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Retirement for Two: How to Save More and Help Trim Taxes with a Spousal IRA

If you and your spouse are serious about building your retirement savings but one of you is not working, you might be interested in funding a spousal IRA. This could be the same IRA that the spouse contributed to while working or it could be a new account.

In either case, IRS rules allow a married couple to fund separate IRA accounts for each spouse based on the couple's joint income. The total of both IRA contributions cannot exceed the total taxable income reported on the couple's joint tax return, or the annual contribution limit for IRAs times two, whichever is less.

For tax years 2024 and 2025, an individual with earned income from wages or self-employment can contribute up to $7,000 annually to his or her own IRA and up to $7,000 more to a spouse's IRA. An additional $1,000 catch-up contribution can be made for each spouse who is 50 or older.

You can make contributions for 2024 up to the April 2025 tax filing deadline. You might also get a head start for 2025 and contribute for both years.

Tax break on the table?

If neither spouse is an active participant in a workplace retirement plan such as a 401(k), contributions to a traditional IRA are fully tax deductible. However, if one or both are active participants, income limits may affect the deductibility of contributions. Limits are higher for contributions to the IRA of a nonparticipating spouse, so some workplace plan participants who earn too much to deduct an IRA contribution for themselves may be able to make a deductible IRA contribution to a spousal account.

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For joint filers, the ability to deduct contributions to the IRA of an active participant in 2024 is phased out at a modified adjusted gross income (MAGI) between $123,000 and $143,000, but contributions to the IRA of a nonparticipating spouse are phased out at a MAGI between $230,000 and $240,000. (For 2025, phaseouts increase to $126,000–$146,000 and $236,000–$246,000.)

Withdrawals from traditional IRAs and workplace plans are taxed as ordinary income and may be subject to a 10% penalty if withdrawn prior to age 59½, with certain exceptions.

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If you have any questions about the topics in this newsletter or about your financial future, call us. We are available to help.

Phased Retirement Can Help Smooth the Transition

In a recent survey, 52% of workers said they would prefer to gradually decrease their hours as they transition to retirement. The percentages were even higher for Gen X (67%) and millennials (56%).[1]

The federal government has offered a formal phased retirement program since 2014, allowing eligible full-time employees to collect half their pensions while working half time. Typically, at least 20% of their remaining work hours must be spent mentoring younger workers. And their pensions continue to grow based on part-time work.[2]

Private industry has been slower to adopt formal programs, with only 16% of employers — mostly larger companies — having regular phased retirement programs. However, 61% of companies have some experience with phased retirement, and — with strong employee interest — it's likely that more will adopt formal programs.[3]

Win-win-win solution

A phased retirement program can be a positive experience for employees, employers, and customers.

For older employees, a reduced schedule offers a more gradual financial transition, maintaining a steady, if reduced, income that can help delay taking Social Security benefits and/or tapping retirement savings. Trying to live on 80% of salary, for example, might also be good practice for retirement budget management. And staying engaged in the workplace can offer mental and psychological benefits.

For employers, older workers provide experience and institutional knowledge that can help maintain and improve current quality while mentoring younger workers to help ensure a smoother transition to the next generation. Contrary to stereotypes that older workers are less productive, recent research found no correlation between age and productivity but a strong positive correlation between job tenure and productivity.[4]

For customers, older workers can provide dependability and continuity. In some cases, customers are also older, and long-time relationships can help maintain customer comfort levels.

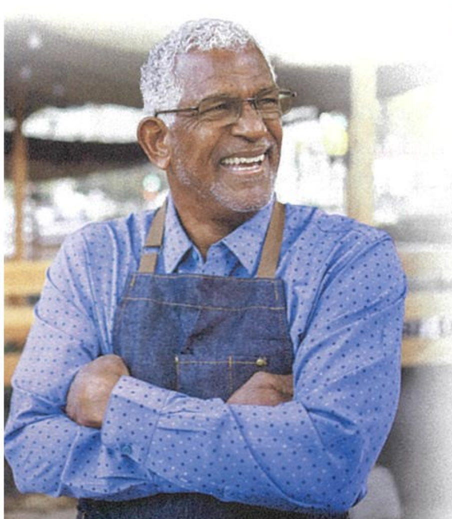
Build your own program

If your company does not offer such a program, you might suggest an arrangement. Emphasize what you can continue to contribute and how it could help the company in the present and the future. But also be sure that the program will work for you. Here are some ideas to keep in mind.

