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The Bedrock Principles of Retirement and Estate Planning

"Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes."

— Judge Learned Hand

We know that many readers don't make it past the first chapter, so we loaded this chapter with some of our most important recommendations for both workers and retirees. If you don't read anything else in this book, please read this chapter. We also encourage you to scan our detailed table of contents and read other relevant chapters or sections. Spending a little time learning the bedrock principles of retirement and estate planning is critical. You will understand the reasoning behind our recommendations and are more likely to implement changes. The difference between the status quo and implementation of optimal strategies could be life changing for you and your family.

Pay Taxes Later—Except for Roths

Don't pay taxes now; pay taxes later, except for the Roth IRA. These words, subject to exceptions, represent the *bedrock* principles of tax planning for accumulating and distributing wealth. It is critical in the accumulation stage when you are saving for retirement. It is essential in the distribution stage when you are withdrawing money from your portfolio after you retire. And in the estate-planning stage, it can dramatically improve the financial lives of your heirs.

The SECURE Act radically modified Required Minimum Distribution (RMD) rules for Inherited IRAs, inherited TIAA-CREF accounts and other retirement accounts. The new rules force your heirs to pay taxes at a significantly accelerated rate (in contrast to the previous "*stretch IRA*" rules). In other words, the new rules require your heirs to pay taxes sooner. That is a major problem for professors.

For many faculty members, your IRAs, TIAA, and other retirement accounts hold the bulk of your wealth, so planning for the distribution of your retirement accounts, both while you are alive and after you are gone, is critically important.

In addition, you likely have additional complications if those funds are held in Traditional TIAA accounts.

I did say *"Pay Taxes Later, except for a Roth IRA and by extension Roth retirement plan options and Roth conversions."* We devote four entire chapters to address Roth IRA conversions in this book. In addition, Roth IRA conversion strategies are mentioned many times throughout the book. It is one of the best defenses that a university faculty member can use to combat the devastation of the SECURE Act. For more on this, please see Chapters 15 and 16.

This book likely has all the information about Roth IRAs and Roth IRA conversions that you will ever want. That said, there is additional information comparing Roth IRAs, Roth 401(k)s, and Roth 403(b)s to Traditional retirement accounts, and the related issues of Roth IRA conversions.

If interested, please go to **https://PayTaxesLater.com/Books/**. There, you can download a free copy of one of our best-selling books, ***The Roth Revolution: Pay Taxes Once and Never Again***. If you are interested in Roth IRAs and Roth IRA conversions—and you probably should be—please read at least the Roth IRA chapters in this book. If you want to take it a step further, please read at least Chapter 1 of ***The Roth Revolution***. You can also get a printed copy by requesting it from our office (contact information is included in the back of the book) or by purchasing a copy from your favorite book seller.

In this chapter, I'll give you an overview of the principles of ensuring a secure retirement, which I will elaborate on in following chapters. For those of you who want to delve into more detail will find the full story in other chapters.

The Accumulation Years: Saving for Retirement While Working

First the conclusion, then the analysis.

Let's assume you have a certain amount of money that you can afford to contribute for your retirement. What is the best hierarchy for contributing to the different types of retirement plans available to you?

Subject to exception:

1. **Take advantage of any employer match.**
2. **Take advantage of a Health Savings Account (HSAs), if available to you.**
3. **Contribute to Roth IRAs and back-door Roth IRAs.**
4. **Contribute to Traditional retirement plans or IRAs.**
5. **Contribute to nondeductible IRAs or nondeductible contributions to a retirement plan.**

6. **Save money in a plain old after-tax brokerage account.**

Make no bones about it: the cardinal rule of saving for retirement is taking advantage of employer-matching contributions to any retirement plan. Most universities and many hospitals, non-profits, governments and museums offer matching contributions, but some offer a percentage of your salary regardless of whether you contribute to the plan. So, if your employer has a retirement plan and an employer match is available to you, make sure you are (1) participating in that plan and (2) contributing at least enough to take full advantage of the match. It's like free money!

