Should You Delay Taking Social Security Payments and Other Client Questions

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski: Hello everybody, and welcome back to 'Keen on Retirement.' I'm your co-host, Steve Sanduski. With me today, we've got Mr. Bill Keen and Mr. Matt Wilson. Hey guys.

Bill Keen: Hey Steve, good to be back on the program with you again today. Matt, thank you once again for stepping into the studio with us. We always appreciate having you here with us.

Matt Wilson: Well, thank you. I'm glad to be here.

Steve Sanduski: Well, great. Well, we've got the brain trust going here, and today what we'd like to do is we're going to answer some listener questions. Bill and Matt, you guys obviously, you're meeting with clients all the time and getting lots of questions that are coming up. Every so often, we like to do an episode where we share some of the questions that seem to be on the minds of our listeners, and of your clients. Why don't we jump into that? Let's start with the first question.

Bill Keen: The first one was around saving in retirement. When we're asking clients to really get clear on their budgeting in retirement, we see the line item, quite often, of saving.

One of the things that we see folks doing is wanting to accelerate money out of their retirement accounts, triggering a tax to build up money into a bank account. There's a psychological aspect that could make sense to that, and we always recommend folks have enough money set aside in the bank account where they know they can get to it, and they don't have to call us or anyone to get access to that capital. Most of the time, it's more about rethinking that and just knowing that those funds are available, if needed, from the IRA accounts.

The other thing that we're seeing a lot of questions on now is how to claim Social Security. There's been so much banter about the different nuances of social security, and we wanted to just take a moment and go over those here on our episode today. One is delaying filing. One of the greatest risks that we see to retirement income is living longer than anticipated, and you hate to say that's a risk, don't you, Steve? I'd like to live longer, wouldn't you?

Steve Sanduski: Well, as long I can be healthy longer.

Bill Keen: That's right, that's right. There's a definitely a caveat there. Now, if you're a married couple where both spouses are 65, there is now a 50% chance one will live to 92. There's a 25% chance that one will make it to 97. As we look at how Social Security works and with 10 year treasuries, if you look at interest rates in the US here, paying barely over 1% now ... that guaranteed 8% increase for each year that you delay your Social Security payments for life, it's hard to beat if you look at the time value of money and you expect to live out into your 90s.

In the planning process, we go through all the Social Security strategies, and look and compare, and make educated decisions. One of the other strategies that you might know about that we've talked briefly about, but really deserves attention, is that last year Congress did away the popular file and suspend strategy

Matt Wilson: That's right. Congress got rid of the file and suspend strategy, but they still grandfathered folks into the restricted application. If you were 62 years or older as of January 1st, 2016, then you can still qualify for this. You go down to the Social Security Administration when you turn 66, your full retirement age ... It could be 66 and some months, depending on your birth year. You tell them, "I'm going to restrict my application to only the spousal benefit." The reason that you would do that is because then your benefit is not impacted at all, and that would continue to grow and accrue up to a higher amount, up to age 70.

There is one caveat that Congress did factor in which changed this a little bit, was your spouse has to be already claiming social security for you to do that. Prior to the Congress rule changes last year, that was not the case. They could do their file and suspend, and then you could do the restricted application. Now, that spouse has to be receiving a check from Social Security for you to apply for the restricted application.

Bill Keen: The other thing has come up quite a bit in the practice with relating to Social Security is the survivor benefits.

Matt Wilson: Yeah, with longer life expediencies, the survivor benefit, it doesn't get as much attention as it should the surviving spouse gets the higher of the 2 benefits. If you've delayed your benefit, and you've maximized it ... Let's say you waited until age 70, and you got the maximum amount, which in some cases, that's nearly

$40,000 in today's dollars for someone to claim Social Security. That would then the surviving spouse's amount. Now, theirs would go away. Whatever they were receiving would stop, but then they would get the higher benefit. What you're, in essence, you're locking in a nice benefit for your spouse,

Bill Keen: There's another one out there that's folks have been asking about a couple times here recently. We had a client who was looking to buy a house, and needed what I would call "bridge funding." Basically what that means is just a short term loan. They have a house they're trying to sell, but they've, or getting ready to make an offer on the house that they would like to buy. They needed the down payment for the new house. One of the places that you can go to is, your IRA account and as long as you get back within 60 days, it was as if it never happened, tax wise.