- Make sure you understand the effect of reduced hours on your benefits, such as health insurance and employer pension or retirement plan contributions.
- Whereas the federal program includes a half pension with part-time wages, pensions are less common in private industry. If you cannot live on your reduced wages, you may have to use other sources of income, but you probably would not have to tap them as much as if you retired completely.
- One of the greatest benefits of phased retirement is that you could delay claiming Social Security, with your benefit increasing 8% annually after full retirement age (FRA), up to age 70. However, if you do claim Social Security before FRA and continue to work, you will receive a permanently reduced benefit for claiming early and be subject to the retirement earnings test, which may temporarily reduce your benefit payments until you reach FRA. Once you have reached FRA, the lost benefits from the earnings test will be added to your benefit amount.

If you phase out of your current job, make sure you don't end up trying to do all of your former work in fewer hours. This could be especially problematic for salaried workers in project-oriented positions. Be sure you and your supervisor are clear on the requirements of your reduced workload.

1) Benefits Pro, March 22, 2024
2) U.S. Office of Personnel Management, August 7, 2014
3) Fortune, March 22, 2024
4) Mercer, 2024



Valuing Older Employees

Percentage of employers who agree completely or somewhat with the following statements.

77% Older employees' company knowledge is crucial to our business's success.

69% We want to keep good employees as long as possible but struggle to find ways to continually advance their career path.

67% We have plans for how employees nearing retirement can transfer knowledge to our business before they leave.

62% We are concerned with our employees' career development.

55% We have hired people who had previously retired from another company.

55% We have asked employees who want to retire from full-time work to stay on part time.

47% We have asked employees who have retired from our business to come back for a specific need (temporary work).

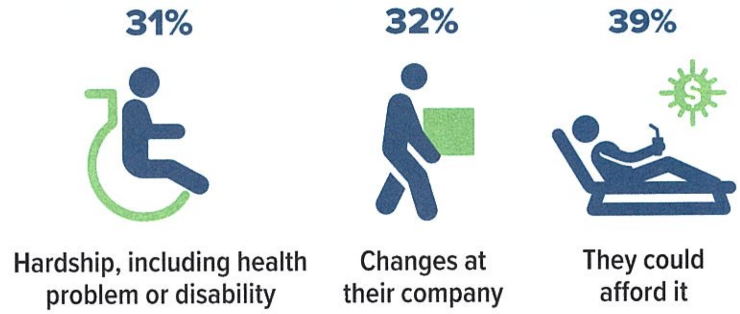
44% We have asked employees who have retired to come back on a full- or part-time basis for the long term.

Source: The Principal Financial Well-Being Index, 2024 (survey conducted November 6–13, 2023)

Would You Be Prepared for an Unplanned Early Retirement?

Most of us would prefer not to think about an unexpected (and unwelcome) early retirement, but it does happen frequently. In fact, nearly half of current retirees retired earlier than planned, and of that group, more than 60% did so due to changes at their company or a hardship, such as disability.[1] For that reason, it's a good idea to take certain steps now to help prepare for the unexpected.

Why 49% of retirees retired earlier than planned



Note: Retirees could have retired for more than one reason.
Source: Employee Benefit Research Institute, 2024

What you can do now

Save as much as possible in tax-advantaged accounts. If you're forced to retire earlier than planned, your work-sponsored retirement plans, IRAs, and health savings accounts (HSAs) could become critical resources. HSA assets can be used tax-free to pay for qualified medical expenses at any time, and you can generally tap your retirement plan and IRA assets after age 59½ without penalty. Although ordinary income taxes apply to distributions from pre-tax accounts, qualified withdrawals from Roth accounts are tax-free.[2]

In addition, the IRS has identified several situations in which retirement account holders may be able to take penalty-free early withdrawals. These include disability, terminal illness, leaving an employer after age 55 (work-based plans only),[3] to pay for unreimbursed medical expenses that exceed 7.5% of your adjusted gross income, and to pay for health insurance premiums after a job loss (IRAs only).

Pay down debt. Generally, it's wise to enter retirement — especially when unexpected — with as little debt as possible. Ensuring that your financial plan includes a strategy for paying down student loans, credit card debt, auto loans, and mortgages can help you minimize your income needs later in life.

Know your bare-bones budget. Another way to help cushion the shock of an unexpected early retirement is knowing exactly how much you spend each month on your basic necessities, including housing, food, utilities, transportation, and health care. Maintaining a written budget throughout life's ups and downs will help you quickly identify how much income you'd need over the short term while you work on a longer-term income-replacement strategy.

Maintain adequate levels of disability insurance. Your employer may offer group coverage at reduced rates; however, you lose those benefits if your employment is terminated. Private disability income insurance can help you secure coverage specific to your needs, and since the premiums are typically paid with after-tax dollars, any benefits would generally be tax-free (unlike work-sponsored coverage that is paid with pre-tax dollars).

