



## 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.<sup>1</sup>

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.<sup>2</sup>

**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.<sup>3</sup>

### 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.

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## Eye on D.C.

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.<sup>4</sup>

## 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.



## As Your Parents Age, Help Them Protect Their Finances

It's heartbreaking to hear stories of people losing money (even their life savings) as a result of fraud or financial exploitation, especially if they are older and financially vulnerable. In fact, it's quite common. People age 70 and older reported losses of \$567 million in 2022.<sup>1</sup> You know your parents could be at risk, and you want to protect them, but how?

One place to start is by looking for warning signs that your parents have been victimized, or are at risk of being influenced, manipulated, or coerced by a stranger or someone they know.

- Unusual bank account activity, including large or unexplained withdrawals, and nonsufficient fund notices
- Missing checks, credit cards, or financial statements
- Unpaid bills
- Lost money or valuables that can't be located after a thorough search
- Relationships with people who seem to have undue influence
- Unexplained changes to legal documents
- Declining memory and decision-making skills

Regularly checking in with your parents may help you spot issues that need to be addressed. If your parents have fallen victim to a financial scam or are being pressured for money from someone they know, they may be embarrassed or reluctant to tell you, even if you ask. Do your best to remain objective and nonjudgmental, and patiently listen to their views while expressing your own concern for their well-being.

Laying some groundwork to help prevent future incidents is also important. For example, talk to your parents about how they might handle common scams. Let them know it's a good idea to get a second opinion from you before acting on any request for information or money, even if it seems to come from their financial institution, a well-known company, law enforcement, a government agency such as the IRS or Social Security Administration, or even a grandchild in trouble.

Encourage them to set up appointments with their elder law attorney or financial professional to talk about concerns and legal and financial safeguards. They might also want to add layers of protection to their financial accounts, such as naming a trusted contact or setting up account alerts.

People are often reluctant to report financial fraud or exploitation, either out of embarrassment or fear of being wrong. But if you suspect your parents have been victimized, you can get help from many sources, including the National Elder Fraud Hotline, sponsored by the U.S. Department of Justice. You can call (833) 372-8311 to be connected with case managers who will assist you and direct you to additional resources.

1) Federal Trade Commission, 2022

Do your family and friends have financial questions? We would be pleased to assist.

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The U.S. stock market struggled in 2022, with the S&P 500 index ending the year down more 19.4%.<sup>1</sup> The S&P 500, which includes stocks of large U.S. companies, is generally considered representative of the U.S. stock market as a whole, and it is a good benchmark for broad market performance. But there are thousands of smaller companies, and many of those held onto their stock value better during the market conditions of 2022.

The S&P MidCap 400, which includes midsize companies, ended the year down 14.5%, while the S&P SmallCap 600, which includes smaller companies, was down 17.4%.<sup>2</sup> Although these were losses, it was the first year since 2016 that midsize and small companies outperformed large companies (in this case, by having smaller losses). While large companies have registered the highest average annual returns over the last decade, midsize and small companies have been stronger over longer periods (see chart).

## Extending Your Reach

As these trends demonstrate, companies of different sizes tend to perform differently in response to market conditions. This suggests that holding stocks in companies of varied sizes could help diversify the stock portion of your portfolio and allow you to pursue a broader range of growth opportunities. Diversification is a method to help manage risk; it does not guarantee a profit or protect against investment loss.

The most convenient and comprehensive way to diversify by size is through mutual funds or exchange-traded funds that track indexes based on market capitalization, calculated by multiplying the number of outstanding shares by the price per share. There is no standard classification system, but Standard & Poor's indexes offer a helpful comparison and are used as benchmarks for many funds.<sup>3</sup>

**S&P 500:** \$14.6 billion or more

**S&P MidCap 400:** \$3.7 billion to \$14.6 billion

**S&P SmallCap 600:** \$850 million to \$3.7 billion

Russell indexes are also commonly used to construct funds based on market capitalization. The Russell 1000 includes large and midsize companies, while the Russell 2000 is a comprehensive small-cap index. Actively managed funds focusing on market capitalization typically include stocks chosen by the fund manager rather than following an index.



