, writing those checks can disrupt your cash flow. Many taxpayers simply divide the previous year's tax bill by four and send 25% on each payment date to wrap themselves in the "100% of last year's tax bill" exception.

But depending on the source of your retirement income, you may be able to satisfy the IRS via withholding from those payments. Unlike withholding from paychecks, withholding from retirement income is almost always voluntary. (The exception: Nonperiodic payouts from company retirement plans, including lump sums, are hit with 20% withholding for the IRS.)

If you want federal taxes withheld from Social Security benefits, you must file Form W-4V ("V" is for voluntary) with the Social Security Administration. You can ask that 7%, 10%, 12% or 22% of each monthly benefit be carved off for the IRS. When it comes to pension or annuity payments, you control how much will be withheld by filing a Form W-4P with the payor. The worksheet for the form is similar to the one that Form W-4 employees use to set withholding from wages.

For IRA distributions, the law requires that 10% be withheld for the IRS unless you tell the custodian otherwise. You can block withholding altogether or ask that as much as 100% be withheld.

A Better Way

Speaking of IRAs, a little-known opportunity may free you from withholding on multiple income sources and from the hassle of filing estimated taxes. We call it the RMD solution.

Starting at age 70½, retirees must take required minimum distributions from their traditional IRAs, based on the balance in the accounts on the previous December 31 divided by a factor provided by the IRS.

If you don't need the money to live on, wait until December to take your RMD and ask the sponsor to withhold a big chunk for the IRS, enough to cover your estimated tax on the IRA payout and all of your other taxable income for the year.

Although estimated tax payments are considered made when you send in the checks—and must be paid as you receive your income during the year—amounts withheld from IRA distributions are considered paid evenly throughout the year, even if made in a lump sum payment at year-end.

So if your RMD is large enough to cover your entire tax bill, you can keep your cash safely ensconced in the IRA most of the year, avoid withholding on other sources of retirement income, skip quarterly estimated payments . . . and still avoid the underpayment penalty.

That's exactly what *Retirement Report* subscribers Neil and Liz Ferrari of Wilmette, Ill., plan to do. "We have two pensions, two Social Security benefits, usually capital gains and now RMDs," says Neil. "Using your RMD solution will save us tons of paperwork and improve our cash flow for years."

Note that RMD withholding might not work when it comes to state estimated taxes because some IRA sponsors won't withhold state income taxes. Vanguard, for example, only withholds for 24 states. Check this point with your IRA sponsor. **K**

Passing the **Benefits Earnings Test**

A BIG REASON EXPERTS ADVISE WAITING UNTIL AT LEAST full retirement age to claim Social Security: You get to skip the benefits earnings test, which hits early claimers who are still working. But there are actually two earnings tests—and the second test can help early retirees leaving work midyear avoid the trap.

The Social Security Administration always applies the annual earnings test first. Based on that test, the agency temporarily withholds $1 of a worker's benefits for every $2 earned over $17,040 in 2018. In a year the worker hits full retirement age, the test is more generous—the worker forfeits $1 in benefits for every $3 in 2018 earnings above $45,360.

In the month a worker hits full retirement age—*poof!*—the earnings test goes away. The worker can earn whatever he or she likes, and the monthly benefit amount will be adjusted upward to take into account all benefits forfeited in the past.

But if you're tripped up by the annual test, you still have a shot at your full benefit. The agency will apply a monthly earnings test and set your payments according to whichever test is better for you. "It helps people who retire in the middle of the year not to be penalized," says Jim Blair, a former Social Security district manager and a partner at Premier Social Security Consulting, in Sharonville, Ohio.

The monthly test can be used for only one year, usually the first year of retirement. And it comes into play generally for midyear retirees who have already earned more than the annual limit. Those who pass the monthly earnings test can receive 100% of their benefits for any whole month the agency considers them retired, regardless of total annual earnings.

Taking the Monthly Test

Here's how the monthly earnings test works: If you are under full retirement age for all of 2018, you are considered retired in any month you earn $1,420 or less. If you reach full retirement age in 2018, you are considered retired in any month you earn $3,780 or less.

Say a beneficiary turns 62 in June. He wants to start benefits in July after working through the end of June and making $80,000 in 2018. On an annual basis, he'd get no benefit. But in July through December, if he earns $1,420 or less each month, the monthly earnings test would open the door to full benefits.