For example, after a three-year waiting period, if a University of Pittsburgh faculty member contributes 8% of their salary to their retirement plan, the university adds another 12%. That's a 150% return on your money on day one, and that doesn't include the enormous tax benefits. Even if your employer matches *"only"* on a dollar-for-dollar basis, it is the same as a *100% return on your investment in one day.*

The money in your retirement plan grows either tax-deferred, as in a traditional IRA or 403(b), or tax-free in a Roth IRA or Roth 403(b). Most universities allow you the option to direct your own contributions to a Traditional or Roth account. However, even if you direct your own contributions to a Roth account, your employer's matching contribution used to always go into a Traditional account. Recent legislation has changed this and allows you to direct an employer's contribution to a Roth assuming your plan at work permits.

Health Savings Accounts

After taking advantage of your university's matching contribution, the next thing you should consider is making contributions to a Health Savings Account (HSA). HSAs are only available to those who choose a health insurance plan with a high deductible. HSAs have more tax benefits than a Roth IRA.

With an HSA you get a tax deduction for your contribution, the money grows tax-free, and the distribution is entirely tax-free, assuming you withdraw it to pay for qualified medical expenses. With a Roth IRA, you do not get a deduction up front. With a Traditional IRA, you do not enjoy tax-free treatment when you make a distribution.

With an HSA, there are no income-based contribution limits to qualify for the deduction. In addition, you do not have to wait until retirement or age 72 for tax-free and penalty-free withdrawals of contributions and earnings as long as the withdrawals are for qualified expenses.

A deduction for contributions to an HSA can reduce any type of taxable income, while deductions for contributions to a Traditional retirement plan require service-related income in order to receive a deduction. HSAs do not have any Required Minimum Distributions (RMDs) at a certain age as is required with Traditional retirement plans.

HSAs are the only area in the IRS tax code where you receive a deduction for a contribution and tax-free distributions for withdrawals. In addition, HSAs do not have a *"use it or lose it"* provision like flexible spending accounts, so they are a great way to sock away money for the increased medical expenses you will likely have in retirement.

Plus, under the current tax rules, there are no requirements to take the distribution in the year the qualified medical expense is incurred. This means you can save your receipts, allow your HSA account to grow, and take the distributions later tax-free. A solid tax strategy is to pay medical expenses from non-HSA funds, retain the expense documentation and defer taking the distribution until a time when you need to take a distribution. This strategy, however, assumes you can afford to pay the medical expenses from sources outside of your HSA. While keeping tax optimization in mind, it is advisable to spend the HSA before both spouses pass away since the HSA is subject to lump sum taxation when paid to a non-spousal beneficiary at death.

Unfortunately, under current law, anyone on Medicare is not permitted to contribute to an HSA. There is a proposed bill to make HSA contributions available to those individuals covered under Medicare since senior citizens are the group of individuals with the highest medical expenses. I will not provide any further coverage regarding HSAs in this book, but since this section is on the optimal way to save for retirement, I would be remiss to not mention them.

After contributing enough to get the full match from your employer's retirement plan and to your HSA (if you have access to an HSA), the next priority during the accumulation stage (subject to exceptions determined by personal circumstances) is to direct maximum contributions to your Roth 403(b)s or 401(k)s, and Roth IRAs through TIAA or Vanguard, or VALIC, or whichever provider your employer uses. Of course, with a plain old Roth IRA not associated with your employment, you have an enormous array of options.

Then, if you're eligible to participate, consider contributing the maximum to the Roth account in your university's 457(b) plan.

Many professors—and even some benefits administrators—are unaware that they may have access to a 457(b). Often faculty members can contribute to both 457(b) and 403(b) plans. That second contribution essentially allows you to double your retirement plan contributions. Please see the 457(b) section in Chapter 2 for important additional details about 457 plans.