What it does though, is sets you up for a big problem if it goes over into day 61. It could trigger the taxes, and if you're not 59 and a half, it could trigger penalties as well. We don't necessarily recommend this strategy, because any times you open yourself up with a time frame like that, it creates a potential problem.

The IRS just came out recently, and given us 10 reasons that they will allow you to not have to pay the penalty. I was going to read the reasons real quick, Steve, here. Some of these might apply to you if you take a distribution, so I wanted you to be aware of these, okay?

Steve Sanduski: Okay, but let me just ask a clarifying question here. If I have an IRA, and I want to pull out $100,000 for this short term loan, say I need it for 45 days. Are you saying I can pull $100,000 out of my IRA, use it for whatever I want for 45, actually up to 60 days, and then do I put it back into the same IRA? That's one question. Then, the second is, you were talking about if I'm in a 401k, for example, and I pull out my money from the 401k, and I want to roll it into an IRA. In that case, I still have that 60 day window to move it from the 401k to the IRA. Are we talking 2 different things here?

Bill Keen: Yeah. They're 2 different things on a high level, but really they're not. It's about taking money out of a qualified plan, and whether that's an IRA or a 401k, and If you take constructive receipt of that money, meaning that you can cash the check.

Steve Sanduski: Right.

Bill Keen: I mean, it had your name on it, you could cash the check, then you now have 60 days to get that back into another qualified plan.

Steve Sanduski: But.

Bill Keen: Somewhere, it doesn't have to be the same one.

Steve Sanduski: But it could be the same one?

Bill Keen: It could be, yes.

Steve Sanduski: Okay.

Bill Keen: Sorry.

Steve Sanduski: I could get a short term 60 day loan from my IRA, or my 401k, and put it right back in within 60 days.

Bill Keen: On the 401ks, if you're still employed.

Steve Sanduski: Yeah, that's all ...

Bill Keen: Now we're taking down another road.

Steve Sanduski: Yeah.

Bill Keen: It's a 401k loan, in that case.

Steve Sanduski: Yeah, okay. We'll save this for another episode.

Matt Wilson: Different roles and restrictions on that.

Bill Keen: That's right. Knowing that there's a pool of money, most financial institutions will not loan money against an IRA, because it's pre-tax money. I think we ran across one, we heard about, I don't have any personal experience with it. Didn't we run across one, Matt, that somebody said?

Matt Wilson: Yeah, I've seen advertisements for a bank, a local bank here in Kansas City, that would do loans against an IRA. I'm not sure how it's structured.

Bill Keen: Yeah.

Matt Wilson: But they advertise it.

Bill Keen: The reason why most institutions wouldn't use an IRA as collateral is because it's not really the collateral, there's going to be taxes withheld in an IRA when it comes out,... I haven't seen a lot of active loans being offered against IRA accounts as collateral. The 60 day things gives folks a little bit of flexibility. The problem, though, is, if you don't get it back, then ... you have to pay the piper.

Matt Wilson: Yeah.

Bill Keen: It can be taxes and the potential penalty.

Matt Wilson: Okay.

Bill Keen: Now however, you know, our last episode, we talked about the IRS scams now. It wasn't really the IRS pulling the scams.

Matt Wilson: Right.

Bill Keen: We'll talk about the IRS today. It used to be if you had a real reason that you missed the 60 day rollover, such as a death or a disaster of some kind, that you could submit a private letter ruling to the IRS. It costs about $10,000 and it's a log of time waiting for their determination. Now what they're saying adds a little bit of relief here that if you miss the deadline, they're going to allow you to self-certify that the reason for the oversight is excusable, as long as it applies to one of these things, are applicable.

