IN THIS ISSUE



Trust UPDATE

Stillman BANK

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# Recalibrating retirement readiness

A recent article in *Financial Planning* magazine reported that Americans are falling behind in saving for retirement readiness ["Four Reasons Retirement Readiness is Declining," May 2023]. Some 55% of Americans are behind, and 35% are "significantly behind" where they need to be able to retire in comfort. Worse, the Federal Reserve has reported that 26% of U.S. workers have no retirement savings at all. Four key impediments were identified:

- ***Inflation***. Prices have been rising at rates not seen in a generation or more. Although the rate of price increases has slowed enough that the Federal Reserve held interest rates steady last month, additional interest rate increases are expected later this year, according to many observers. As higher prices put the squeeze on the family budget, suspending retirement savings is a tempting way to economize.
- ***Stock market volatility.*** Rising interest rates have affected the economy in a variety of ways, with some sectors suffering more than others. Stocks were down in 2022, which may have undermined investor confidence for some savers. Finding the time for navigating these choppy markets can be a daunting task for someone with other responsibilities.
- ***Health care costs.*** Rising medical expenses are another factor that may impinge upon keeping up with a plan for saving for retirement. Some 55% of those who return to work after retiring identified health care needs as a key factor in "unretirement," according to the article.
- ***Unrealistic expectations.*** Some people underestimate how much savings will be required for a comfortable retirement, or they may overestimate the investment returns their portfolios will yield.

For those who have successfully accumulated sufficient financial resources to take the big step of declaring the end of the working years, there are still other important questions to consider.

*Continued on next page*

### *The emotional side*

Retirement is an emotional transition as well as a financial transformation, a declaration of financial independence. Here are some questions that one must face, and issues to sort through.

***Is the time right?*** After a long career, it may be time for a change, time for a rest. Even if that is the case, it's important to enter retirement with a plan for staying mentally and physically active, and in contact with other people.

***Are there are more compelling things to do?*** Career demands may have caused the deferral of some activities or pursuits, and retirement provides the time needed for exploration and enjoyment.

***Is your job changing?*** Especially during periods of economic transition, the needs of an employer may be evolving in ways that demand too great an adjustment by older employees. That's why many will accept an offer of early retirement during a reorganization or downsizing.

But one also should check for reasons *not* to retire, because they may indicate that more emotional preparation is needed before taking the retirement plunge.

***Is work enjoyable?*** The daily routine can be full of habits that are hard to break. For jobs that are not physically taxing, one can continue to be productive until age 70 and beyond.

***What about the pleasures of camaraderie?*** Some people feel a sharp sense of loss after retiring. They may miss the workplace and colleagues.

***Are there better options?*** Without a good plan for retirement, one runs the risk of loneliness and depression. Being a couch potato may be temporarily relaxing, but it isn't very satisfying.

## Don't overlook taxes on Social Security benefits

More and more retirees are paying income taxes on their Social Security benefits, because the thresholds for this taxation are not indexed for inflation. The computation of this tax is not simple. It starts with a determination of "provisional income," which is modified adjusted gross income *plus* half of Social Security benefits *plus* all tax-exempt interest from municipal bonds or mutual funds that invest in such bonds. As provisional income rises, more and more of the Social Security benefits become taxable, up to 85%, as shown in the table below.

### Calculating the tax on Social Security benefits

| | Provisional income | % of benefits that are taxable |
|---|---|---|
| Single filers | \$25,000-\$34,000 | Up to 50% |
| | Over \$34,000 | Up to 85% |
| Marrieds filing jointly | \$32,000-\$44,000 | Up to 50% |
| | Over \$44,000 | Up to 85% |

Source: Internal Revenue Code; M.A. Co.

There are some strategies that may reduce this tax bite.