Since combining a 457(b) plan with your Traditional retirement plan can double your retirement plan contributions, it will pay to find out if you have access to a 457(b) plan and consider whether you can afford additional contributions, even if it doesn't have a matching feature which it probably will not.

Finally, if you meet the income guidelines, contribute to a Roth IRA. If you do not meet the Roth income guidelines but you meet other requirements, contribute to a Traditional IRA, and use a technique called a *"back-door Roth IRA"* to immediately convert the Traditional IRA to a Roth. As we go to press, the back-door Roth IRA is still allowed, but we fear it will be eliminated sometime in the future. We cover the back-door Roth IRA conversion in Chapter 7.

Why Roth? Because the math proves that, subject to exception, you will have more purchasing power in the long run if you contribute to a Roth account than to a Traditional retirement account. Please see Chapter 4.

In my experience, the matching contributions offered to university faculty are extremely generous, sometimes exceeding 100%. By law, your employer's matching contributions used to have to go to the Traditional account in your retirement plan. Recent legislation gives employers the option to give you the option of whether the employer's contribution of your retirement plan is directed to a Traditional or Roth retirement plan (of course if the employer Roth contribution was selected, it would be included in your taxable income). Plans may need to be rewritten to include this option.

So, if you direct all of your own contributions to the Traditional account as well, every withdrawal that you take after you retire will be taxable. Most professors would be well served to have a diversity of Roth and Traditional accounts. I'll talk more about Roth IRA conversions in Chapter 7. Subject to exceptions, after the matching portion I generally recommend Roth IRAs and Roth 403(b)s.

Many professors, and even some benefits administrators, are unaware that they may have access to a 457(b). Often faculty members can contribute to both 457(b) and 403(b) plans. That second contribution essentially allows you to double your retirement plan contributions.

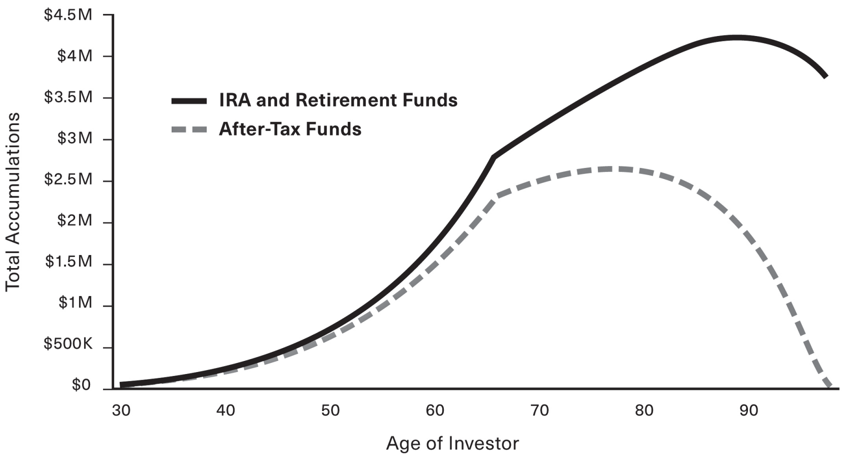
If your emloyer doesn't offer a Roth account in their retirement plan offerings, and you don't qualify for a Roth IRA contribution because your income is too high, and you don't qualify for a back-door Roth IRA conversion, or if you have exhausted those possibilities, the next best option would be to save inside a Traditional 403(b), 401(k), or even an IRA. Even though it's not tax-free, it is still preferable to saving in a taxable brokerage account. I cover this topic in greater depth in Chapter 2.

So, for the sake of simplicity, I offer this figure as proof of the value of saving in retirement accounts as opposed to a regular investment account (labeled after-tax funds). The figure that follows shows the difference in savings over a lifetime.

In the following figure, two professors with the same tax rates, investments, etc. invest in their retirement differently. The professor represented in the solid black line took advantage of his employer's retirement, even disregarding the match. The professor represented in the dashed line did not take advantage of his employer's retirement plan.