Here they are. One, the financial institution receiving the contribution, or making the distribution, was in error. If it's their fault, the financial institution. Two, the distribution was made as a check, it was actually misplaced and never cashed. The distribution was deposited into and then retained in an account that the taxpayer mistakenly thought was an eligible retirement plan. The next one, the tax payer's principle residence was severely damaged. The member of the taxpayer's family died. If the taxpayer or a member of the taxpayer's family was seriously ill. Restrictions were imposed by a foreign country. I'm not sure exactly what that one means. A postal error occurred, that never happens, right?

Matt Wilson: That's right.

Bill Keen: The distribution was levied and returned to the taxpayer after the rollover deadline. The party making the distribution did not provide timely information that was required by the receiving plan or IRA to complete the rollover. A couple of those are kind of all pointing back to the institutions involved, making a mistake. Finally, Steve, you will get relief if you are incarcerated over that 60 day period.

Steve Sanduski: That's good to know, yeah.

Bill Keen: We were trying to figure this one out. I guess if you take a rollover check, and then in that 60 day period, something happened, I guess, and you had to go away for a bit. They would have some leniency on you when you got back and got that deposited.

Matt Wilson: Yeah, a few of those, it sounds like the IRS has a soft spot in their heart. The one where they thought they deposited into a qualified plan, I could see a lot of ... finagling on that one.

Bill Keen: Right, right.

Matt Wilson: Saying that they thought they deposited it in the right account.

Bill Keen: Would that be including buying a boat, or a new car?

Matt Wilson: I guess, yeah.

Bill Keen: Okay.

Matt Wilson: Yeah.

Bill Keen: All right.

Steve Sanduski: It's nice to see that the IRS is helping us out a little bit, because I mean, you guys know real well, people do make honest mistakes when it comes to these rollovers and stuff. I know in the past, there's been horror stories about people that lost a lot of money because they didn't do this properly, but it wasn't really through their own fault. A victim of circumstances. Yeah, it is nice to see.

Bill Keen: That's right.

Steve Sanduski: That we do have some leeway here from the government, and they recognize that.

Bill Keen: That's right, and I do believe that it makes a lot of sense because filing a private letter with the IRS, it would just be onerous for an individual to follow the bat through.

Steve Sanduski: Yeah.

Bill Keen: Especially on something that they could ... Like, this says, they can self-notify and come up with, file a form and be set. There's a couple more, and I know we're going through them quickly here, but this is a big one. There's a lot of fear around it, too, out there, and it's around required minimum distributions. A lot of folks know that when you hit age 70 and a half, you're required to start taking money out of your IRA account in minimums based on a schedule that the IRS provides.

If you do not take your minimum distribution when you are supposed to, the penalty is 50% of what you should have taken. That can start to add up pretty quickly.

There's a couple of ways around this now, and I know Matt, you've gone over it several times with folks here recently. Luckily, the way our firm operates is we make sure folks get their minimum distributions. We talk about checklist driven processes here. This is one that's kind of at the top of the list for folks that are over 70 with us.

Matt Wilson: Yeah, and you know what's interesting, too. We talk about the penalty being 50%. Now let's say you realize that it's been several years that you forgot, or maybe it was a parent of yours that mistakenly forgot. Not only would there be a penalty, there will be interest on that penalty, too.

Bill Keen: Sure.

Matt Wilson: That number will creep up, and it will get much higher than 50% based on what they tell you.

Bill Keen: Basically, you take it or they take it.

Matt Wilson: That's right. If you happened to miss the RMD there's a process to possibly get out of the 50% penalty. The first step is just to admit your mistake, you make that distribution. You get with your custodian, and you have that distribution, and you have that file. Then along with that, there is a tax form, tax form 5329. That form is called "Additional Taxes on Qualified Plans." You'll file that for each year that you missed your required minimum distribution.

