

# Prime Capital

FINANCIAL



**5 THINGS YOU NEED TO KNOW  
FOR A SUCCESSFUL RETIREMENT**



# 5 THINGS YOU MUST UNDERSTAND FOR A SUCCESSFUL RETIREMENT

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## #1: THE CHALLENGE OF CREATING MONTHLY INCOME FROM YOUR RETIREMENT ACCOUNTS

Most people have been working diligently their entire careers, saving, and putting away as much money as possible in their 401(k)s, IRAs, and other investment accounts for that day in the far-off future when they will finally be able to retire. If you are an entrepreneur, you have probably put away even more for retirement because of all the tax-advantage options you have available to you as a business owner.

This is the accumulation phase when you are living on your paycheck or earnings and saving what's left over—as much as you can afford—for later in life.

Decades go by quickly. Your kids grow up, graduate from college, get married and have families of their own. You've hit many of your life milestones, and as you reach age 55 to 60, you may suddenly notice that your time horizon to retirement is getting shorter. So, you start putting away even more, beginning to ask yourself when you will have saved up enough money.

Do you need to have a million dollars? Or a million and a half? Will you need more than that?

Asking how much money you need to have saved for retirement is actually the wrong question. Even wealthy retirees with millions of dollars can run out of money in retirement. It's all about balancing your desired retirement lifestyle with the reliable income streams you can generate from what you have accumulated.



The question you should be asking yourself now is not how much money you need to have saved, or which accounts you should empty out first, it's **what are you going to spend your time doing?** This is a serious question that needs a lot of thought as well as some realistic answers.

Are you planning to visit your grandchildren as much as possible? Do they live far away? Think about how many visits you want to make and how much transportation and other costs will be involved annually, then write that down. Do you want to take a couple of cruises every year, maybe invite the whole family on at least one of them as a life-changing adventure that you can all share? Where will you go, and what will those trips cost? Do some research into your bucket-list travel, calculate what estimated funds you'll need and write that down. Or maybe you're more of a homebody. Do you have equity in your home? Want to remodel your house—perhaps a better kitchen, a new swimming pool, or new planting beds and a greenhouse to satisfy your green thumb? Or perhaps you've been dreaming about a second home. Or making a big move, selling it all and downsizing. Everyone's life ambitions are different.

The time to consider your retirement lifestyle is now, before you retire. What you want to do as well as where and how you want to live allows you and your financial advisor to create a realistic budget for your retirement lifestyle expenses. Then you can add in your fixed expenses like housing, utilities and food, as well as factor-in inflation, set aside liquid funds to cover unexpected expenses, and determine how you will cover health care costs and income taxes. Retirement planning also includes a plan to optimize your Social Security benefits and consider your Medicare premiums, which are based on your income two years prior to retirement. It's a huge undertaking to put all the pieces of your plan together, not the least of which is creating a reliable income stream from your retirement assets.

Retirement is known as the decumulation phase of life—where you're taking money out of savings instead of putting money in—and that's why planning is critical. Knowing what you want to do in retirement is the only way you will really know how much money you need to save, and therefore when you can retire.

**Having a spending plan along with adequate streams of income is the number one thing you need to know to retire successfully, and it all starts with your retirement lifestyle.**







## #2: WAYS TO REDUCE TAXES BEFORE YOU RETIRE

When it comes to “winning” the retirement game, understanding your taxes may be just as important as saving money. And unfortunately, many people getting ready to retire simply do not understand the negative impact income taxes may have on their nest egg in the future.

If you’ve been putting money away in a traditional, non-Roth 401(k) or similar traditional retirement account on a pre-tax basis, you will owe ordinary income taxes on all that money. (Or your heirs will.)

In fact, the IRS requires you to withdraw money from your traditional retirement accounts and pay ordinary income taxes on the amounts withdrawn every year beginning at age 73, whether you need the money or not. (NOTE: The age has been raised to 74 in the year 2030, and age 75 in 2033.)