Figure 1.1

Tax-Deferred Savings Build Wealth*



* *Detailed assumptions can be found in the Appendix.*

The professor who made Traditional (meaning, non-Roth) contributions to his employer's retirement plan enjoyed immediate tax savings and enjoyed tax-deferred growth during the accumulation years. That professor is represented by the solid black line. Ultimately, however, he had to pay taxes when he began taking distributions.

The professor who saved outside of his employer's retirement plan, didn't invest in a Roth, didn't get a tax break up front, and had to pay taxes on the interest, dividends, and realized capital gains every year. That professor is represented in the figure by the dashed line.

The professor who used his employer's plan had $1,118,724 more at age 80 than the professor who did not invest in his employer's plan, even though the amount of money he saved on a tax-adjusted basis was the same and there was no employer match. This figure reflects our basic premise that ***paying taxes later*** while you are in the accumulation stage means you can retire richer instead of *"broker."*

We have also analyzed the issue of saving in Roth 403(b)s and Roth IRAs versus Traditional 403(b)s and IRAs. Though the difference is not nearly as dramatic, subject to exceptions, workers contributing to Roth 403(b)s and Roth IRAs will usually be much better off in the long run than workers contributing to Traditional 403(b)s and IRAs. Please see Chapter 4.

Roth IRAs and Roth 403(b)s are wonderful because they can grow income tax-free for your life, your spouse's life, and for as many as 10 years after you and your spouse are gone. If your beneficiary qualifies under one of the exceptions, the Roth IRA to some extent can be invested tax-free for the life of your beneficiary. Additionally, for you and your spouse, there are no Required Minimum Distributions (RMD) for Roth IRAs. Roth 403(b)s no longer have RMD requirements.

Having the ability to access tax-free money during your retirement years can provide useful options. But since the passage of the SECURE Act, there is an even greater incentive for university faculty members to contribute to Roth 403(b)s and Roth IRAs instead of Traditional 403(b)s and IRAs.

The SECURE Act mandates that, subject to exceptions, your retirement plans must be fully distributed within 10 years of your and your spouse's death. That could be brutal if all inherited retirement money is subject to income tax. Your contributions to a Roth account and Roth conversions can provide you with much-needed flexibility during retirement and will be an even more valuable asset to leave behind.

Planning for Retirement Before You Retire

Advance planning for retirement and for your estate is always a good idea. First, you must make sure you have sufficient resources to afford the life you want to live after you retire. Unfortunately, more than one client has come to see me after they signed their retirement papers, and they will not be able to confidently afford the life they pictured. Had they come to me beforehand, I would have either counseled them to plan on spending less in retirement or to keep working. Working part time or teaching a course or two rarely has anywhere near the financial impact of just working longer.

Second, whether you understand the nuances of all your options or not, making the wrong choices can negatively impact your financial position and that of your family. We have seen many clients come through our doors over the years and for a multitude of reasons comment, *"I wish I would have met you five years ago."*

It is extremely profitable to do appropriate planning while you are still working. You and your family might profit in ways you could not have imagined. And there may be advantages that are not available if you wait until after retirement. I try to counsel all my clients to talk to me or someone on our team before announcing their retirement.

I would offer the same advice to you. Please see someone you trust that can provide good advice before you announce your retirement or sign any retirement papers. The same holds true with phased retirement.

Roth IRA Conversions

Please see Chapter 4 regarding Roth IRA and Roth 403(b) conversions. This is a critical topic for professors. This is also an area that most professors fail to *optimize*, and the result is a dramatic and unnecessary tax burden for themselves and their families.

