

# 21<sup>st</sup> century retirement



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Executive Benefits • Employee Benefits  
Wealth Preservation and Insurance Planning

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## Retirement Plan Assets and Multiple Taxation

Retirement planning generally focuses on accumulating funds to support your desired lifestyle after your departure from the workplace. At the same time, it is important to realize that, in all likelihood, your retirement savings may constitute a very large portion of your total assets. Upon your death, items such as your personal property and savings may ultimately be subject to varying degrees of estate taxation. Like all other assets, your retirement savings are generally included. However, retirement plan assets are also subject to *income* taxes in addition to *estate* taxes.

### Should You Be Concerned?

Historically, high net worth individuals have been the most concerned with estate taxation. If you have more than the applicable exclusion amount of \$5.34 million in 2014 (adjusted annually for inflation), you may want to review the Federal estate tax implications with your professional advisors. With advance planning, you may be able to minimize your estate tax liabilities. Since your retirement plan assets are part of your estate, they may also be subject to estate taxation. In general, estate taxes are based on the full, *pre-income tax* value of the plan assets. In addition, income taxes will also be due on *pre-estate tax* values.

A distribution of the qualified plan or Individual Retirement Account (IRA) balance at an employee's or IRA owner's death can be income in respect of a decedent (IRD). Generally, IRD is included in the gross income of the recipient beneficiary, although there is a deduction for estate and generation-skipping transfer (GST) taxes paid on the income. If the income is distributed over a number of years, only a proportional amount of the deduction is allowable each year.

Substantial retirement plan assets, especially those for which no advance planning has been made, may ultimately be subject to income and estate taxes at a combined marginal rate that could potentially approach, or even exceed, 70%. That translates into nearly three out of every four dollars of your retirement savings going toward paying taxes, rather than funding your retirement or passing to your heirs.

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## Easing into Retirement

**f**or many people, crossing the bridge into retirement is a big step. If you're approaching retirement, it's time to develop a strategy to facilitate a smooth transition from the more structured world of work to one of leisure.

After spending years building your professional career, you've accumulated assets along the way. While retirement planning usually focuses on preparing for your financial future, *nonfinancial* matters may also need to be addressed. When retirees feel dissatisfied, it's often the lifestyle changes that accompany retirement living that tend to create difficulties with self-esteem and identity associated with ending one's profession.

### Staying Active

One possible solution for managing these challenges may be to ease into retirement. Some individuals may welcome the opportunity to continue some form of work, such as consulting, job-sharing, mentoring, or back-up management. Mentoring, in particular, enables you to transfer a lifetime of learning and experience to a friend, relative, or younger colleague. Phased-in retirement provides an "anchor," allowing new retirees to explore other activities while also maintaining their role at work.

Since some people may have more of an emotional reaction to the separation and disengagement from working than they expected, taking between two to five years to "decompress" may be an appropriate option.

### Maintaining a Healthy Perspective

While "retirement" suggests the end of your working life, a more positive perspective to take could be that it's the beginning of a new phase of life—when you can do all the things you never seemed able to find the time for while you were working. For example, volunteer work can allow you to make a valuable contribution to a charitable cause and meet new people. Taking courses in subjects that interest you can sharpen your intellect and help maintain your cognitive abilities. If chosen thoughtfully, these activities can be enjoyable and fulfilling.

Obviously, it's a lot easier for a retiree to consider other pursuits if financial considerations are secondary. People may think that it costs less to live in retirement. However, it's actually common for retirees to increase, rather than decrease, their expenditures, especially in the first few years of transition. Without working full-time, retirees may have

more energy and time to enjoy entertainment, dining out, travel, and recreation.

### On Spending and Inflation

During the working years, it's common to take a certain lifestyle for granted. In retirement, however, you may need to change your priorities or consider budgeting depending on your circumstances. On the other hand, you may find that you no longer need or want to do some of the things that seemed so important when you were working.

