Soundview Financial Monthly

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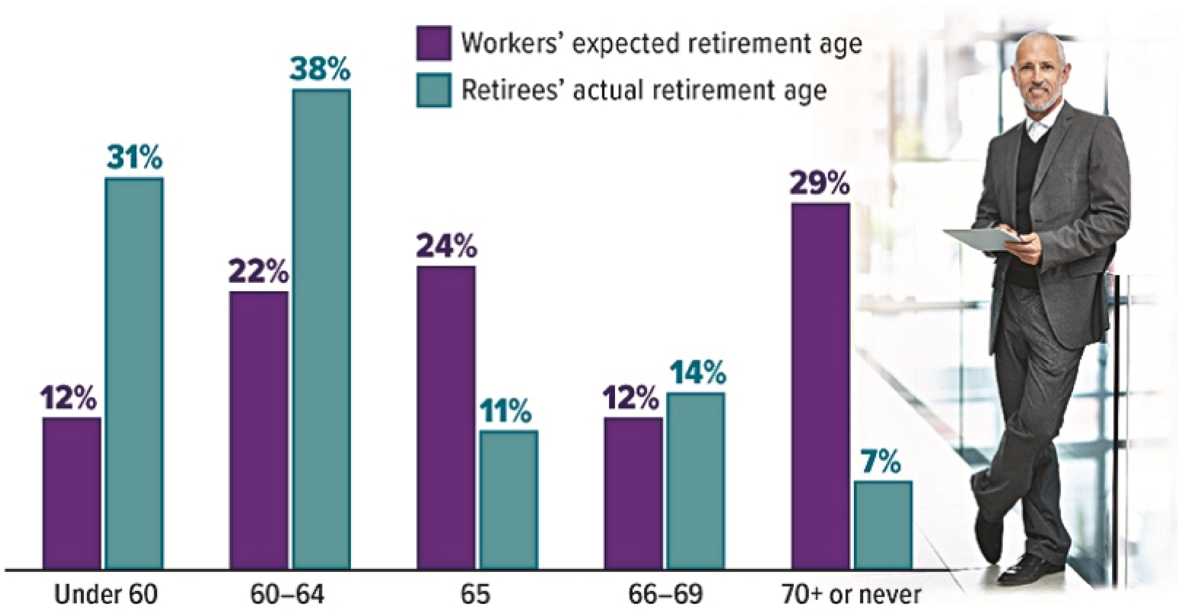
Retirement Age Expectations vs. Reality

Workers typically plan to retire much later than the actual age reported by retirees. In the 2022 Retirement Confidence Survey, 65% of workers said they expect to retire at age 65 or older (or never retire), whereas 69% of retirees left the workforce before reaching age 65. When choosing a retirement age, it might be wise to consider a contingency plan.



Source: Employee Benefit Research Institute, 2022

How Taxes Impact Your Retirement-Income Strategy

Retirees face several unique challenges when managing their income, particularly when it comes to taxes. From understanding how taxes relate to Social Security and Medicare to determining when to tap taxable and tax-advantaged accounts, individuals must juggle a complicated mix of factors.

Social Security and Medicare

People are sometimes surprised to learn that a portion of Social Security income becomes federally taxable when combined income exceeds $25,000 for single taxpayers and $32,000 for married couples filing jointly. The taxable portion is up to 85% of benefits, depending on income and filing status.[1]

In addition, the amount retirees pay in Medicare premiums each year is based on the modified adjusted gross income (MAGI) from *two years earlier.* In other words, the cost retirees pay for Medicare in 2023 is based on the MAGI reported on their 2021 returns.

Taxable, Tax-Deferred, or Tax-Free?

Maintaining a mix of taxable, tax-deferred, and tax-free accounts offers flexibility in managing income each year. However, determining when and how to tap each type of account and asset can be tricky. Consider the following points:

Taxable accounts. Income from most dividends and fixed-income investments and gains from the sale of securities held 12 months or less are generally taxed at federal rates as high as 37%. By contrast, qualified dividends and gains from the sale of securities held longer than 12 months are generally taxed at lower capital gains rates, which max out at 20%.