• **Delay taking Social Security benefits.** Benefits are increased by 8% for each year of delay after reaching normal retirement age. By delaying the benefits, retirement expenses will have to be met from taxable and tax-deferred savings. Spending those resources down may reduce portfolio income by age 70 enough to lower the overall tax burden, even though the benefits will be higher.

• **Invest for growth instead of income.** Capital gains are not taxable until they are realized by selling the security, and then they are more lightly taxed if they have been held for at least 12 months.

• **Convert IRAs to Roth IRAs.** The conversion of an IRA to a Roth IRA is taxed as ordinary income, and that can be a substantial hit. The potential benefit is that distributions from the Roth IRA may be tax-free and won't be counted in provisional income. What's more, there are no required minimum distributions from Roth IRAs at age 73 and up, as there are for traditional IRAs. To ease the tax bite on the conversion, it might be done in smaller increments over a period of years.

• **Give IRA money to charity.** A Qualified Charitable Distribution is a direct payment from an IRA to a qualified charity that is not included in taxable income, even though it satisfies the rule for required minimum distributions. Up to \$100,000 may be transferred per year by those who are 70½ and older.

### *Retirement budgeting*

Developing a realistic retirement budget is an important exercise, one that requires an examination of values as much as resources. Some people enjoy living rather modestly during retirement. But one retiree we know says, "Life is too short to drink cheap wine." The retirement budget needs to be understood from three perspectives.

*Essential versus discretionary spending.* Which expenditures could be curtailed, even eliminated, in the event of financial reversals? Food is essential; restaurant dining is not. Is there room in the budget for savings?

*Structural versus peripheral expenses*. Some costs are binding, not subject to modification, and failure to meet them means a structural change in retirement. If you own real property, you must pay the taxes. If you have a mortgage, you must make the payments. If you own a car, you have to pay for routine maintenance. Trips, vacations and gifts, in contrast, are peripheral expenses.

*Fixed versus inflation-prone costs.* Most retirement expenses are vulnerable to inflation, while retirement income generally is fixed. The response to rising prices may include cutting back on optional purchases or substituting less expensive items for those that become unaffordable.

Understand also that long, modern retirements typically include three phases:

• *active retirement,* filled with travel and pursuit of deferred dreams;

- *passive retirement,* typically beginning in the late-70s, when activities are gradually reduced; and
- *final retirement,* a period often marked by failing health and a need for long-term care.

A different retirement budget applies to each of these three periods.

### Put us on your team

We specialize in two areas of personal financial management:

- Helping clients ***achieve*** financial independence, using tax-sensitive techniques as appropriate.
- Helping clients ***maintain*** financial independence by providing unbiased investment advice and trusteeship.

For specifics on how we might help you, schedule a meeting with one of our wealth consultants. ☐

# Why the national debt is important

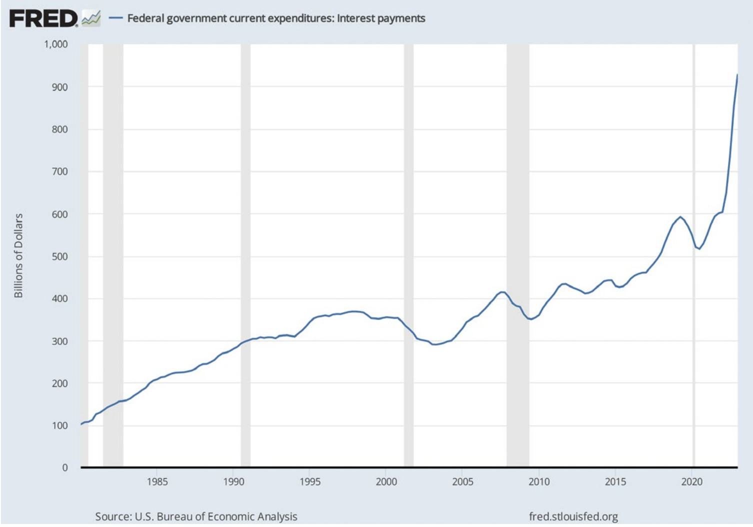
The U.S. national debt stood at $31.4 trillion before Congress acted with legislation to avoid a default on the debt. That number is so huge that it is hard to comprehend. An easier way to think about it is to compare the debt to the economy that must support it. The International Monetary Fund has provided data on the debts of nations over time, which is quite interesting (see https://www.imf.org/external/datamapper/CG_DEBT_GDP@GDD/USA).