Additionally, be sure to keep an eye on the effects of inflation after retirement. For example, an item costing \$100 when you are age 65 will cost \$180 at age 80, assuming a 4% inflation rate compounded annually. Therefore, it's important that your retirement plan be not only a plan "at" retirement, but also a plan continuing "through" retirement, which may require revision on a regular basis.

If you view retirement as your opportunity for growth and exploration, you can make this transition exciting and enjoyable. After all of your hard work, you've earned this opportunity—enjoy the freedom! ■

## What are SEPs and SIMPLEs?

**S**implified Employee Pensions (SEPs) are typically offered by small businesses with 100 or fewer employees. Through SEPs, employers use **Individual Retirement Accounts (IRAs)** as a way of providing their employees with pension benefits. The contributions are not considered part of an employee's gross income, and

taxes are not due until funds are withdrawn.

**Savings Incentive Match Plans for Employees (SIMPLEs)** are tax-advantaged plans also offered by small businesses with 100 or fewer employees that use *either* IRAs or **401(k) plans**. Subject to restrictions,

employers may choose to match employee contributions up to a certain percentage of salary, or they may choose not to match, but rather to make contributions on behalf of all eligible employees, based on a percentage of salary. Contributions are pre-tax, and taxes are deferred until funds are withdrawn. ■

## Divorce and Retirement Plan Proceeds

**b**ecause divorce usually involves the division of assets, including some that may have tax implications, it is important to be aware of potential “tax traps,” such as **vested account balances**, when you begin your retirement planning strategies.

In the past, with traditional **defined benefit plans**, such as company pension plans, participants generally received a retirement benefit, but they had no vested balance in an individual retirement account. In other words, employees had no rights to the employer’s contributions to the retirement plan. However, with the popular shift toward workplace **defined contribution plans**, such as the 401(k), contributions made by employees to their retirement plan are always vested, and employer contributions vest over time, according to the schedule set forth in the plan document. Consequently, dividing vested retirement plan assets in divorce proceedings has become a complex financial issue.

### Protect Yourself with a QDRO

A **qualified domestic relations order (QDRO)** is a judgment or order that involves child support, alimony, and property rights pertaining to a spouse, former spouse, child, or other dependent. A QDRO can be used to establish one spouse’s right to part or all of the other spouse’s retirement plan(s) and ensure that the recipient spouse pays the tax.

To be protected through a QDRO, it must specify the following:

- The name and address of the plan participant and the “alternate payee” (typically, the participant’s spouse).
- The name and account number of each retirement account involved.
- The percentage (or dollar amount) of each plan that is to be paid to the alternate payee.

- The period of time or the number of payments covered by the QDRO.

The QDRO must be a part of a divorce decree or a court-approved property settlement document. The decree must also specify that a QDRO is being established under Section 414(p) of the Internal Revenue Code (IRC) and the particular state’s domestic relations laws. Intent to establish a QDRO is insufficient; it must be documented in the divorce papers.

Getting divorced can be “taxing” enough, so be sure that you understand the process of dividing retirement plan assets. Through a QDRO, an individual can provide retirement funds for a former spouse, child, or other dependent, and ensure that those assets are taxed appropriately. Consult your qualified tax and legal advisors for guidance on your unique situation. ■

## retirement plan assets and multiple taxation

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### Are There Any Alternatives?

Implementing a tax strategy geared toward passing retirement plan assets *in full* to heirs can be challenging, especially if you plan to depend on these assets to meet your retirement income needs. However, those who are fortunate enough not to need the bulk of this income may consider taking all, or part, of the balance in a lump sum. Amounts not distributed may be directly

transferred from the plan to an IRA. Even though income taxes are due in the tax year of the withdrawal, the after-tax proceeds may be slowly gifted directly to heirs free from additional taxation.

This gifting program can involve either *direct* transfers or transfers to an irrevocable trust established to benefit the heirs (gifts of \$14,000 per individual or \$28,000 for married couples in 2014, indexed annually for inflation, can be made annually without incurring a gift tax).