These mandatory withdrawals are called required minimum distributions (RMDs) and they come with strict rules regarding which accounts must be tapped by which percentages. Additionally, they must be completed no later than December 31st by midnight each year—there’s no grace period until April 15 (Tax Day). And if you handle RMDs incorrectly—say, withdrawing from the wrong accounts in the wrong percentages—tax penalties apply, although the former excise tax penalty of 50% of taxes owed dropped to 25% after the passage of the SECURE Act 2.0. (The new law states that the penalty drops further to 10% plus taxes owed if you fix your mistake within two years.)



But let's examine how income taxes and RMDs might affect you. Let's say you have a million dollars in a traditional 401(k). If your tax bracket remains relatively low throughout retirement, for example, as low as 2024's 12% rate for a married couple earning from \$22,001 to \$89,450, you may end up paying \$120,000 of your million to Uncle Sam. At the next bracket, which is currently 22%, you may pay \$220,000. But tax brackets are set to go back up. On January 1, 2026, tax brackets will return to 2017 levels and the earnings amounts in each bracket will be adjusted for inflation.

So, let's say taxes go up, you're in a higher bracket and you end up owing 35% in income tax on that \$1 million, or \$350,000. That's more than a third of your retirement savings paid to the IRS, which means you only have two-thirds of what you thought you had to spend in retirement.

This is yet another reason why pre-retirement is a time when you really should seek help—anywhere from five to 10 years before you plan to retire. Financial professionals with experience in retirement will help you plan to mitigate income taxes, but they often need a few years to help you implement the strategies that may help you.

A knowledgeable financial advisor and tax professional can help you do future tax calculations related to your actual situation. You may be able to potentially lower your future tax burden by shifting funds from tax-deferred, taxable accounts like traditional 401(k)s into tax-free accounts like Roth IRAs, or other alternatives. Of course, you will still have to pay income taxes on taxable amounts. But depending on your situation, a series of Roth conversions just before retirement, or during the first years of your retirement when your income is low may reduce your overall tax burden over time, especially if taxes go up in the future.

Be sure to seek professional help because Roth conversions cannot be undone, and they are subject to numerous IRS rules and regulations.

If your financial and tax team finds that Roth conversions will likely help you for the long-term, remember that, while you will owe income taxes on conversion amounts during the tax years you convert money, you won't owe taxes later under current tax law. Furthermore, RMDs are not required from Roth accounts, and Roth accounts are not taxable to your heirs.







In fact, that's an important point. Creating tax advantages for your non-spousal heirs has become more important since the passage of the original SECURE Act when rules for inherited accounts changed. Since 2019, non-spousal heirs must not only drain traditional 401(k) and IRA accounts within 10 years of inheritance, but heirs must also take annual RMDs based on the original account holder's schedule. This income tax burden can really erode any legacy you hoped to leave them.

Finally, surprise! You need to understand that even your Social Security benefits can be taxed up to 85%!

Once you have started receiving Social Security benefits, each tax year, you must do a "provisional" or "combined" income calculation. To determine annual provisional income, the taxpayer must add their gross income before Social Security benefits (including any RMD amounts from taxable accounts), plus any tax-free interest received from investments, and finally, you must add in one-half of your Social Security benefits. This formula will give you your provisional or combined income for the tax year.

Under current law, if you are married and your joint provisional income adds up to more than \$44,000, 85% of your Social Security benefit will be taxable. That's a pretty easy income number to hit, and this comes as a shock to many Americans. In fact, since Social Security became taxable in 1984, an estimated 48% of Americans pay taxes on at least a portion of their Social Security benefits!

**Understanding taxes—and how to minimize them—is an important part of retiring successfully. Make sure you assemble a team who can help you.**

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## #3: HOW THE STOCK MARKET FITS IN DURING RETIREMENT

When it comes to the stock market, the first thing you need to understand is that there is a difference between what is sometimes called the “accumulation” versus the “decumulation” phases of your investing life.

