

# AWM Financial Planning

## Essential Estate Planning



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A Gallup Poll found that less than half of Americans have basic estate planning documents, potentially representing the biggest gap in your financial plan. By definition, estate planning is a process designed to help you manage and preserve your assets while you are alive and to conserve and control their distribution after your death according to your goals and objectives.

Since death and incapacity can strike at any time, getting your affairs in order is not only imperative, it can be a blessing to your loved ones - especially in their time of grief.

There are several essential estate planning documents that you should consider

- \* Will
- \*Living Will
- \*Health-Care Proxy
- \*Durable Power of Attorney
- \*Revocable Living Trust

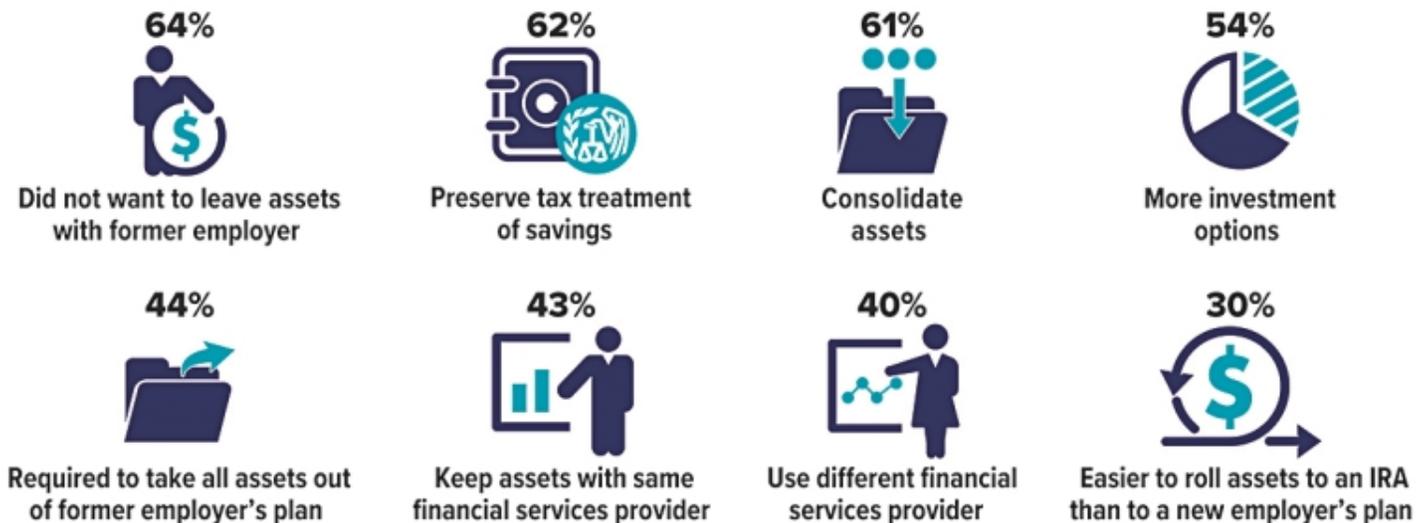
These documents should be current, signed, recorded and accessible. You may also want to consider an ethical will to document your wishes and values to succeeding generations.

For a review of your estate plan or to discuss further, give us a call.

## 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)

# 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.

## 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.<sup>4</sup>

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## 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.

