TheStreet Retirement Daily

RETIREMENT INCOME AND DISTRIBUTION STRATEGIES

Really Want to Enjoy Your Retirement? Don't Outlive Your Assets

By Andrew Rafal, Retirement Daily Guest Contributor | Apr 9, 2018 10:58 AM EDT

Death, taxes, and... longevity? It may seem strange to lump together the idea of living a long life with death and taxes but make no mistake: Life expectancies are increasing, and you need to plan properly so your retirement resources last as long as you do.

Gone are the days when you could retire, move to the Sun Belt, play some golf, collect a few Social Security and pension checks and then check out yourself. As we embark upon the "Roaring '20s" (staying optimistic here) you need to view longevity as a real risk and take the proper action within your financial and retirement plan to protect against its downside.

Unfortunately, most people are not properly prepared to handle this increased life expectancy -- especially on the financial front.

Long ago, when stagflation was the buzzword of the day, most workers could rely on having a steady paycheck in retirement via a monthly pension. This pension check, in conjunction with Social Security benefits and a lower life expectancy, meant there was a much smaller risk of running out of money in retirement.

In 1980, more than 60% of private sector workers could count on a company pension, or defined-benefit plan, in retirement. Today, it's less than 5%. Much of this is a result of Congress passing the Revenue Act of 1978, which paved the way for companies to shift their risk to the employee by way of the 401(k), a defined-contribution plan.

If you are one of the very few fortunate enough to still have pension, you need to make sure you understand all the options associated with it. Over the past decade we have seen an increase of companies offering a buyout of the pension plan to current and former employees. This is another way for the employer to take risk off the table. The question of whether to accept a pension buyout offer should not be taken lightly. There are advantages to both sides; each individual needs to review thoroughly their situation (preferably with the advice of financial professionals) and weigh the pros and cons of taking control of these funds.

Here are a few ways that you can hedge against longevity risk and protect yourself from running out of your retirement funds.

Work Longer, Play Longer

Beyond the financial benefit, there are other advantages to working longer. Studies have shown that having a purpose leads to a happier and healthier life. The Stanford Center on Longevity is currently doing research on the extent that participation in work roles contributes to cognitive health and vitality as we age. The financial benefit of working longer is much easier to prove, as this allows the worker to delay taking Social Security benefits, continue to save in their retirement accounts and have access to (in most cases) a more affordable group healthcare plan.

Delay Social Security

Delaying Social Security can be an excellent hedge against longevity risk. By delaying claiming Social Security benefits, you get an extra 2/3 of 1% for each month you delay after your Full Retirement Age (FRA) birthday month, adding up to 8% each full year until age 70.

Additionally, Social Security has a cost of living adjustment which has historically averaged over 2% each year. Plus, some individuals will not owe any federal taxes on this income and no one pays taxes on more than 85% of their benefit. Thus, it is vital to fully understand the nuances of Social Security.

There are many creative ways to optimize your benefits especially if you are married, divorced or a widow/widower. We recommend using analysis software such as Social Security Analyzer to help you make the right decision.

Build a Personal Pension Using Annuities

Annuities get a bad rap and they are not right for everyone, but in some cases that can be beneficial in protecting your income in retirement. There are several types of annuities built for income purposes rather than accumulation, including:

Single premium immediate annuities (SPIA): You pay the insurance company a sum of money up front and they will contractual guarantee to pay you a certain amount of money for a specific period or for life.

Deferred Income Annuity (DIA): Like a SPIA but the income is delayed until a future date, allowing you to maximize your future income with the least amount of upfront cash.

Qualified Longevity Annuity Contract (QLAC): Funded from qualified retirement money (IRA) and which provides guaranteed monthly income payments. Beyond providing for lifetime income, the QLAC reduces a person's required minimum distribution, which could help keep a retiree in a lower tax bracket. Under the current rules, you can use up to 25% from your qualified retirement accounts to purchase the QLAC (up to a maximum of $125,000 for single and $250,000 for married couples)

The downside to any of the above options is that you will lose control of your funds and the income is usually fixed, which means inflation could eat away at your future purchasing power.

Be Proactive in Tax Planning

With the recent changes to the tax code in the Tax Cuts and Jobs Act, this is a good time to plan to minimize future tax liability, especially if you have the bulk of your assets positioned in qualified accounts (401(k), IRA, SEP IRA, 457, 403(b), TSP). These tax-deferred accounts are a great way to lower your tax bill during the working years but become a potential tax headache in the retirement years.

More company retirement plans are now offering the option of the Roth 401(k). It's a good idea to find out if the option is available, especially with the lowering of the tax brackets.

This option allows you to fund your retirement with after-tax dollars (up to the maximum or $18,500 or the catch-up limit of $24,500). Unlike Roth IRA contributions, there are no income limit rules to deal with.

While there's no tax deduction now, contributions grow tax-deferred and will be tax free later.

Funds inside of Roth 401(k)/Roth IRA are not subject to required minimum distributions (RMDs) at 70½.

The Roth conversion strategy allows you to convert a portion of your pre-tax money into a tax-free bucket. You will pay taxes on the funds that are converted. In a sense it's like buying tax insurance against the likely probability that tax rates will be higher in the future.

Some factors to consider before a Roth conversion include your adjusted gross income (AGI), whether you are currently receiving Social Security benefits, whether you have the funds to cover the taxes on the conversion and how far away you are from retirement.

Partner with an Adviser Who's Right for You

Financial planners, CPAs, estate attorneys and other trained professional advisers can help you build your roadmap, hold you accountable to your plan and keep your emotions from getting the better of you when markets begin to melt down.

You can do it all on your own but having a team work on your behalf provides peace of mind that you are able to consider every option that is available to you. Additionally, a team can help you stay updated on changes to the laws (taxes, estate, etc.) and be a sounding board when it comes to major decisions, such as paying off your mortgage or deciding exactly when to retire.

A true plan will bring all the pieces of the retirement puzzle together and provide you a high-level view to see the probability of the plan working against various scenarios -- including living a long life.

About the author: Andrew Rafal is founder and president of Bayntree Wealth Advisors and a member of Ed Slott's Elite IRA Advisor Group. For more information about this group, or to find a member near you, visit IRAHelp.com. Bayntree Wealth Advisors does not provide specific legal or tax advice. Please consult with your tax adviser or legal professional for guidance with your individual situation. Investment advice offered through Bayntree Wealth Advisors, LLC, a registered investment adviser. Insurance services offered through Bayntree Planning Group, LLC.