## Diversifying with Market Caps

### Stability, Growth, and Volatility

Stocks of larger companies, or large caps, are generally considered more stable than the stocks of smaller companies, because their size can help them weather rough economic times — as demonstrated by their strong performance during the pandemic. Large caps may provide solid long-term returns, but they typically have lower growth potential, because they have already experienced substantial growth. Many large U.S. companies have heavy overseas exposure, which makes them more sensitive to global economic forces, one reason they struggled in 2022.

Mid caps may have greater growth potential than large caps, and midsize companies might react more nimbly to changes in the business environment. Mid caps are associated with

higher risk and volatility than large caps, but are considered more stable than small caps.

Small-cap stocks might offer the highest growth potential of the three classifications, because they have the furthest to grow and are more likely to react quickly to market opportunities. However, they are typically the most risky and volatile class of stocks.

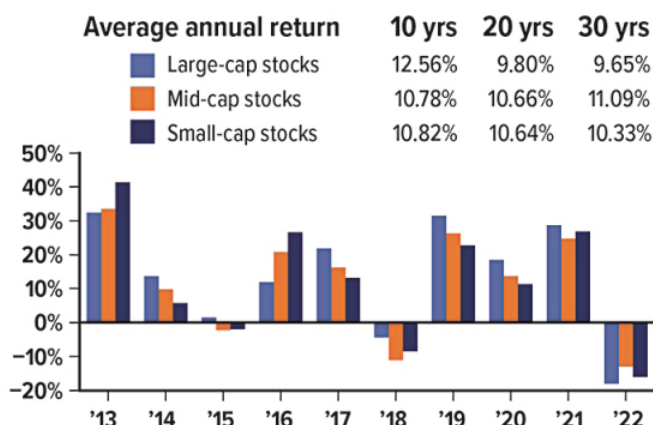
The investment return and principal value of stocks, mutual funds, and ETFs fluctuate with market conditions. Shares, when sold, may be worth more or less than their original cost.

Mutual funds and ETFs are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. You should read the prospectus carefully before investing.

1-3) S&P Dow Jones Indices, 2023

### Performance in Three Sizes

Even with poor performance in 2022, large-cap stocks have provided the highest returns over the last decade. However, mid caps were the leader over the last 20- and 30-year periods, with small caps not far behind.



Source: Refinitiv, 2023, for the period 12/31/2012 to 12/31/2022. Large-cap stocks are represented by the S&P 500 Composite Total Return Index, mid-cap stocks by the S&P 400 MidCap Total Return Index, and small-cap stocks by the S&P 600 SmallCap Total Return Index. Expenses, fees, charges, and taxes are not considered and would reduce the performance shown if they were included. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

# A Mortgage Recast is an Alternative to Refinancing

If you would like to reduce your monthly mortgage payment without having to refinance, then you may want to explore a mortgage recast. When you recast your mortgage, you put money toward the principal balance of your current home loan. Your mortgage lender then recalculates (reamortizes) your loan based on your new, lower balance, which reduces your monthly payment. Your interest rate and the number of years remaining on your loan stay the same. Here are three scenarios where a mortgage recast might be especially appealing.

- You have extra cash on hand, perhaps from a bonus or an inheritance. It's sitting in a low-yield account.
- You are close to retirement or retired. You want to keep your home but lower your monthly expenses.



- You bought a new home with a smaller downpayment than you intended because your old home is still on the market. But once your old home sells, the proceeds can be applied to your new mortgage through a recast.

Refinancing your mortgage may be a better option if your goal is to pay off your loan faster by shortening the term, or if you want to lower your interest rate or obtain cash. But if your objective is simply to lower your monthly payment and save on interest charges, then recasting your mortgage may be appropriate. Recasting is generally simpler and less expensive than refinancing because you're keeping the same mortgage instead of applying for a new one. It doesn't require an extensive application, a credit check, a new appraisal, or closing costs, though you typically will need to pay a processing fee.

## Check with Your Lender

Not all mortgage lenders offer recasts, and some types of loans, including FHA, VA, USDA, and certain jumbo loans are not eligible for recasting. If you do qualify for a recast, your lender will give you more details about the process.