"You have to be careful if you go up to $1,421—then the agency would add the $80,000," Blair says. In that case, you would lose a check for that month, but not for other months when benefits are below the monthly threshold. "A sneaky five-Friday payday month might end up passing the monthly earnings amount," he says.

When retiring in the year you reach full retirement age, the earnings test only applies in the months prior to the month of your birthday. The higher threshold of $3,780 would apply if the monthly test is used in 2018. The earnings tests count only earned income from a job or self-employment; investment income, for example, and retirement-plan payouts are ignored.

If you work while claiming early benefits, call Social Security with your estimated earnings so you don't get more benefits than you are due. "Eventually, earnings are posted to your record and they'll see they overpaid," Blair says. The agency will want the money back—and will withhold benefit checks until the overpayment is cleared. **K**

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FROM THE MAILBOX

Your Questions **Answered**

Don't Include House Value In Withdrawal Estimate

I've read that you should pull out no more than 4% of assets during the first year of retirement, and then increase that amount by 3% a year to account for inflation. Do those assets include equity in your home?

No. You consider only liquid assets when you determine your withdrawal strategy. So if you have a $1 million portfolio and $500,000 in available equity in your house, the 4% formula would set the first-year payout at $40,000 (4% of the $1 million portfolio). Remember, you will need your house to live in. If you sell your house and move into a smaller one, you can put the profit into your investments and take the 4% from the larger nest egg.

Tap Life Insurance Benefits Before You Die

Can you tap your life insurance death benefits in advance if you're diagnosed with a terminal illness?

Many life insurance policies offer "accelerated death benefits," which allow policyholders who have been diagnosed with a terminal illness to access a portion of the death benefit while they are still alive. These benefits may be available for term life insurance policies and permanent life insurance policies. With both kinds of policies, the money you receive early is subtracted from the death benefit your heirs will receive when you die. Details vary by company, type of policy and state.

Earned Income Required for Roth IRA Contributions

My wife and I are both retired. I receive a pension and would like to contribute to a Roth IRA. Am I allowed to do that?

Not if that's your only income. You or your spouse must have compensation from a job or self-employment to contribute to a Roth IRA. If you have a part-time job to supplement your pension, though, you can use income from that job as the basis for a Roth contribution. Eligible individuals can contribute up to $5,500 for 2018—plus a $1,000 catch-up contribution for those 50 and older—of their compensation to an IRA. K

Rates and Yields

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High-Dividend Stocks

We screened for stocks that have at least five years of consecutive dividend increases.

DIVIDEND STOCKS	YIELD	SHARE PRICE
AT&T (T)	**5.5%**	$36
Southern Co. (SO)	**5.2**	45
Verizon Communications (VZ)	**4.9**	48

Benchmarks

	THIS MONTH	3 MONTHS AGO	YEAR AGO
Inflation rate*	**2.20%**	2.20%	2.70%
Six-month Treasury	**1.93**	1.58	0.93
One-year Treasury	**2.07**	1.80	1.03
Ten-year Treasury	**2.83**	2.47	2.34

*Year-to-year change in CPI as of February 2018, November 2017 and February 2017.

Fixed Annuities

SINGLE-PREMIUM IMMEDIATE-ANNUITY MONTHLY PAYOUT FACTOR	HIGHEST	AVERAGE
Male age 65	$5.37	$5.21
Female age 65	5.16	4.94
Male age 70	6.05	5.88
Female age 70	5.73	5.55

Payouts are guaranteed to the annuitant for life, with a minimum payout period of ten years. Payout factors are per each $1,000. SOURCE: *Comparative Annuity Reports* (www.comparativeannuityreports.com). Data are to April 1, 2018.

Information to Act On

INVESTING

■ **Upgrades.** The Financial Industry Regulatory Authority has improved its Fund Analyzer tool (www.finra.org/fundanalyzer), which lets you compare mutual funds and exchange-traded funds and evaluate their expenses. Features include an annual expense comparison, which shows how a fund's expense ratio stacks up against an industry average of similar funds.

BANKING

■ **CD penalties.** Only 44% of financial institutions that post rate and fee information online also include details on early-withdrawal penalties for certificates of deposit, according to DepositAccounts.com. How that penalty is calculated can differ by institution. The penalty may be a specified percentage of principal, for instance, or a certain number of days of interest. DepositAccounts.com spells out the penalty terms of specific CDs.