Essentially what you're requesting with that tax form is a deferral, or a waiver of that 50% penalty. Then along with that form, it is recommended that you write up a letter and explain what happened. Again, apologizing for what you did, as soon as you realized that you missed your required minimum distribution, that you took the distribution. You can lay out that the reason for it, as to whether it was just an oversight, or it was a custodial error, or whatever it was.

Bill Keen: Almost like this other one we talked about.

Matt Wilson: That's right, yeah. There's no promise that the IRS will waive it, but if you basically can prove that it was a reasonable error. You know, reasonable error, that is what the IRS is going to look at. If they do waive it, they will give you a letter explaining that they did waive it. You would save that letter, that is recommended to keep that with your tax forms~~,~~ in case anyone ever comes back, or if they come back in the future and not realize it. There's no guarantee.

Bill Keen: Yup.

Matt Wilson: That they will get out of it, but it is within other professionals that we work with, and especially tax professionals that have had this happen with some of their clients in the past. They have said it's generally expected that the IRS will waive one of them, if you had it happen, that they would waive that.

Bill Keen: It's not to be taken for granted though, is it? Both of these things we're talking about, it seems like the IRS is doing things that make sense, and that are reasonable for people.

Matt Wilson: Yeah.

Bill Keen: As long as it's not abused, and repeated.

Matt Wilson: That's right. It's complicated, so they are giving some folks some leeway a little bit.

Bill Keen: That's right. Steve, we bring good news today, with respect to the IRS. How's that for you?

Steve Sanduski: That's good, very good. Yeah. You don't always think of the IRS as the bearers of good news.

Bill Keen: That's right. The bearers of kind of good news.

Matt Wilson: Yeah, I guess it's canceling out the bad news.

Bill Keen: Right, yeah.

Steve Sanduski: Yeah, yeah. At least they have some sympathy if you make a honest mistake here.

Matt Wilson: Along those same lines with requirement of distributions, I came across this survey and it was a survey that was given to advisors on requirement of distributions, and the aggregation of them. Again, this displays how complex this can be, and why I believe the IRS has a little bit of flexibility.

Bill Keen: Yes.

Matt Wilson: When it comes to it.

Bill Keen: You're saying this is for ... this was something that was given to an advisors?

Matt Wilson: It was!

Bill Keen: A question for advisors.

Matt Wilson: It was a question for advisors.

Bill Keen: Okay.

Matt Wilson: The understanding how different accounts, what the requirement of distribution has to come out of them, different retirement plans, and how that works.

Bill Keen: Okay. I'm starting to feel like there could be a question coming, Steve.

Steve Sanduski: Okay.

Matt Wilson: Well, here is the question.

Bill Keen: Okay.

Matt Wilson: I'll pose it to both of you, and I have the answer. Mike is 73, and he is subject to required minimal distributions for all of his retirement accounts. He has two IRAs, two 401ks, two 403bs, an inherited IRAs from his mother and his father. What is the minimum number of accounts from which Mike must take a distribution in order to avoid a penalty? Now here, it's multiple choice. I'll give you those.

Bill Keen: Did you get all that, Steve?

Matt Wilson: Yeah, that makes...

Steve Sanduski: Yeah, I did, and I've got my answer.

Matt Wilson: Okay.

Bill Keen: Okay, so let me just restate what I've got.

Matt Wilson: Yes sir, yup.

Bill Keen: We got Mike, he's 73. He's firmly over the 70 and a half. He's got two IRAs, I'm assuming those are in his name?

Matt Wilson: Those are in his name.

Bill Keen: He's got two 401ks.

Matt Wilson: Yup, those are his also.

Bill Keen: Those are currently at ex-employers, is that right?

Matt Wilson: Ex-employers. He is retired.

Bill Keen: Okay. He's got two ... He's retired, okay. That's a good part of it to know. He's two 403bs, are they at different ex-employers as well?

Matt Wilson: That's correct.

Bill Keen: Boy, Mike jumped around a lot in his lifetime.

Matt Wilson: You know, he's kind of like these millennials these days.

Bill Keen: He did save some money though.

Matt Wilson: Didn't stay very long. Yup.