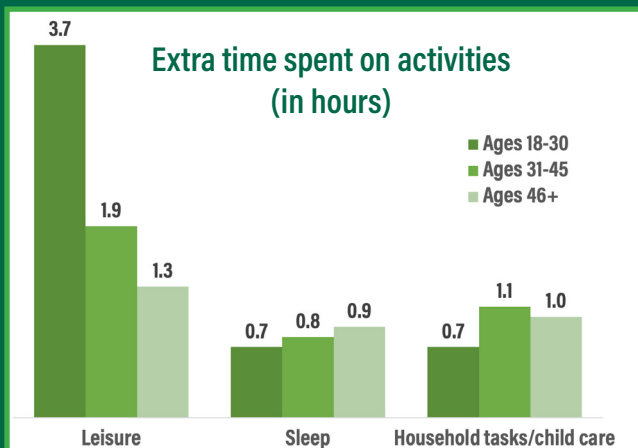
You may be able to recast once you've increased your equity by making extra payments or by paying a lump sum toward your mortgage balance. Minimums vary, but the additional principal required may be as little as \$5,000. Of course, the more you put toward your principal, the lower your future monthly mortgage payment. If you are currently paying principal mortgage insurance (PMI), putting a lump sum toward your mortgage may help erase that, further lowering your monthly payment.

One drawback of a mortgage recast is that it could tie up money you might need later for other purposes. To access your equity in the future, you may need to refinance, take out a home equity loan, or even sell your home.



# Remote Workers Trade Commutes for Much-Needed Rest

According to a detailed analysis of the American Time Use Survey, individuals who worked at home in 2020 instead of commuting to an office collectively saved 60 million hours each day that could be spent doing other things. Employees reported spending 35% of their saved commute time working, but overall paid work hours fell, because activities such as child care, housework, and exercise were squeezed in throughout the day. There were differences among age groups, but they all spent more leisure time with family and friends — and got nearly an additional hour of sleep.



**27.6 million**

The number of people primarily working from home in 2021. This tripled from about nine million people in 2019.

Source: Census Bureau, 2022



Combining finances can be complicated for any couple, but the challenges become more complex the second time around, especially when children are involved. Here are some ideas to consider if you are already part of a blended family or looking forward to combining households sometime soon.

## Be Clear and Comprehensive

It's important to reveal all assets, income, and debts, and discuss how these should be treated in your combined family. A prenuptial agreement may seem unromantic, but it could prevent acrimony and misunderstanding if the marriage ends through divorce or the death of a spouse. If you don't want a legal agreement, have an open and honest discussion, and lay all your cards on the table. It's not too late to clarify the situation after you've tied the knot.

One of the most fundamental issues is where you and your new spouse will live. It might be more convenient — and perhaps better financially — to move into a residence that one of you already owns. But couples in a second marriage often report that moving into a new home gives them a feeling of a fresh start, which could have value that can't be measured financially.<sup>1</sup>

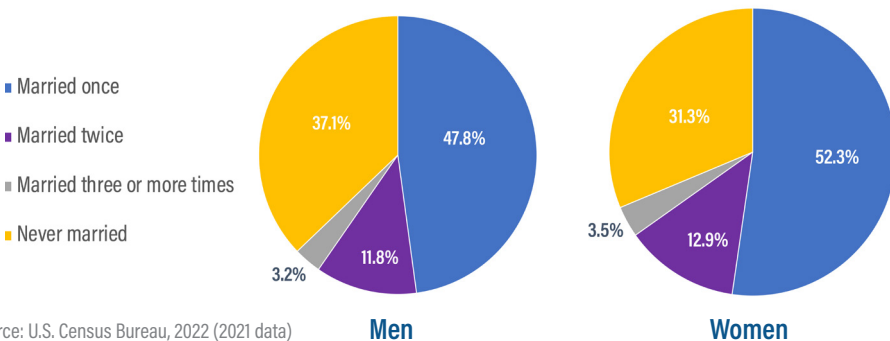
Create a blueprint for short-term and long-term finances. Do you plan to combine bank accounts or keep separate accounts, perhaps with a joint account to pay shared expenses? To what accounts will each of your salaries be deposited? Will one spouse help pay off the other spouse's debts such as student loans, auto loans, and credit cards? Research suggests that remarried couples are generally happier when they pool resources, but there are many variations in how that might be carried out.<sup>2</sup>

## Consider the Kids

Discuss how you plan to handle financial responsibility for children from previous marriages versus any children you have together. Are they going to be "your kids, my kids, and our kids," or are they all "our kids"? Being a stepparent and/or a divorced parent can be complex emotionally, and there are

## I Do, I Do

Roughly two out of three Americans ages 18 and older have been married at least once, and a substantial number have been married more than once.