■ **FDIC limits.** To make sure your money is fully covered by the Federal Deposit Insurance Corp., use the "Electronic Deposit Insurance Estimator" tool at www.fdic.gov/edie. The FDIC insures up to $250,000 for an individual account per bank. It also covers up to $250,000 for each person's share of a joint account, and up to $250,000 in deposits in retirement accounts, such as IRAs, at each bank.

CONSUMER INFORMATION

■ **Background check.** If you are looking for a new financial adviser, you can check an investment adviser's disciplinary record at www.adviserinfo.sec.gov. And to look into a broker's background, go to http://brokercheck.finra.org.

■ **Plan help.** The federal Employee Benefits Security Administration offers a consumer assistance Web page. Go to www.dol.gov/agencies/ebsa and click "Ask EBSA." You can submit questions and complaints about health and retirement plans. The page also features educational fact sheets and videos. EBSA has a toll-free consumer help line at 866-444-3272.

BENEFITS

■ **Faster processing.** The Social Security Administration will expedite disability claims for applicants with severe medical conditions. The agency lists 228 conditions for which the expedited process applies. (You can find the list at www.socialsecurity.gov/compassionateallowances.) These claims should be decided within days, the agency says.

■ **Online statements.** The Social Security Administration reports that more than 22 million "My Social Security" accounts have been created. With an account, you can see your Social Security benefits statement online; it provides estimates for retirement, disability and survivor benefits. Go to www.socialsecurity.gov/mystatement.

LONG-TERM CARE

■ **Deduct more premiums.** You can deduct more of your long-term-care premiums as a medical expense in 2018. Taxpayers 71 and older can claim up to $5,200, seniors 61 to 70 can claim up to $4,160, while people 51 to 60 can deduct up to $1,560.

TAXES

■ **Plate break.** You can get a tax break when paying extra for a license plate that advocates a charitable cause. In a case involving a plate in which the extra money went to preserve public lands, the IRS said that the additional fee is a charitable contribution. You can deduct the fee on Schedule A.

■ **Retiree taxes.** Kiplinger.com's retiree tax map (kiplinger.com/links/retireetaxmap) can help determine the most tax-friendly states for you and your assets in retirement. You can sort the map by such categories as states that don't tax Social Security benefits.

ESTATE PLANNING

■ **All-in-one guide.** The American Institute for Economic Research offers a publication that helps devise a "master plan" to handle your estate if you become incapacitated or die. *If Something Should Happen* includes worksheets to help pull together pertinent information. Copies are $10; order one at www.aier.org/bookstore, or call 888-528-1216.

CAREGIVING

■ **Caregiving support.** The Family Caregiver Alliance's "Family Care Navigator" helps families locate government, nonprofit and private caregiver support programs. The online guide includes information on legal resources and disease-specific organizations. Find it at www.caregiver.org/family-care-navigator.

As a subscriber, you can personally contact Kiplinger retirement planning experts

Don't Get Trapped By **Medicare Rules**

RETIRING PAST AGE 65? YOU MAY CHOOSE TO STICK with your employer's health plan rather than signing up for Medicare. But you could risk going without insurance for several months, and pay an annual penalty for life, if you don't follow Medicare's strict enrollment rules.

When you turn 65, you're eligible to sign up for Medicare Part B, which covers outpatient services. You may decide that it's easier or cheaper to continue with your employer coverage—either opting to take corporate retiree medical benefits or going with COBRA. Under the federal COBRA law, companies with at least 20 employees must allow former workers to buy into the group health plan for up to 18 months.

That could be a big mistake. When you turn 65, you can forgo Medicare without consequence if you are still working and are covered by your employer's group health plan. But once you leave the job, you must enroll in Part B within eight months after the month you retire, even if you continue to be covered by your employer's health plan. This eight-month period is known as the "special enrollment period."

If you miss this deadline and your employer coverage expires, you could find yourself uninsured for many months. You will not be allowed to enroll in Medicare Part B until the next "general enrollment period," which runs from January 1 to March 31. Your coverage won't begin until July. Plus, you may be subject to late penalties. "You should enroll in Part B as early as you can," says Joe Baker, president of the nonprofit Medicare Rights Center. "The penalties and waiting periods for not doing so can be substantial and ongoing."