The Distribution Years: Spend the Right Money First When You Retire *(including a New Wrinkle in our Bedrock Principle)*

Again, we start with the conclusion and then move to the explanation. Assume you are retired, are receiving some income that you must pay taxes on (like Social Security, RMDs, interest and dividends, and capital gains), and you also have investments in Traditional retirement plans, Roth retirement plans, and plain old after-tax dollars. Subject to exception, we recommend you spend money in the following order:

1. **Spend your income first.**
2. **Spend your after-tax dollars that do not have any or much appreciation.**
3. **Spend your highly appreciated after-tax dollars.**

4. **Spend your Traditional retirement assets like IRAs and 403(b)s.**
5. **Spend your Roth dollars last.**

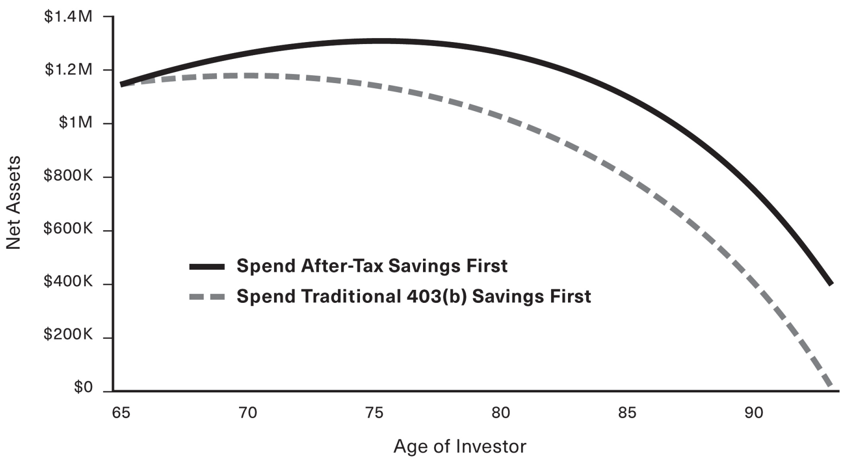
The following figure supports the premise that, subject to exception, you should spend your after-tax dollars before your retirement plan or IRA dollars.

In Figure 1.2, both professors start with the same amount of money in a regular brokerage account—which I refer to as after-tax dollars—and in their Traditional retirement plans which could be IRAs or 403(b)s and/or TIAA.

The figure indicates, subject to exceptions, that most readers should spend their after-tax dollars first and then IRA and retirement plan dollars. The solid line shows what happens to the first professor who spends after-tax dollars first and withdraws only the minimum from the IRA when required to (more on RMDs in the next section). *He paid-taxes-later.* The dashed line shows what happens to the second professor who spends his IRA before his after-tax dollars. *He paid-taxes-now.*

Figure 1.2

Spend the Right Money First*



* *Detailed assumptions can be found in the Appendix.*

The only difference between the dashed line and the solid line in this figure is that the first professor retained more money in the tax-deferred IRA for a longer period. Even starting at age 65, the decision to defer income taxes for as long as possible gives the first professor an extra $340,199 if he or his spouse lives to age 89. If one of them lives longer, paying taxes later will be even more valuable to them.

Subject to exception, I generally prefer you not spend your Roth IRA dollars unless there is a good reason. The Roth IRA grows income tax-free for the rest of your life, your spouse's life and for 10 years after you and your spouse are gone. In addition, there is no Required Minimum Distribution for you or your spouse with a Roth IRA.

So, in general, the last dollars you want to spend are your Roth IRA dollars. Of course, there may be time when it makes sense to spend your Roth dollars before other retirement plan dollars if it keeps you in a lower tax bracket because the alternative would be making taxable withdrawals that would push you into a higher tax bracket.

That said, subject to exceptions, you and your spouse will realize a benefit by deferring the income taxes due on your retirement plans for as long as possible and generally hold off on spending your Roth IRA. And with the SECURE Act now part of the law, your children, and grandchildren (subject to some important exceptions, which I will cover in Chapter 12) will have to pay income taxes on the Inherited Traditional IRA within 10 years of your death.