Source: U.S. Census Bureau, 2022 (2021 data)

no easy answers. But there are some not-so-complex financial questions you should address up front.

Be clear about alimony payments, child support, and other financial responsibilities. For example, what is each spouse's intention and/or legal obligation to pay college tuition costs for children from a previous marriage? Are there assets that one spouse wants to reserve for the benefit of his or her children? Is the other spouse willing to waive rights to those assets?

Communicating and planning with an ex-spouse is essential if you share custody of children. Along with responsibilities for everyday expenses, be sure you understand and agree on other financial issues, such as who will claim the child as a beneficiary on tax returns, and who is the "custodial parent" for purposes of financial aid applications. A beneficiary deduction may be more valuable for a parent with higher earnings, but a custodial parent with lower earnings may enable a student to qualify for more financial aid.

## Update Wills and Beneficiary Forms

Be sure that your will and all beneficiary forms reflect your new situation and current wishes. A will can designate heirs and facilitate distribution of assets when an estate goes through the probate process. However, the assets in most pension plans, qualified retirement accounts, and life insurance policies convey directly to the people named on the beneficiary forms — even if they are different from those named in your will — and are not subject to probate. By law, your current spouse is the beneficiary of an ERISA-governed retirement account such as a 401(k) plan. If you want to designate an ex-spouse or children from a previous marriage as account beneficiaries, you must obtain a notarized waiver from your current spouse.

Blending families can be challenging on many levels. Financial matters may be easier to deal with than personal aspects as long as you take appropriate steps to identify the issues and agree on your shared financial goals.

1-2) American Psychological Association, August 23, 2019 (most current information available)





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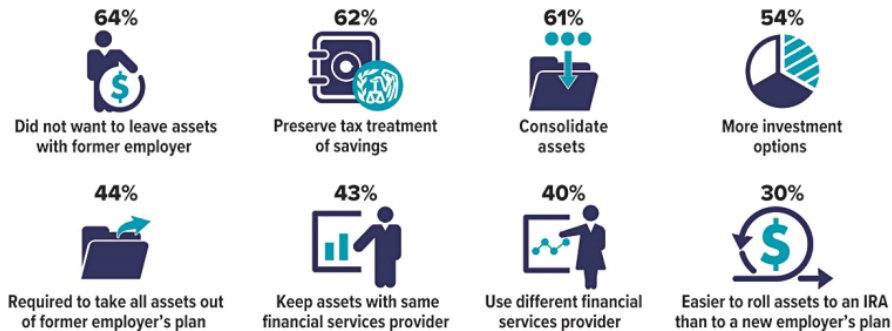


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## Reasons to Roll

When you leave your job or retire, you have an opportunity to manage your funds in an employer-sponsored retirement plan such as a 401(k), 403(b), or government 457(b) plan. Depending on the situation, you generally have four options.\* The approach that typically gives you the most control over the funds is to transfer some or all of the assets to an IRA through a rollover.

Three out of five households who owned traditional IRAs in 2022 had executed at least one IRA rollover from an employer-sponsored retirement plan. These were the top reasons for the most recent rollover.



\*Other options may include leaving assets in the former employer's plan, transferring assets to a new employer-sponsored plan, or withdrawing the money.

Source: Investment Company Institute, 2023 (multiple responses allowed)



**55 million:** Number of U.S. households with an IRA in 2022. Some households have more than one type of IRA: 40.9 million have a traditional IRA, 32.3 million have a Roth IRA, and 4.9 million have a SEP IRA, SAR-SEP IRA, or SIMPLE IRA.

Source: Investment Company Institute, 2023

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