During the accumulation phase, you still have a long time-horizon to retirement. For investors comfortable with market risk, historically your portfolio can weather recurring stock market downturns and come out ahead in the long-term, so long as you stay invested. In fact, “dollar-cost averaging” can even allow you to pick up bargains during market downturns if you continue to invest steadily.

But what about the decumulation phase? Decumulation begins when you retire and stop getting a paycheck or earning income. Suddenly all the money you’ve been saving for retirement now has to be used to pay for your living expenses for your entire remaining lifetime. Before you retire and hit the decumulation phase, most advisors recommend you lower your level of portfolio risk because protecting your assets is critical, especially as these assets must last during the 15, 20, even 30 years you will live in retirement.





However, you should know that many financial professionals, especially those working for banks and large brokerage firms, focus on accumulation rather than decumulation. While they might talk about “diversification” between asset classes and types of stocks (i.e. international, commodities, large cap, mid cap), they are captive to their firms, and their firms have proprietary investment products. They mainly manage assets by splitting them between stocks and bonds, and the number of possible choices they offer clients is limited. They usually don’t offer much in the way of alternatives or what are called non-correlated investment options—meaning investments not tied to stock market performance.

This brings up another point. Bonds are considered lower risk and banks and brokerages usually move people into more bonds and less stocks as they get older, sometimes using a principle called the Rule of 100. This rule basically states that you should hold a percentage of stocks that is 100 minus your age. Thus, if you are 70 years old, your portfolio should be comprised of 30% stocks and 70% bonds. While individual bonds themselves, such as Treasuries that you can purchase from the federal government might be considered less risky than stocks, bond funds might be correlated with the market, meaning they might go down in value when the market goes down. Once again, a captive financial professional at a bank or brokerage firm sometimes won’t differentiate between investing in individual bonds versus bond funds. And they also rarely disclose fees.

When it comes to fees, you might be paying fees you didn’t even realize, which can really erode your retirement savings over time. Even a 1% higher fee can add up to hundreds of thousands of dollars lost over 20 years’ time. Independent advisors, depending on the way they are structured or licensed, may be required to be completely transparent, disclosing all fees to you. Be sure to ask!

Additionally, when it comes to retirement, captive financial professionals at banks and brokerages may have a simplistic retirement planning procedure. They may name a big number you must accumulate, be it \$1 million or \$2 million or more, before they say, “you can retire now.” Then you’re on your own to start drawing down whatever percentage they recommend. They don’t typically consider taxes, nor are they equipped to help you with other retirement strategies. Nor is any real thought given to sequence of returns risk.

Sequence of returns risk, simply put, is the risk of negative market returns occurring right before you retire and/or very early in your retirement. During this time, market downturns can have a much more significant impact on your money directly invested in the market if you are pulling money out to provide retirement income. Sequence of returns risk applies to vehicles like employer-sponsored retirement accounts, traditional and Roth IRAs, mutual funds, brokerage accounts, variable annuities and any other assets that can lose value during market downturns.



### Sequence of Returns Risk Example: John versus James

Let's consider two retirees, and what happens during their first 10 years of retirement. Both John and James have \$1 million saved in the market, and they have both determined they need to withdraw 5%, or \$50,000 per year, from their accounts to fund their lifestyles.

John is lucky. He retires and then proceeds to experience eight years of a bull market, growing his portfolio by 5% each year. In the next two years, however, he experiences declines of 5% annually.

James sees the exact opposite sequence. He immediately encounters a two-year bear market upon entering retirement, which drops his accounts by 5% annually in the first two years. Then the market rebounds, going up 5% each year for the next eight years.

Both retirees continued to withdraw \$50,000 per year from their accounts. So, what is the result?

Even though both retirees had the same initial balance, withdrew the same amounts, experienced eight years of bull markets and two years of bear markets, the order or "sequence of returns" made a big difference.