Bill Keen: That's the thing I like about him. He's inherited an IRA from his mother, and he's inherited one from his father.

Matt Wilson: That's correct. A lot of IRAs for Mike.

Bill Keen: All right, and tell me the question once again.

Matt Wilson: Okay, so the question is what is the minimum number of accounts from which Mike must take a distribution in order to avoid a penalty?

Bill Keen: Okay.

Steve Sanduski: You want to go first, Bill?

Bill Keen: Yes. I'm going to say 7. The reason why I say that is I think he can combine his IRAs, take it from one of those. You do have to take it separately from each 401k. You have to take it separately from each inherited IRA, and I believe you have to take it separately from each 403b as well.

Steve Sanduski: Well, I'm going to say ... and Matt, didn't you say this was going to be multiple choice.

Matt Wilson: There is a multiple choice, so do you want me to get?

Steve Sanduski: Yeah, what are our choices?

Matt Wilson: Okay. A) is 8, B) is 4, C) is 1, and D) is 6.

Steve Sanduski: Okay.

Matt Wilson: E) is 7.

Bill Keen: Okay, so 7.

Steve Sanduski: Yeah.

Bill Keen: Good, I thought 7 wasn't even on there. I was like, in trouble. Anyways.

Steve Sanduski: I'm going to go with 'C.' I'm going to say it's one. I'm going to say that you have to calculate the RMD separately from each account that is subject to an RMD, but I think you can pull it all from one account.

Matt Wilson: Okay, are those your final answers?

Bill Keen: Yeah.

Steve Sanduski: That's my final answer.

Matt Wilson: Okay.

Steve Sanduski: I'm not going to use a lifeline.

Matt Wilson: Okay.

Bill Keen: He sees me over here scribbling. I'm writing down ... I'm recalculating such.

Matt Wilson: Yeah. You can hear his pen.

Bill Keen: I mean, we're here live, so I'm trying to get this right because people expect me to know this.

Matt Wilson: Yeah, so here the answer is D, 6.

Steve Sanduski: Six?

Matt Wilson: It was selected by last than 18% of the survey respondents. Here's why: the most common was C) number one, what you chose, Steve. Six is the answer, and it is because what Mr. Keen said, you can aggregate your IRAs.

Steve Sanduski: Okay.

Matt Wilson: So there's only one on the two IRAs, each 401k must have it's own required distribution, so there's 3 total.

Bill Keen: Three, okay.

Matt Wilson: Now this rule, this is an obscure rule that many people don't know about is 403bs can be aggregated.

Bill Keen: Okay.

Matt Wilson: You only have to take one out of both the 403b accounts. Now we're at 4, and then one for each inherited IRA. There's your 6.

Bill Keen: Steve, we talked about this in the past, but I think we're going to have roll it out at this time. Based on this question, and your and my answers, we have this in effect.

Steve Sanduski: Yes, we missed out. That 403b rule, I didn't know that, Matt.

Matt Wilson: Yeah, that's right. It is obscure.

Bill Keen: All right, so I think the rule here ... or I think the lesson here if you have these accounts scattered about, you either need to be doing some really close tracking on these things, or you need to get things consolidated, don't you?

Matt Wilson: That's right, and to your point, too. Your answer with 7.

Bill Keen: Yes.

Matt Wilson: If you lean to just taking them from each one, you will always have that covered versus trying to aggregate it. If you didn't know.

Bill Keen: Yes.

Matt Wilson: You are better off just being taking them from each account.

Bill Keen: That sounds like a lot of work.

Matt Wilson: It is a lot of work, and as you get older and you have a lot of custodians, a lot of moving parts ... as things maybe go paperless, it's easy to get this stuff confused.

Bill Keen: Yes.

Matt Wilson: And miss one of these things, which I believe is why the IRS does provide some.

Bill Keen: Some leniency.

Matt Wilson: Leniency

Bill Keen: Once or so.

Matt Wilson: Yeah, a little bit. Yeah.