### It Pays to Plan

Saving for retirement requires hard work, foresight, and diligence. Once you have built your retirement assets, the challenge becomes asset preservation. With the assistance of qualified legal, tax, and financial professionals to review all the legal and tax consequences of your planning decisions, you may be able to enjoy your retirement while simultaneously passing on a sizable nest egg to your loved ones. ■

## How Social Security Affects Your Retirement

When contemplating retirement, you, like many other people today, may be counting on Social Security benefits to provide you with a basic level of income. The age at which you choose to retire is an important part of the equation. In addition, there are many other issues to consider when making that choice.

Let's look at the following questions: 1) How would an early retirement, for example, at age 62 vs. age 65, affect your Social Security benefits? 2) How will those benefits be taxed? and 3) Is it in your best interest to continue working to earn extra income when your Social Security benefits could be reduced, based on your earnings?

### What's the Maximum?

As most people realize, Social Security provides only a *base level* of income. The maximum benefit for a person who retires in 2014 at full retirement age (65–67 depending on your year of birth) is \$2,642 per month. In comparison, the maximum benefit in 2013 was \$2,533 per month. It is important to note that the benefit for a non-working spouse is only 50% of that amount.

### Should You Delay Retirement?

If you delay retirement past your **full retirement age**, your monthly benefit will increase, based on the age at which you elect to take retirement benefits. But, upon reaching age 70, the benefit increase no longer

applies, even if you continue to delay the payment of benefits.

Receiving benefits at age 62 (considered early retirement) is appealing to many people. However, if you decide to take early retirement benefits from Social Security, your monthly benefit amount will be permanently reduced by 20–30%, based on your full retirement age.

Some people continue working and earning additional money to supplement basic Social Security income. This is where you need to be careful. If you earn more than the maximum amount allowed, you may forfeit some of your benefits. If you are under full retirement age, receive Social Security benefits, and earn additional income, your benefits will be reduced by \$1 for each \$2 you earn over \$15,480 in 2014. During the year in which you attain full retirement age, your benefits will be reduced by \$1 for every \$3 earned over \$41,400 in 2014. Upon attainment

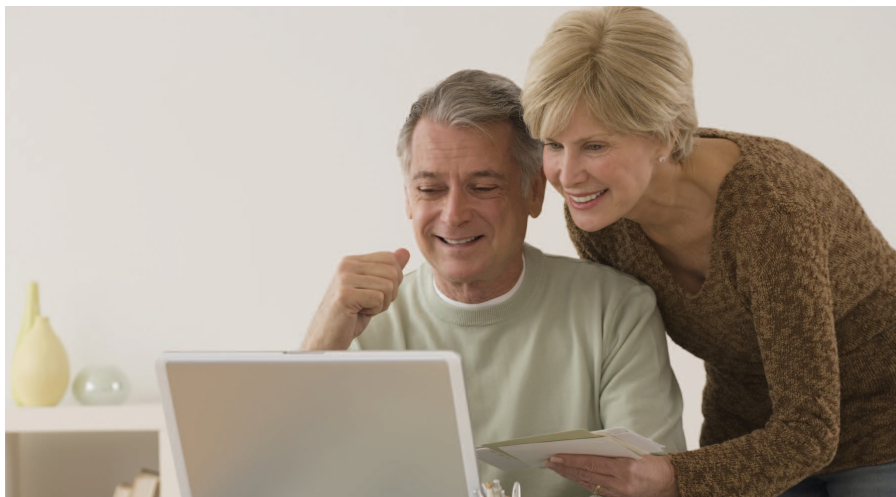
of full retirement age, there is no earnings limit, and Social Security benefits will not be reduced.

### Full Retirement Age: It's Changing

For a long time, the retirement age has been 65. Due to longer life expectancies, that age will increase in gradual steps until it reaches age 67. This change began in the year 2000 and affects people born in 1938 and later. Age 62 still remains the earliest you may begin to receive Social Security retirement benefits.

### For Your Information

Note that as of April 2011, the SSA stopped mailing out annual estimated benefit statements to workers under age 60 and retirees already receiving benefits as a fiscal restraint measure. To receive an estimate of your projected payments, you can go to the SSA's website at [www.ssa.gov](http://www.ssa.gov). ■



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