John didn't experience market dips at the beginning when his account balances were highest. At the end of the 10-year period, he still had \$788,329 left in his account. James wasn't so lucky. He took losses during the first two years of his retirement, on his highest balances, and by the end of the 10-year period, had only \$695,226.

Please remember this example is purely hypothetical and not reflective of real scenarios or real people. We simply used a starting balance of \$1 million for each person, then subtracted \$50,000 in income at the beginning of each year, then multiplied the accounts' balances by the annual positive or negative effect on the market we imagined for this example. Actual market returns are unpredictable and tend to vary far more than in the case study shown. In fact, during the global recession of 2008, many retirees were forced back to work because their retirements were wiped out. This example is strictly to display the potential effects of sequence of returns risk—actual results could be better or worse depending on unpredictable market returns.





As opposed to advocating the accumulation of a certain number like \$1 million, then a certain annual withdrawal percentage like 4%, some financial advisors focus on helping people who are five to 10 years away from retirement with detailed retirement planning strategies and risk management, including tax planning strategies, monthly income planning and much more. For their retirement clients who have accumulated a great deal of money, sequence of returns risk may be lower. In fact, for those with high net worth, retirement planning may be more a matter of finding potential ways to mitigate taxation, cover health care expenses, pay for long-term care future expenses and create a tax-advantaged estate plan.

But for their retirement clients who haven't accumulated as much, avoiding sequence of returns risk may be a more important priority in the retirement plan. For them, it may make sense to take part of their retirement savings and purchase what could be considered a "private pension", or annuity guaranteed by the strength of an insurance company to provide a certain amount of income to supplement other guaranteed sources like Social Security. The goal is to cover living expenses so that the money in the remainder of the portfolio doesn't have to be withdrawn from the market during economic downturns, thus avoiding sequence of returns risk. The retiree then can cover expenses but still take advantage of potential market gains until a future time when the balance of the portfolio might be needed or can be passed on to heirs, hopefully during times of market upswings.

**It's important to work with a financial advisor who focuses on financial planning and understands things like sequence of returns risk and how to create and optimize retirement income streams. Market risk should match both your risk tolerance as well as your individual financial situation and the need for reliable income that lasts throughout retirement.**

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## #4: FILING FOR SOCIAL SECURITY CORRECTLY

When it comes to Social Security, often people don't understand that the age you begin collecting benefits has a big impact on the amount of money you ultimately get from the program. The key age to know is your "full retirement age." For people born between 1943 and 1954, full retirement age is 66. It gradually climbs toward 67 if your birthday falls between 1955 and 1959. For those born in 1960 or later, full retirement age is 67.

The earliest age you can file early for Social Security benefits is 62, but according to the SSA, filing at age 62 will reduce your benefit by about 30% compared with waiting until your full retirement age of 67.

Many people aren't fully educated on the advantages of waiting, since almost 30% of Americans file early at age 62. The average benefit is \$1,287.61 per month for those who file at age 62, while it's an average of \$2,399.86 for those who file at age 67.

And waiting just a few more years can pay off even further. For each year you wait past your full retirement age, 8% is added annually to your Social Security benefit, until you reach age 70. This may make sense for many people, since retirement may be longer than we think. According to the SSA, about one out of every three 65-year-olds today will live until at least age 90, and one out of seven will live until at least age 95.





But while waiting might be best for many, depending on your health, marital status, or employment situation, filing early may be the right option for you.

For those who are married, widowed, or divorced, there are even more considerations and options in filing for Social Security. Working with a financial advisor can help you determine the best time to file for your unique situation so that you optimize your overall benefits. For instance, if your spouse is old enough to claim their Social Security benefit, you could file to receive 50% of their benefit at your own full retirement age, while your spouse waits and files at age 70 for their maximum amount. In other words, both spouse's options should be calculated and added together for the long-term benefit of both.