Some retirees realize they have made a mistake when the group health plan rejects their claims. When you turn 65, a retiree health plan or COBRA will pay only for medical expenses that Part B won't cover, says Baker. Even if you decide not to enroll in Medicare, your former employer's plan will consider the government insurer to be the primary payer.

In some cases, it could take time for the health plan to realize that the beneficiary is eligible for Medicare. Once the insurance company discovers its error, though, it could stop paying claims and may try to recoup the benefits it already paid out, Baker says.

Falling Into a Coverage Gap

These enrollment rules came as a big surprise to Kent Evanson, who lives in Glen Ellen, Ill. He left Merrill Lynch as a financial adviser at the end of June 2008 at age 69. Because he liked his employer plan, he decided to go on COBRA rather than enroll in Medicare.

Over the next year or so, the plan rejected a couple of Evanson's medical claims. Its reason: Because he was eligible for Medicare, the plan considered itself to be the secondary payer. "I was paying $1,000 a month in premiums for nothing," he says. "I wanted out."

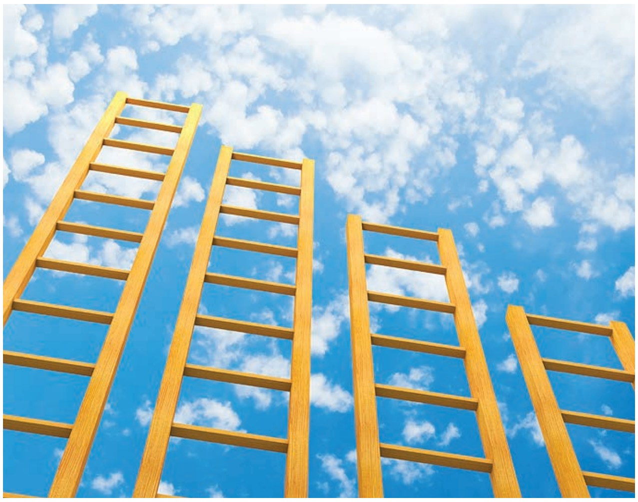
By that time, however, Evanson had missed the eight-month enrollment window. When he went to sign up for Medicare in July 2009, he was told he would have to wait until January 1, 2010, to apply, and that coverage would not begin until July 1, 2010.

Even if you leave your job before you turn 65, you could face trouble if you ignore the enrollment rules. Assume you retired in January 2017 and went on COBRA. You turned 65 nine months later, in October 2017. In this case, the "initial enrollment period" applies to you. The initial enrollment period starts three months before the month of your 65th birthday and ends three months after your birthday month. Because your 65th birthday was in October 2017, your initial enrollment period would have run until the end of January 2018.

Let's say you decided instead to stick with COBRA for the full 18 months, until it expired in June 2018. You wouldn't be able to enroll in Part B until the next general enrollment period starting January 1, 2019. And you wouldn't be covered until July 2019, about a year after your COBRA coverage ended.

To add insult to injury, you'll also be hit with lifetime penalties for missing an enrollment period. For each 12-month period you delay enrolling when you're eligible, you'll pay a penalty of 10% of your Part B premium—forever. **K**

for more guidance on anything you read in *Kiplinger's Retirement Report*.



RETIREMENT INCOME

A Ladder of Annuities Can Hedge Your Bets

IN TODAY'S LOW INTEREST-RATE ENVIRONMENT, LOCKING up a big chunk of your portfolio in a fixed immediate annuity may not seem wise. But if you like the security of guaranteed payments and you believe rates will rise in coming years, you can hedge your bets by laddering annuities.

As with ladders of bonds or certificates of deposit, the strategy calls for buying fixed immediate annuities over a period of time. Instead of spending a lot of money on a single annuity that locks you into one rate for your lifetime, you split your money among several. Perhaps you buy an annuity every year for five years, or you purchase one every five years over the next 15 years.

Today's payouts for fixed immediate annuities are relatively low because interest rates and bond yields are low. A 70-year-old male could recently get an average monthly payout of $5.88 per $1,000 invested, compared with $8.32 in the summer of 2000.