Tax-deferred accounts. Distributions from traditional IRAs, traditional work-sponsored plans, and annuities are also generally subject to federal income tax. On the other hand, company stock held in a qualified work-sponsored plan is typically treated differently. Provided certain rules are followed, a portion of the stock's value is generally taxed at the capital gains rate, no matter when it's sold; however, if the stock is rolled into a traditional IRA, it loses this special tax treatment.[2]

Tax-free accounts. Qualified distributions from Roth accounts and Health Savings Accounts (HSAs) are tax-free and therefore will not affect Social Security taxability and Medicare premiums. Moreover, some types of fixed-income investments offer tax-free income at the federal and/or state levels.[3]

The Impact of RMDs

One income-management strategy retirees often follow is to tap taxable accounts in the earlier years of retirement in order to allow the other accounts to continue benefiting from tax-deferred growth. However, traditional IRAs and workplace plans cannot grow indefinitely. Account holders must begin taking minimum distributions after they reach age 73 (for those who reach age 72 after December 31, 2022). Depending on an account's total value, an RMD could bump an individual or couple into a higher tax bracket. (RMDs are not required from Roth IRAs and, beginning in 2024, work-based plan Roth accounts during the primary account holder's lifetime.)

Don't Forget State Taxes

State taxes are also a factor. Currently, seven states impose no income taxes, while New Hampshire taxes dividend and interest income and Washington taxes the capital gains of high earners. Twelve states tax at least a portion of a retiree's Social Security benefits.

Eye on Washington

Finally, both current and future retirees will want to monitor congressional actions over the next few years. That's because today's historically low marginal tax rates are scheduled to revert to higher levels in 2026, unless legislation is enacted (see table).

Help Is Available

Putting together a retirement-income strategy that strives to manage taxes is a complex task indeed. Investors may want to seek the help of a qualified tax or financial professional before making any final decisions.[4]

Tax Rates Scheduled to Rise

Unless legislation is enacted, federal marginal income tax rates are scheduled to rise in 2026.

Current rate	2026
10%	10%
12%	15%
22%	25%
24%	28%
32%	33%
35%	35%
37%	39.6%

1) Combined income is the sum of adjusted gross income, tax-exempt interest, and 50% of any Social Security benefits received.

2) Distributions from tax-deferred accounts and annuities prior to age 59½ are subject to a 10% penalty, unless an exception applies.

3) A qualified distribution from a Roth account is one that is made after the account has been held for at least five years and the account holder reaches age 59½, dies, or becomes disabled. A distribution from an HSA is qualified provided it is used to pay for covered medical expenses (see IRS publication 502). Nonqualified distributions will be subject to regular income taxes and penalties.

4) There is no guarantee that working with a financial professional will improve investment results.

When Should Young Adults Start Investing for Retirement?

As young adults embark on their first real job, get married, or start a family, retirement might be the last thing on their minds. Even so, they might want to make it a financial priority. In preparing for retirement, the best time to start investing is now — for two key reasons: compounding and tax management.

Power of Compound Returns

A quick Internet search reveals that Albert Einstein once called compounding "the most powerful force in the universe," "the eighth wonder of the world," or "the greatest invention in human history." Although the validity of these quotes is debatable, Einstein would not have been far off in his assessments.

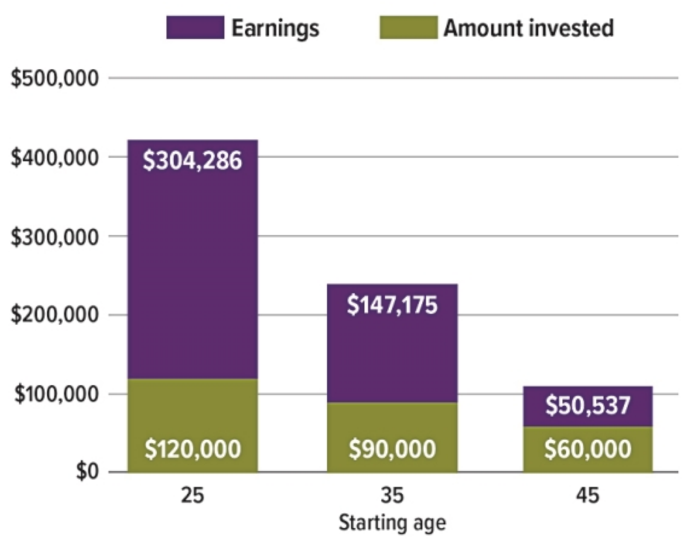
Compounding happens when returns earned on investments are reinvested in the account and earn returns themselves. Over time, the process can gain significant momentum.

For example, say an investor put $1,000 in an investment that earns 5%, or $50, in year one, which gets reinvested, bringing the total to $1,050. In year two, that money earns another 5%, or $52.50, resulting in a total of $1,102.50. Year three brings another 5%, or $55.13, totaling $1,157.63. Each year, the earnings grow a little bit more.