A widow or widower can file for what is called a survivor benefit, which is worth 100% of what your spouse was receiving or would have been eligible for, or your own benefit, whichever is greater. And those who are divorced—provided they were married for at least 10 years, are age 62 or older and have not remarried prior to age 60—can qualify to receive a benefit based on their ex-spouse's work record. (An ex-spouse will never know because you apply for the benefit directly through the Social Security Administration, and taking a benefit on an ex's record has no effect on his or her benefit, nor the benefit of any new spouse they may now have.)

Importantly, while marriage brings more options when it comes to Social Security planning, there is a critical issue for which it's important to plan. When both people in a marriage are receiving Social Security checks, one of the checks will stop when a spouse passes away. The larger of the two checks will continue, but your retirement plan must consider that one check plus other income sources must eventually cover all of the living expenses for the surviving spouse.

Another crucial issue to address is that the Social Security program itself may have a solvency issue. By 2034, Social Security is expected to be able to pay only 78% of the full benefits owed. New legislation, policy changes, raising the cap, or payroll tax hikes could mitigate future projected shortfalls, but it's best to retire with a long-term retirement plan in place that covers your risk of losing at least some Social Security income.

Lastly, and surprisingly, Social Security benefits are often taxed. Refer to the last paragraphs of “#2: Ways to Reduce Taxes Before You Retire” to learn more.

**There are many factors to consider when deciding when and how to file for Social Security based on your unique circumstances. A financial advisor who specializes in financial planning can help you create a customized plan to generate retirement income, including the optimization of your Social Security benefits.**

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## #5: WHAT HEALTH CARE MAY COST

Health care costs are rising, and according to Fidelity's latest study from 2023, health care is expected to be one of the largest expenses in retirement after housing and transportation costs. On average, a retired couple, age 65, will need approximately \$315,000 saved (after tax) to cover Medicare premiums, deductibles, co-pays and other out-of-pocket expenses for services and prescription drugs.

It's a big number to plan for, and Fidelity's estimate does not include other health-related expenses, such as over-the-counter medications, dental services, or hearing aids.

These enormous costs often surprise retirees, who may have been under the impression that Medicare was free. In fact, it isn't, and premiums are often deducted right from Social Security checks. This is yet another reason retirement planning is so important.

For most people, Medicare Part A is free, and Part B costs \$174.70 per month per person in 2024. But Part B premiums are higher for those with higher incomes. Called the Income-Related Monthly Adjustment Amount, IRMAA is an amount you may pay in addition to your Part B or Part D premium if your income is above a certain level.

The IRMAA table for 2024 goes as high as \$594 per month per person for those with modified adjusted gross incomes of more than \$500,000. And the Social Security Administration determines if you owe an IRMAA based on the income you reported on your IRS tax return two years prior to filing for Medicare.





Understanding that income matters when it comes to your Medicare premium can make a difference in your retirement strategy. Although you must file for Medicare within a 7-month period, which starts three months prior to the month you turn 65 and lasts until three months after, you may qualify for a special enrollment period if you have qualifying health insurance past age 65 through your own or your spouse's employer.

This may give you extra time to adjust your income before filing to receive Medicare health benefits.

The fact that Medicare does not cover long-term care is yet another important consideration in your financial planning. Although a stay of up to 100 days may be approved after a major health event, ongoing coverage for help with custodial care or daily living activities is not covered by Medicare, whether it's needed for physical health reasons or because of dementia or Alzheimer's. Long-term care can quickly wipe out even a robust portfolio of retirement savings, and 70% of seniors will need some form of care in their lifetime. In 2023, the annual median cost of a semi-private room in a nursing home was \$94,896. For those who haven't planned, the costs can be catastrophic.

Qualifying for Medicaid, the government's program to provide low-income seniors with nursing care, requires a drastic spend-down of nearly all assets, with a five-year lookback period. Attempting to hide money or assets can result in major penalties, and you may leave your spouse or family members financially devastated if Medicaid is required.

**Be sure to plan for the costs of health care, including Medicare premiums, deductibles, co-pays, and out-of-pocket costs, as well as coverage for long-term care expenses in order to retire successfully and protect your legacy for your loved ones.**



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