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A Retirement Myth & Being Age 50

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"*Whatever method you use to pick stocks…your ultimate success or failure will depend on your ability to ignore the worries of the world long enough to allow your investments to succeed. It isn't the head but the stomach that determines the fate of the stock picker." –* Peter Lynch (Fidelity Investments, *Beating the Street*, 1994 and former manager of Fidelity Magellan Fund)

It happened within the last couple of weeks as well as last summer and probably a few times in between. A client discussion turns to the question of the proper allocation between stocks and bonds as they enter into retirement. After all, the discussion goes, we need to reduce our risk as we enter into our golden years. A decades old "formula" is that you subtract your age from 100, and that is the percentage that should be in stocks with the remainder in bonds. As an example, if you are 65 years old, subtract 65 from 100 and that equals 35. Hence, 35% of your investment portfolio should be in stocks and 65% should be in bonds. Conversely, if you are 35 years old, 65% of your investment portfolio should be in stocks and 35% in bonds. A good rule of thumb? Not really.

This rule of thumb may have been more relevant in a bygone era when life expectancies were much shorter than they are today. However, with average life expectancies now stretching into the eighties for both men and women, the rule is outdated. Studies from the Financial Planning Association, Financial Advisor magazine and Morningstar research all show that the chance of running out of money is actually greater when higher percentages of bonds are used in your investment portfolio. The bottom line is that retiring should not necessarily be the catalyst to populate your portfolio with a high percentage of bonds. There may be some good reasons to have a conservative portfolio laden with bonds but the myth of using a higher percentage of bonds to reduce risk and thus create portfolio longevity is not one of them. We are here to help you figure out what is the best allocation for you.

For those of you who are lucky enough to be age 50 or older, there may be some very good investing "perks" out there for you - in addition to discounts on travel, restaurants and the movies. Consider the following opportunities after we pass the half century mark.

- Age 50: After turning age 50, you can make "catch-up" contributions to retirement plans such as IRAs and 401(k)s. In 2014, people over age 50 can contribute as much as $23,000 of their pre-tax earnings to a 401(k) or 403(b). This is $5,500 more than a younger worker. You can also contribute $6,500 to a traditional or Roth IRA instead of only $5,500.
- Age 55: You may tap into an employer based retirement plan penalty-free starting the calendar year you turn 55 if you retire, quit or are laid off from your job (age 50 for public safety workers). In most cases there would be a 10% penalty for this distribution if you are under age 59 ½. Also, some employer 401(k) plans may permit in-service withdrawals after a certain age while you are still working. This would allow a rollover to an outside IRA. Another benefit of age 55 is that in 2014, an additional contribution of $1,000 may be made to a HSA (health savings account) to pay for health expenses now and later in life.
- Age 59 ½: This is the age at which penalty-free distributions may be taken from most types of retirement accounts. You also become exempt from the five year rule on IRA to Roth IRA conversions. Pre 59 1/2, there is a penalty in most cases if the conversion money is withdrawn from the account before five years.
- Age 65: You are able to make nonmedical expense withdrawals from your HSA (health savings account) without the usual 20% penalty. However, this type of withdrawal is still taxable if not used for medical purposes.
- Age 70 ½: While the benefit of transferring money directly from an IRA to a charity without being a taxable distribution expired at the end of 2013, there is a reasonable chance it may be reinstated this year or next. Required Minimum Distributions do start from retirement accounts at 70 ½.

In conclusion, I do hope that you will be able to use some of these ideas to enhance your retirement years. As I write this letter, the stock market has been in a very tight trading range for most of this year - up one day, down the next. We may not know its true direction for awhile yet. This month's guest article is from the newsletter of Carol Soens, CPA. It discusses ideas to think about before moving to another state to retire. Take good care!!!

Choosing a Retirement Destination

From the May 16, 2014 Newsletter of Carol Soens, CPA

With health care, housing, food, and transportation costs increasing every year, many retirees on fixed incomes wonder how they can stretch their dollars even further. One solution is to move to another state where income taxes are lower than the one they currently reside in.

But some retirees may be in for a surprise. While federal tax rates are the same in every state, retirees may find that even if they move to a state with no income tax, there may be additional taxes they're liable for including sales taxes, excise taxes, inheritance and estate taxes, income taxes, intangible taxes, and property taxes.

In addition, states tax different retirement benefits differently. Retirees may have several types of retirements benefits such as pensions, social security, retirement plan distributions (which may or not be taxed by a particular state), and additional income from a job if they continue to work in order to supplement their retirement income.

If you're thinking about moving to a different state when you retire, here are five things to consider before you make that move.

1. Income Tax Rates

Retirees planning to work part-time in addition to receiving retirement benefits should keep in mind that those earnings may be subject to state tax in certain states, as well as federal income tax if your combined income (individual) is more than $25,000. Combined income is defined as your adjusted gross income + Nontaxable interest plus 1/2 of your Social Security benefits. If you file a joint return, you may have to pay taxes if you and your spouse have a combined income that is more than $32,000. If you see this scenario in your future, it may be in your best interest to consider a state with low income tax rates (Pennsylvania, Arizona, or New Mexico for instance) or no income tax such as Florida, Nevada, Alaska, or Washington state.

2. Income Tax on Retirement Income

Income tax on pension income varies for each state. In 2014, three states, including Pennsylvania, Illinois, and Mississippi do not tax it at all. In twenty-one other states a portion of pension income is exempt, and fifteen states tax pension income in its entirety. Remember however, that state tax laws, like federal tax laws are always changing. Call us if you have any questions about tax law changes in your state.

3. Tax on Social Security

In 2014, fourteen states tax social security income in addition to taxing social security income at the federal level. Among them are Colorado, Connecticut, Montana, New Mexico, Vermont, and West Virginia.

4. State and Local Property Taxes

Despite a decline in property values, property taxes have not decreased for most homeowners. Some states however, offer property tax exemptions to retirees who are homeowners and renters. Again, this varies by individual state. Please consult us if you have any questions about your state or the state you are planning to move to.

5. State and Local Sales Taxes

State and local sales taxes may or may not be a factor in the overall decision about where you decide to retire, but keep in mind that only five states, Alaska, Delaware, Montana, New Hampshire, and Oregon do not impose any sales or use tax.

6. Estate Taxes

Estate tax may or may not matter, depending on your estate and whether you care about what happens to your estate after you die. Like other state taxes, estate tax varies depending on which state you reside in. In eighteen states, there is a tax on estates below the federal threshold amount ($5.34 million in 2014). Three states, Delaware, Hawaii and North Carolina, use the same threshold amount as the IRS when figuring federal estate tax, and three states have no estate tax whatsoever--Kansas, Oklahoma, and Arizona.

So what's the bottom line? When it comes to retirees, relocating, and taxes there are a number of factors to consider--including the overall tax burden. And, as you've read here, not all states are created equal. If you're thinking about retiring to another state, please consult us first. We'll help you figure out which state is best for your particular circumstances.

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