RETIREMENT

These Are the Key Decisions You Need to Make for Retirement

These important issues are all connected and can affect your taxes, likely setting them at a certain level for the rest of your retirement.

(Image credit: Getty Images)

When you're preparing to retire, you're most likely looking forward to relaxing. But instead of the relaxing interlude you were imagining, retirement plunges you into making possibly some of the most complex decisions you've ever made in your life.

Think about it — during what I call the Dynamic Decade+, the period between ages 62 and 75 — there are consequential decisions associated with retirement that should be made. That includes deciding when to stop working, choosing when to claim Social Security, starting Medicare, planning for required minimum distributions (RMDs), considering when to start withdrawing money from your retirement accounts — and more.

What's more, these decisions are intimately connected, with one decision affecting the next like a row of dominos falling. These decisions are also closely correlated to your tax situation. Essentially, the decisions you make before and during retirement about these issues will likely set your taxes at a certain level for the rest of your retirement, barring major changes in federal tax laws.

These are not decisions that you want to make without a good deal of thought, because they can be so consequential and complex. While complexity can be annoying, it also creates

opportunity. If you're like many pre-retirees or retirees, you may have little idea about how complicated these matters are until you start investigating them.

In this article, you'll gain an appreciation for the opportunity that retirement creates to control your financial destiny and tax situation through the decisions I'm going to walk you through — some that are irrevocable. These are all decisions that you'll need to make between ages 62 and 75.

The Dynamic Decade+

Briefly, here are some of the major milestones you'll hit in the Dynamic Decade+ and their financial implications:

Quitting employment. At some point, you — and your spouse if you have one — will stop working. The average retirement age in the U.S. is 62. When you stop working, you'll need to either begin Social Security, draw on your retirement savings or both, unless you have an alternative method to generate income.

Enrolling in Medicare. Initial Medicare enrollment begins three months before you turn 65 and ends three months after the month in which you turn 65. Medicare Part B costs $174.70 each month in 2024 — costs will increase if your income reaches certain levels. From there, you can select a Medicare Advantage plan or a Medicare supplemental plan, each with their own specific premiums, copays and deductibles. Medicare Part D, which is prescription drug coverage, also has costs, which can vary based on income. You can change Medicare Advantage, supplemental and Part D providers once a year during open enrollment, which occurs yearly October 15 through December 7.

Claiming Social Security. The earliest age to claim Social Security is 62, and the latest is 70. If you claim at 62 in 2024, your benefit will be about 30% less than if you waited to claim until your full retirement age of 67. In contrast, if you delay claiming past full retirement age, you will receive 8% in additional income for each year you wait. Up to 85% of your Social Security may be taxable if your individual income is above $34,000 a year. If your income is between $25,000 and $34,000, up to 50% may be taxable.

Receiving a defined benefit pension. When you stop working, you will need to decide when and how to take your defined benefit pension, if you have one. Most entities offering a defined benefit pension will allow you to take it either as a lump sum that you can roll over into an IRA, or you can receive monthly income instead. If you are married, you will have to decide whether to take a joint or single payout; the joint payout is less, but the single payout would mean your pension dies when you do. Defined benefit pensions are taxable at your household marginal tax rate.

Taking retirement distributions. The SECURE 2.0 Act further delayed the point at which you must take distributions from your traditional retirement accounts. If you turn 73 after Jan. 1, 2023, you will be required to take RMDs at age 73. However, if you turn 75 after Jan. 1, 2033, you must take RMDs by age 75. Traditional retirement benefits are taxable at your individual marginal tax rate.

Deciding how to invest retirement savings. At some point during this journey, you must decide how to invest your retirement savings to meet your retirement-specific needs. You can, of course, continue to invest the same way you did when you were working. However, considering

that you need to replace the income that you no longer have from working, it's worthwhile to consider a different approach. Many individuals find their risk tolerance is reduced in retirement, which is another consideration.

Determine distribution strategies

Embedded in all of these decisions is the challenge of creating a sustainable income that will cover your expenses for the rest of your retirement, regardless of how long that lasts. You must take into account your projected expenses and income, which will flow from all of the decisions you'll make between ages 62 and 75. If you're like many people, you'll want to make sure that you can maintain your standard of living throughout retirement.

You've also spent decades saving for this moment in time — the moment you retire. You likely have assets in a variety of different accounts. Additionally, they may be subject to different types of taxation. You and your spouse may have traditional IRAs, taxable brokerage accounts and a Roth IRA. You'll draw monthly income from Social Security, but odds are that Social Security won't be enough to pay all your bills and give you the standard of living that you want to maintain in retirement.

How taxes fit in

In the absence of an intentional plan, taxes can take a big bite out of your distribution strategy. As I mentioned above, Social Security is taxed for most people, as are defined benefit pensions and distributions from traditional IRAs. You must take those distributions when you turn 73 or 75, regardless of whether you need that money on or not. While delaying RMDs from 70½ to 72, 73 and ultimately 75 can seem like a gift, there's also a downside. That's because RMDs are calculated based on life expectancy, and when you are older, your life expectancy is shorter, which means higher RMDs. Higher RMDs mean more taxes.

Then there is the expense side. If your taxable income increases past a certain level, your Medicare Part B premiums can increase. For example, if you and your spouse have modified adjusted gross income greater than $206,000 and less than or equal to $258,000, your premiums would rise by $69.90 a month per person. That's not unimaginable for many affluent individuals preparing to retire. If you have a joint Social Security benefit of $6,500 a month, bond income of $3,000 a month from a taxable brokerage account and a $2.5 million IRA with distributions of about $100,000 a year, you could easily hit that level.

But what if, instead, you engaged in intentional tax minimization planning so that you converted at least some of your traditional IRA to a Roth IRA before you turned 75 so that your RMDs were significantly reduced? This might involve retiring but waiting to claim Social Security so that you can have reduced income one year and convert funds from your traditional IRA at a lower tax rate. This is possible if you have money saved in a taxable brokerage account or cash in the bank that you could live on without tapping other sources of income.

This is just one potential strategy you could avail yourself through learning enough about the tax laws and potential distribution strategies or by partnering with a knowledgeable and tax-savvy retirement income financial planner.

However you do it, don't wait. Many of the decisions you'll make during the Dynamic Decade+ are irrevocable and time-sensitive. Before you get to the point of making a mistake that might

create tax headaches for you later in retirement, investigate your options so that you can, to the greatest possible extent, optimize your retirement for taxes and sustainable income.

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As the firm's owner and lead wealth advisor, Bowman supports the firm's clients with custom financial planning solutions. He provides detailed retirement planning strategies, investment management, Social Security planning and tax-efficient retirement distribution strategies.

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