Understand Social Security benefits. If you stop working due to disability, you may qualify for Social Security Disability Insurance benefits if you meet certain requirements. You must have earned a certain number of work credits in a job covered by Social Security and have a physical or mental impairment that has lasted or is expected to last at least 12 months or result in death. If you remain eligible, benefits may continue up to age 65 and then convert to Social Security retirement benefits.

If you need to retire earlier than planned for reasons unrelated to disability and are eligible for Social Security retirement benefits, you can apply as early as age 62. However, starting payments prior to your full retirement age (66 or 67, depending on year of birth) will result in a permanently reduced monthly benefit.

For more information on Social Security disability and retirement benefits, visit the Social Security Administration's website at ***ssa.gov.***

Consider your health insurance options. Terminating employment prior to age 65 could leave you without health insurance. You may opt to continue your employer-sponsored health coverage for a limited period (permitted through COBRA, the Consolidated Omnibus Reconciliation Act), although this can be quite expensive. If you're married and your spouse works, you may get coverage under their plan. You may also seek coverage through the federal or a state-based health insurance marketplace. If you receive Social Security disability benefits, you'd automatically qualify for Medicare after 24 months.

Don't be caught off guard

Don't wait for an unwelcome surprise. Take steps now to help ensure your overall financial plan considers the "what-if" of an unexpected early retirement.

1) Employee Benefit Research Institute, 2024
2) Qualified Roth withdrawals are those made after a five-year holding period and after the account owner dies, becomes disabled, or reaches age 59½. The penalty for early retirement account distributions and nonqualified withdrawals from Roth accounts is 10%. Nonqualified withdrawals from HSAs will be subject to ordinary income tax and a 20% penalty. After age 65, individuals can take money out of HSAs penalty-free, but regular income taxes will apply to funds not used for qualified medical purposes.
3) Age 50 or after 25 years of service for public safety officers

Three Ways to Invest in Yourself

Investing in yourself means focusing on your personal growth and well-being. By fostering a stronger "you," you might be in a better position to give your time and energy to other people and things, including your financial goals, which require discipline, perseverance, and often sacrifice to maintain a robust savings effort month after month.

Here are three areas you might target.

Your health and well-being

Staying active is critical to maintaining good physical and mental health, and it might make it easier for you to tackle all the tasks, financial and otherwise, on your plate each day. Feeling sluggish, stressed, or sore? Having trouble sleeping? To get on a better health track, consider joining a gym, working with a personal trainer or nutritionist, taking a fitness class, experimenting with a wearable fitness tracker, or buying home exercise equipment. Or you might invest in an ergonomic office chair, a stand-up work desk, or a new bed and pillows.

What about your diet? To take your eating habits to the next level, consider investing in some new kitchen equipment and/or appliances; signing up for a food delivery service that sends ingredients for healthy meals right to your door; or trying new cookbooks and recipes to discover dishes you enjoy.

Could you use more peace and quiet in a 24/7 world? To enhance your inner solitude, you might invest in a cozy chair, small desk, greenery, soft lighting, and assorted furnishings to create a quiet spot for reading, reflection, or meditation.

Your lifelong learning

The world is a big place, and there is so much to see and do. Trying something new outside your normal routine or comfort zone can provide inspiration and a fresh perspective. Possibilities include traveling to a new destination, investing in new equipment for outdoor recreation, enrolling in an adult education class, or getting involved in a new project or hobby.

Your everyday life

Still wearing clothes, eyeglasses, or a hairstyle from your younger days? Trying to get by using an older laptop, phone, or printer? It might be time to update your wardrobe, look, or tech gadgets.

By investing in yourself today, not only might you feel better now, but you might reap future benefits, too, in the form of potentially lower health-care costs, a wider social circle, expanded hobbies and experiences, and a new perspective on life.

Ed Slott is a professional speaker and the creator of several public television specials, including "Retire Safe & Secure! with Ed Slott." He is the author of *The Retirement Savings Time Bomb...And How to Defuse It* and many other books about IRA planning.

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The Roth option

Roth IRA contributions are made with after-tax funds, so they can be withdrawn without penalty at any time. Qualified withdrawals of earnings are also tax-free, regardless of how much growth the account experiences. For distributions to be considered qualified, the account must meet a five-year holding requirement, and the withdrawal must take place after age 59½ (or result from the owner's death or disability).

However, the ability to contribute to a Roth IRA in 2024 is phased out at a joint MAGI between $230,000 and $240,000 ($236,000–$246,000 in 2025).

When deciding whether to make traditional or Roth contributions, there is another factor to consider. Annual required minimum distributions (RMDs) from traditional IRAs must begin no later than April 1 of the year after you turn age 73, whether you need the income or not. Not only will this raise your income taxes, it could push you into a higher tax bracket for the purposes of calculating Medicare premiums and taxes on Social Security benefits. With Roth IRAs, on the other hand, original account owners never have to take RMDs.