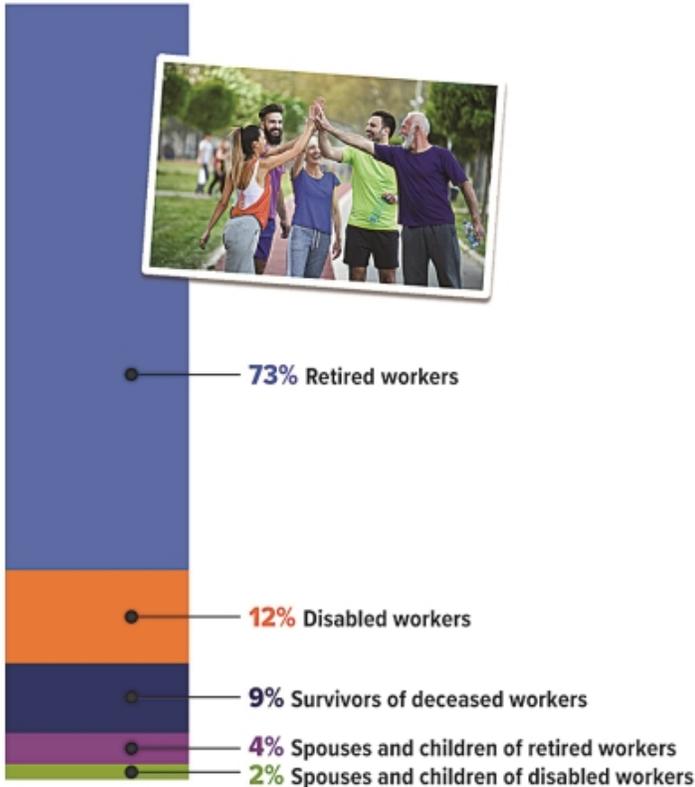
3) A qualified distribution from a Roth account is one that is made after the account has been held for at least five years and the account holder reaches age 59½, dies, or becomes disabled. A distribution from an HSA is qualified provided it is used to pay for covered medical expenses (see IRS publication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

# Social Security Offers Benefits from Birth Through Old Age

The bulk of Social Security benefits go to retirees, but Social Security is much more than a retirement program. Most Americans are protected by the Old-Age, Survivors, and Disability Insurance (OASDI) program — the official name of Social Security — throughout their lives.

## Current Social Security Beneficiaries



Source: Social Security Administration, 2023

## At the Beginning of Your Career

Your first experience with Social Security might be noticing that Federal Insurance Contributions Act (FICA) taxes have been taken out of your paycheck. Most jobs are covered by Social Security, and your employer is required to withhold payroll taxes to help fund Social Security and Medicare.

Although most people don't like to pay taxes, when you work and pay FICA taxes, you earn Social Security credits. These enable you (and your eligible family members) to qualify for Social Security retirement, disability, and survivor benefits. Most people need 40 credits (equivalent to 10 years of work) to be eligible for Social Security retirement benefits, but fewer credits may be needed for disability or survivor benefits.

## If You Become Disabled

Disability can strike anyone at any time. Research shows that one in four of today's 20-year-olds will

become disabled before reaching full retirement age.<sup>1</sup>

Social Security disability benefits can replace part of your income if you have a severe physical or mental impairment that prevents you from working. Your disability generally must be expected to last at least a year or result in death.

## When You Marry...or Divorce

Married couples may be eligible for Social Security benefits based on their own earnings or on their spouse's.

When you receive or are eligible for retirement or disability benefits, your spouse who is age 62 or older may also be able to receive benefits based on your earnings if you've been married at least a year. A younger spouse may be able to receive benefits if he or she is caring for a child under age 16 or disabled before age 22 who is receiving benefits based on your earnings.

If you were to die, your spouse may be eligible for survivor benefits based on your earnings. Regardless of age, your spouse who has not remarried may receive benefits if caring for your child who is under age 16 or disabled before age 22 and entitled to receive benefits based on your earnings. At age 60 or older (50 or older if disabled), your spouse may be able to receive a survivor benefit even if not caring for a child.

If you divorce and your marriage lasted at least 10 years, your former unmarried spouse may be entitled to retirement, disability, or survivor benefits based on your earnings.

## When You Welcome a Child

Your child may be eligible for Social Security if you are receiving retirement or disability benefits, and may receive survivor benefits in the event of your death. In fact, according to the Social Security Administration, 98% of children could get benefits if a working parent dies.<sup>2</sup> Your child must be unmarried and under age 18 (19 if a full-time elementary or secondary school student) or age 18 or older with a disability that began before age 22.

## At the End of Your Career

Social Security is a vital source of retirement income. The benefit you receive will be based on your lifetime earnings and the age at which you begin receiving benefits. You can get an estimate of your future Social Security benefits by signing up for a *my* Social Security account at [socialsecurity.gov](https://www.socialsecurity.gov) to view your personal Social Security statement. Visit this website, too, to get more information about specific benefit eligibility requirements, only some of which are covered here.

1-2) Social Security Administration, 2022

# 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 down payment 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.

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## IMPORTANT DISCLOSURES

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