In addition to possibly benefiting from higher interest rates, laddering enables you to capture higher payments because of your age. The older you are when you buy a fixed immediate annuity, the higher the payout you'll receive.

Say a 65-year-old man wants to spend a total of $300,000 on annuities. If he buys a $300,000 lifetime annuity with no payments to beneficiaries at 65, he'd receive $1,654 a month, according to a recent quote on ImmediateAnnuities.com.

Instead, if he wants some guaranteed income at age 65, he can buy a lifetime annuity for $100,000 now and get $551 a month. At 70, he buys another $100,000 annuity to get an extra $628 a month, for a total payout of $1,179. He buys his third $100,000 annuity at 75 to get $752 a month, boosting his combined payout to $1,931 a month. This assumes that interest rates and life expectancies remain the same.

You will forgo the extra guaranteed income early on. But the money that's not annuitized could continue to be invested in the markets.

Faster Investment Growth

There's no guarantee that an annuity ladder would provide more income than if you'd bought one annuity. But research indicates that laddering annuities might boost a nest egg.

A study by MassMutual Financial Group compared several retirement-income strategies, including one portfolio made up just of stocks and bonds and one that also included a ladder of fixed immediate annuities purchased at various times. Each portfolio started off at $100,000 and was assumed to be held by a 65-year-old man.

The MassMutual study reviewed the investments' growth using market data from 1980 to 2006. The stock and bond portfolio ended up with a value of $489,346, while the one with laddered annuities ended at $735,292, the highest value of all the strategies tested.

As for deciding how you should stagger your ladder, there are no hard and fast rules. Experts say generally you want to get to halfway between your age and your life expectancy. For example, a 65-year-old would want to complete the ladder in about ten years.

Also, consider buying products from several insurance companies to spread your risk if one of the insurance companies goes under. States generally offer up to $100,000 in liability protection, although rules vary by state.

If you need more guaranteed income right away, laddering might not be suitable. "Waiting has a cost," says Hersh Stern, who runs ImmediateAnnuities.com. "The cost is the loss of the monthly checks." He also cautions that rates could still decline.

But Drew Denning, vice-president of Income Solutions for The Principal, a financial-services firm, notes that laddering provides a psychological benefit. Someone who is 65 might feel comfortable monitoring a portfolio closely, but by 75 wants to have the security of a guaranteed income stream. K

MANAGING YOUR FINANCES

Inheriting an IRA Poses Hazards for Heirs

IT'S EASY TO BE DISTRACTED WHEN A LOVED ONE DIES, but you need to keep your wits about you if you're inheriting an IRA. Surviving spouses have some leeway, but nonspouse heirs must tread carefully. Make a mistake, and you could trigger a huge tax bill and lose your opportunity for a lifetime of tax-deferred growth. "There are a lot of little traps," says IRA expert and certified financial planner Jeffrey Levine. Here are some common pitfalls for nonspouse beneficiaries.

■ **Failing to take required distributions.** Owners of traditional IRAs must start taking required minimum distributions when they turn 70½. Nonspouse beneficiaries of any age who want to "stretch" the IRA over their own life expectancies must start RMDs the year following the year the owner died. Heirs will have to pay tax on distributions of deductible contributions and earnings from a traditional IRA.

Also, while Roth IRA owners never have to take RMDs, nonspouse beneficiaries must. However, withdrawals from an inherited Roth IRA are still tax free.

Not taking an RMD results in a 50% penalty on the amount that should have been withdrawn for the year. If you miss an RMD, you may avoid the penalty by emptying the account within five years of the owner's death (if the owner died before he had to start RMDs). "However, depending on the size of the IRA and the age of the beneficiary, it might be smarter to pay the penalty than to liquidate the account simply to avoid the penalty," says Twila Slesnick, author of *IRAs, 401(k)s & Other Retirement Plans* (Nolo, $35).

Note, if the owner died after starting RMDs but had not yet taken the RMD for the year in which he or she died, that required distribution must be withdrawn from the account.

■ **Titling the account improperly.** Nonspouse beneficiaries cannot roll an inherited IRA into their own IRA. Instead, a separate account must be set up with a title that includes the decedent's name and the fact that the account is for a beneficiary, says Levine. For example, the account could be retitled to "John Doe (deceased February 1, 2018) IRA for the benefit of Jane Doe." If the account is split among beneficiaries, each new IRA must be properly retitled. And once the IRA is retitled, don't forget to name successor beneficiaries.