In 1950, the U.S. national debt amounted to 78.2% of the nation's Gross Domestic Product (GDP). The very high costs of World War II were still being paid down. The debt declined over time, reaching 27.51% of GDP in 1974, the modern low point. It rose slowly, reaching 57.39% of GDP in 1993, at the beginning of the Clinton administration. Through a combination of spending control and increased tax revenue, the debt fell to 41.38% of GDP by the end of the Clinton years.

Interestingly, the war on terror after 9/11 was not accompanied by a major increase in the national debt, in terms of the GDP, despite increased military spending. In 2007, it was still only 45.17% of GDP. The onset of the Great Recession in 2008 marked a dramatic change, as the debt grew steadily faster than the economy as a whole through 2019, when it reached 93.11% of GDP. Then we had the pandemic, and the massive government spending to offset the economic effects that ensued. In 2020, we reached the modern high of 119.37% of GDP, before dipping to 115.28% in 2021 (latest data available).

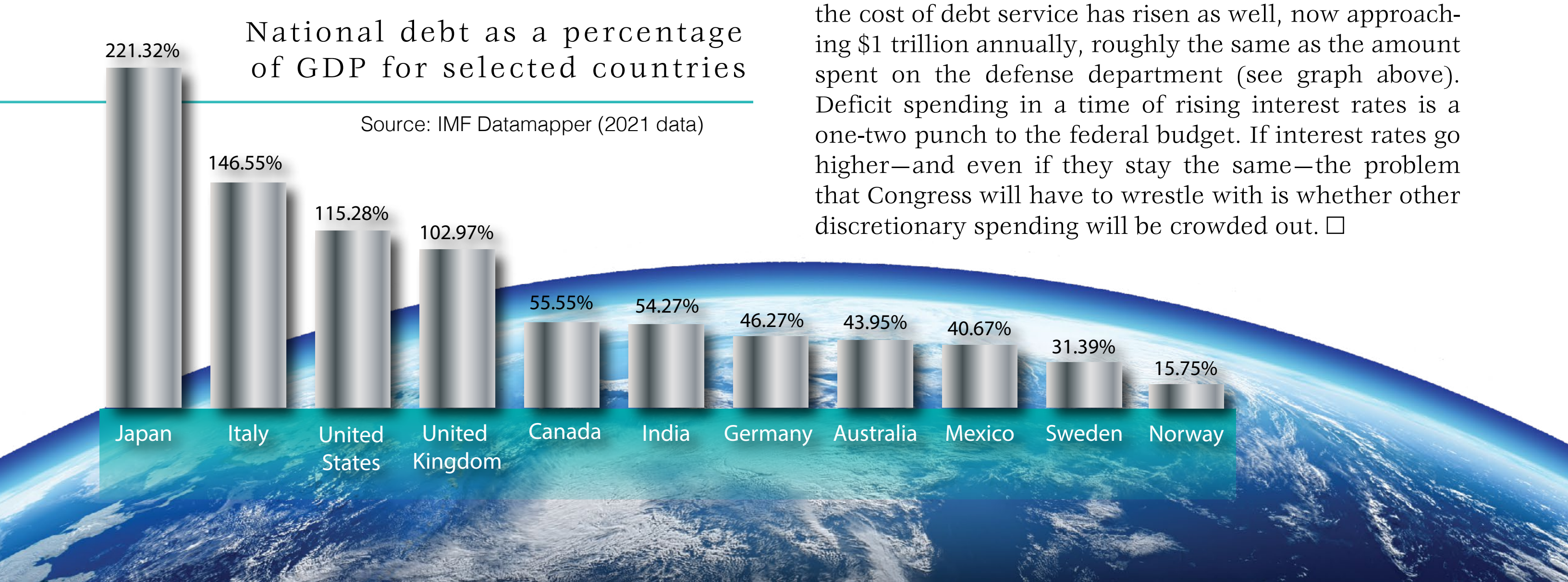
### An international angle

The U.S. is far from having the highest national debt as a percentage of GDP in the world, but we are in the top tier. For example, Japan's national debt comes to 221.32% of its GDP! In contrast, Germany's debt is 46.27% of its GDP, Sweden's is 39.31%, and Norway's is just 15.75%. The graph below compares the national debts of several other countries.




### The cost of debt

When interest rates are low, the cost of paying the interest on the national debt is also relatively low. However, as interest rates have risen to put a damper on inflation, the cost of debt service has risen as well, now approaching $1 trillion annually, roughly the same as the amount spent on the defense department (see graph above). Deficit spending in a time of rising interest rates is a one-two punch to the federal budget. If interest rates go higher—and even if they stay the same—the problem that Congress will have to wrestle with is whether other discretionary spending will be crowded out. ☐



## Planning for pets

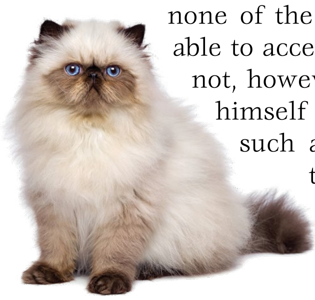
In 2007, Leona Helmsley's will left $12 million in trust to care for her dog after her death. The legacy was later reduced to $2 million. Now comes a story of a Tampa woman, Nancy Sauer, with a similar estate planning strategy. Her will bequeathed her $2.5 million mansion and an unspecified amount of cash to her seven Persian cats, Cleopatra, Goldfinger, Leo, Midnight, Napoleon, Snowball and Squeaky. The cats were to live in the house for their natural lives, with the house to be sold only after all had died.