Bill Keen: Matt, there's one other thing that I think we should try to cover today, and that's with respect to the Medicare premiums. We see this coming up a lot with retired folks who are new to Medicare, and their premiums are being calculated based on an income that they had for, what was it, 2 years prior?

Matt Wilson: Two years prior, yup.

Bill Keen: Okay.

Matt Wilson: For example, this year, 2016, you retire this year and you're over 65, so you're going to sign up for Medicare. They are going to base the premium that they charge you on your 2014 tax return. The reason they say they do that is that's the earliest, or most recent data that they have when it comes to your income.

Bill Keen: Most people don't realize that the more money you make in retirement, the more you pay for your Medicare premiums. I think it's 120 or so now is the minimum you can pay.

Matt Wilson: That's correct. $120 a month, per person.

Bill Keen: For folks last year that were under the provision becasue

Matt Wilson: They're grandfathered into the ...

Bill Keen: 105.

Matt Wilson: Yeah, 105.

Bill Keen: The most a individual can pay is somewhere close to $500.

Matt Wilson: It is.

Bill Keen: Is that correct? Yes.

Matt Wilson: It's a multiple of that.

Bill Keen: Did you know that, Steve, that Medicare premiums were based on income?

Steve Sanduski: I did not.

Bill Keen: Yeah.

Matt Wilson: Yeah, so as your income goes up in retirement, you will pay more on your Medicare premiums. Now, this is what most people don't know about. They have a life changing event circumstance to reduce that premium. We had a client just recently go through this. They retired halfway through the year, they got the letter from ... Social Security referencing their premium, and it said "Based on your 2014 income, your premium is going to be increased over and above the $120 a month." The first tier is an additional $50, roughly. He was going to pay ... and he was a single gentlemen. He was going to pay $170 a month for his Medicare premium.

With this life changing event form, he can go down to the Social Security Administration and [said 00:34:30] he has retired, essentially his work has ceased, and his income in 2016 will be less than the thresholds that require an increased premium. Given that information, they will reduce his premium to the lowest amount.

Bill Keen: What he stayed at, basically it will be, correct?

Matt Wilson: He has to state that. If it's not, then they'll fix that once his income comes in. He will state that his income is lower than the threshold. Now, if it's not going to be lower than the threshold, he needs to verify that, too, and say it's going to be within whatever tier it's going to be in.

Bill Keen: That's right.

Matt Wilson: They'll ask that question.

Bill Keen: They'll figure it out eventually.

Matt Wilson: They will.

Bill Keen: What it really was.

Matt Wilson: They'll back charge you for it.

Bill Keen: The issue is we see people coming in who are paying the higher premiums based on what their income was when they were still working 2 years prior, and they think that they're stuck paying the higher premiums until that rolls off. This one piece of paper that Matt mentioned and going down, and letting them know about that can reduce the Medicare premiums to what they should be.

Matt Wilson: That's right. The terminology, if you're going to go down there and do that, is a you want to ask for a new initial determination. One, you have a life changing event, and now you want to ask for a new initial determination and then they'll go through the steps to calculate that, and ask you the questions they need to verify what that is going to look like for you.

Bill Keen: Very good.

Steve Sanduski: Boy, just goes to show, this stuff can get complicated. There's so many combinations and permutations here that it really takes an expert to understand all these nuances, and to use them to the advantage of our consumers and investors.

Bill Keen: That's why you see us spending a lot of time on these things, and talking about having a checklist driven process so that you're not trying to remember all these things yourself. We have a nice checklist, and it's broken down into areas where you can just walk through it and check the boxes and say, "Does this apply? Does this apply? Does this apply?" We just know that we haven't missed anything. It's very important.

Steve Sanduski: Great. Well guys, I think is a good way to wrap up this episode. As always, Bill, Matt, thanks. You guys are giving us some great info, some great advice here, appreciate that. We'll look forward to catching up on the next episode.

Bill Keen: Very good. Thank you, Steve. Thank you, Matt.

Matt Wilson: Thank you.