Over the long term, the results can snowball. Consider the examples in the accompanying chart.

A Head Start Can Be a Strong Ally

This chart illustrates how much an investor could accumulate by age 65 by investing $3,000 a year starting at age 25, 35, and 45 and earning a 6% annual rate of return, compounded annually.



These hypothetical examples of mathematical compounding are used for illustrative purposes only and do not reflect the performance of any specific investments. Fees, expenses, and taxes are not considered and would reduce the performance shown if they were included. Rates of return will vary over time, particularly for long-term investments. Investments offering the potential for higher rates of return also involve a higher degree of investment risk. Actual results will vary.

Tax Management

Another reason to start investing for retirement now is to benefit from tax-advantaged workplace retirement plans and IRAs.

Lower taxes now. Contributions to traditional 401(k)s and similar plans are deducted from a paycheck before taxes, so contributing can result in a lower current tax bill. And depending on a taxpayer's income, filing status, and coverage by a workplace plan, contributions to a traditional IRA may result in an income tax deduction.

Tax-deferred compounding. IRAs and workplace plans like 401(k)s compound on a tax-deferred basis, which means investors don't have to pay taxes on contributions and earnings until they withdraw the money. This helps drive compounding potential through the years.

Future tax-free income. Roth contributions to both workplace accounts and IRAs offer no immediate tax benefit, but earnings grow on a tax-deferred basis, and qualified distributions are tax-free. A qualified distribution is one made after the Roth account has been held for five years and the account holder reaches age 59½, dies, or becomes disabled.

Saver's Credit. In 2022, single taxpayers with adjusted gross incomes of up to $34,000 ($66,000 if married filing jointly) may qualify for an income tax credit of up to $1,000 ($2,000 for married couples) for eligible retirement account contributions. Unlike a deduction — which helps reduce the amount of income subject to taxes — a credit is applied directly to the amount of taxes owed.

Avoiding penalties. Keep in mind that withdrawals from pre-tax retirement accounts prior to age 59½ and nonqualified withdrawals from Roth accounts are subject to a 10% penalty on top of regular income tax.

Additional Fuel for the Fire

Workplace plans that offer employer matching or profit-sharing contributions can further fuel the tax-advantaged compounding potential. Investors would be wise to consider taking full advantage of employer matching contributions, if offered.

Don't Delay

With the power of compounding and the many tax advantages, it may make sense to make retirement investing a high priority at any age.

Three Ways to Help Simplify Your Finances

Over time, finances tend to get complicated, especially when you're juggling multiple goals and accounts. Simplifying your finances requires a bit of effort up front, but making just a few changes may help free up more time to focus on your financial priorities.

Make Saving Automatic

Saving for a goal is simpler when money is set aside automatically. For example, you may be able to regularly and automatically deposit a portion of your paycheck into a retirement account through your employer. Your contribution level may also increase automatically each year, if your plan offers this feature. Employers may also allow you to split your direct deposit into multiple accounts, enabling you to build up a college fund or an emergency fund, or direct money to an investment account.

Another way to make saving for multiple goals easier is to set up recurring transfers between your savings, checking, or other financial accounts. You decide on the frequency and timing of those transfers, and you can quickly make necessary adjustments.

Consolidate Retirement Funds

If you've had a few jobs, you might have several retirement accounts, such as IRAs and 401(k) or 403(b) plans, with current and past employers. Consolidating them in one place may help make it easier to monitor and manage your retirement savings and distributions, and prevent you (or your beneficiaries) from forgetting about older or lower-balance accounts. Not all accounts can be combined, and there may be tax consequences, so discuss your options with your financial and/or tax professionals.

Take a Credit Card Inventory

Credit cards are convenient, but managing multiple credit-card accounts can be time-consuming and costly. Losing track of balances and due dates may lead to increased interest charges or late payments. You could also miss out on some of the rewards and benefits your cards offer. If you've accumulated a few credit cards, review interest rates, terms, credit limits, and benefits that may have changed since you got the cards. Ordering a copy of your credit report can help you quickly see all of your open credit-card accounts — there may be some you've forgotten about. Visit annualcreditreport.com to get a free credit report from each of the three major credit reporting agencies (Experian, Equifax, and TransUnion).

Once you know what you have, you can decide which cards to use and put the rest aside. Because it's possible that your credit score might take a temporary hit, it may not always be a good idea to close accounts you're not using unless you have a compelling reason, such as a high annual fee or exposure to fraud.