As the cats were only five years old, that might be a long time. After six months alone in the mansion, a probate judge ruled that the cats needed to be moved to a place where they could be better cared for. The local humane society is arranging for adoption of the pets.

The more predictable and reliable method to provide for a pet animal is for the owner to create an enforceable lifetime or testamentary trust in favor of a human beneficiary who will be charged with caring for the pet. The trustee is then required to make distributions to the human beneficiary to cover the pet's expenses, provided the beneficiary is taking proper care of the pet. This technique avoids the two traditional problems with gifts to benefit pet animals. The actual beneficiary is a human, and, thus, there is a beneficiary with standing to enforce the trust, and there is a human measuring life for Rule Against Perpetuities purposes. Even if the owner lives in a state that authorizes statutory pet trusts, the conditional gift in the trust may provide for more flexibility and a greater likelihood of the owner's intent being carried out.

It is of utmost importance for the pet owner to locate a beneficiary/caregiver who is willing and able to care for the animal in a manner that the owner finds acceptable. The prospective caregiver should be questioned before being named, so as to make certain that the caregiver will assume the potentially burdensome obligation of caring for the pet, especially when the pet is in need of medical care or requires special attention as it ages. The pet and the prospective caregiver should meet and spend time together to make sure that they, and the caregiver's family, get along harmoniously with each other.

The pet owner should also name several alternate caregivers, should the owner's first choice be unable to serve for the duration of the pet's life. To prevent the pet from ending up homeless, the owner may authorize the trustee to select a good home for the pet, should none of the named individuals be willing or able to accept the animal. The trustee should not, however, have the authority to appoint himself or herself as the caregiver, for such an appointment would eliminate the checks and balances aspect of separating the caregiver from the money provider. □



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Contact us today for a no-cost, no-obligation consultation.

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