■ **Not dividing the IRA among heirs.** Be sure to advise your beneficiaries to split the IRA, especially if they have a wide age difference. If the account is not split, the age of the oldest beneficiary will be used to calculate RMDs, which will shorten the number of years the money can grow tax deferred.

Say the beneficiaries are a 75-year-old sister, a 50-year-old son and a 20-year-old grandchild. If the account remains whole, all the heirs will have to calculate their RMDs based on the 75-year-old's life expectancy. Instead, if the account is split by December 31 of the year following the year the owner dies, each beneficiary can use his or her own life expectancy to take RMDs—and can choose how to invest the money. "The distribution depends on age—the younger the beneficiaries are, the less they have to take out," says Mike Piershale, president of Piershale Financial Group, in Crystal Lake, Ill.

■ **Ignoring non-person beneficiaries.** IRAs with multiple beneficiaries that include a charity or other non-person entity must pay out that entity's share by September 30 of the year following the owner's death. If that share isn't paid out and the account hasn't been split, the rest of the beneficiaries can't take withdrawals over their life expectancies. They will have to empty the account within five years if the owner died before his required beginning date for taking distributions. If the owner died after that date, the beneficiaries must take annual RMDs based on the deceased's life expectancy, as noted in IRS tables.

If a trust is a beneficiary, send a copy of the trust to the IRA custodian by October 31 of the year following the year the owner died. Otherwise, the trust is considered a nondesignated beneficiary and the same payout rules that applied in the previous scenario with the charity will kick in. K

No Simple Rule for Spending Your Assets

MOST NEW RETIREES FACE THE SAME CONUNDRUM: How best to spend down assets? One rule of thumb is to spend only portfolio interest and dividends. Another popular strategy is to withdraw 4% of the initial retirement balance and adjust the dollar amount annually to keep pace with inflation.

But recent studies show that a third spend-down option is more beneficial for many retirees. That approach bases annual spending on the required minimum distribution rules that apply to traditional IRAs.

Still, rather than relying on a simple rule, retirees should understand each strategy's trade-offs and custom-build a spending plan to match their goals. Any strategy a retiree chooses should keep expenses covered and minimize the risk of running out of money. It also should fit with the retiree's goals, which may include maintaining a stable cash flow throughout retirement and leaving money to heirs.

That's a complex challenge—hence the appeal of simplified spending rules. Yet some academics dismiss widely used strategies. Consider a retiree spending only the portfolio's interest and dividends. His need for income may influence his asset allocation, leading him to a portfolio full of risky bank stocks, says Anthony Webb, research economist at the Center for Retirement Research at Boston College. And leaving the principal untouched may fit with a retiree's desire to leave money to heirs—or put a crimp in his lifestyle.

As for the popular 4% rule, "it doesn't respond to realized investment returns," Webb says. Retirees drawing fixed dollar amounts from a sinking portfolio, for example, will soon run into trouble.

A spend-down strategy based on RMD rules sidesteps that stumbling block. Owners of traditional IRAs must draw minimum amounts from these accounts after age 70½. These amounts are calculated by dividing the year-end balance by a life expectancy factor listed in IRS Publication 590-B. Retirees of any age can use RMD calculations as a spending guidepost by simply dividing their total year-end portfolio balance by the life expectancy factor listed for their age.

In a recent study, Webb and a co-author found that the RMD strategy outperformed the spend-the-interest strategy and the 4% rule, given a typical retiree's asset allocation. Since the RMD approach calculates the annual withdrawal as a percentage of the remaining portfolio, it is responsive to investment returns. And the withdrawal percentage increases with age, allowing retirees to use more of their portfolio as their life expectancy decreases.

This strategy isn't perfect. It may result in withdrawal rates that are too low, particularly early in retirement—causing retirees to leave behind money that they may have preferred to spend. But if we're entering an extended period of low returns, retirees may want to keep spending rates conservative.

While no simple rule is ideal, retirees may incorporate an RMD approach into a broader plan for covering expenses. A 2010 Vanguard Group paper, for example, found that combining an immediate inflation-adjusted annuity with an RMD approach produced stable cash flows that grew at a faster rate than those of other rules of thumb. **K**