A New Wrinkle in our Bedrock Principle

Since the passage of the SECURE Act, which will be explained in Chapter 12, adhering to the pay-taxes-later rule in the distribution stage might not always be the best advice. With income tax rates likely on the rise, for some professors it might make more sense to plan for a transition from the taxable world (most TIAA accounts, IRAs, 403(b)s retirement assets, etc.) to the tax-free world (Roth IRAs, 529 plans, HSAs, life insurance, your children's Roth IRAs, etc.). To get the best result, it is best to analyze each situation on a case-by-case basis.

In short, the SECURE Act dramatically accelerates the taxes on your retirement plan after your death. For your children, losing the lifetime stretch on an inherited retirement account can carry a huge tax burden. I will cover this idea more in Chapter 12.

One reasonable strategy for some professors with significant IRAs and retirement plans who will not likely spend all their money is to make taxable withdrawals from the retirement plan and/or IRA, pay the tax, and then gift the net proceeds. The gift could be invested in something that grows tax-free like a 529 plan, HSA plan, your children's Roth IRAs, life insurance, etc. That serves the purpose of getting some money out of your estate and allows tax-free growth for your children.

As a result, for many faculty members, an earlier transition from the taxable world to the tax-free world might work better than the standard rule of *"pay taxes later."* We call this strategy transferring assets from the taxable world to the tax-free world. We cover this strategy in greater detail in Chapter 3.

Required Minimum Distributions (RMDs) Explained

You may already know that the SECURE Act raised the age at which you are required to take mandatory distributions from your Traditional retirement accounts to 72 (technically April 1 of the year after you turn age 72)[1].

In simple terms, your RMD is the minimum amount you must withdraw from your retirement account each year. That income will be added to your taxable income unless it was contributed on an after-tax basis or if the qualified withdrawals are tax-free, as in the case of the Roth IRA or Roth 403(b). Beginning at age 72, you must withdraw your RMD by December 31 of every year. Roth IRA accounts are excluded from this requirement; they do not require withdrawals until after the death of the Roth IRA owner and his or her spouse.

If you decide to defer your initial RMD to April 1 of the year following the year you reach age 72, you will be required to take two RMDs in that year. For example, if you reach age 72 in November 2023 and decide to take your RMD on March 15, 2024, you will still need to take another RMD before December 31, 2024, to meet your 2024 RMD requirement. This means you will receive two RMDs in the 2024 year.

This is where additional planning can make a big difference in how much tax you will pay. If you are planning on retiring, depending upon the amount of the RMD, you may be better off taking the RMD in the year in which you turn 72, even though you will have taxable wages, instead of taking two RMDs the following year.

Your RMD is calculated by dividing the year-end balance of your IRA or retirement account by a distribution period (or factor) found in *IRS Publication* 590. Table III (also called the Uniform Lifetime Table) applies if you are married and your spouse is NOT more than 10 years younger than you, or if your spouse is not the sole beneficiary of your IRA, or if you are unmarried.

Table I would only be used to calculate your RMDs if you inherited an IRA from someone other than your spouse prior to January 1, 2020. Table I is also

1 The SECURE Act 2.0 further raised the ages for RMDs. If you were born in 1949 or earlier, RMDs start at age 70 ½ If you were born in 1950, RMDs start at 72. If you were born between 1951 and 1959, RMDs start at 73. If you were born in 1960 or later, RMDs start at 75.

used when a spousal beneficiary elects to defer distributions until the original owner would have turned 72. If you are married and your spouse is more than 10 years younger than you and the sole beneficiary of your IRA, you would use Table II: Joint Life and Last Survivor Expectancy.

You will probably use Table III. Effective 2022, the Table III distribution period (or factor or divisor) for your first RMD at age 72 is 27.4. (That is a change from the old law but isn't part of the SECURE Act). We include it because it is relevant.

It doesn't matter if you're in perfect health and that both of your parents lived to be 100. Table III is based on the government's estimate of the joint life expectancy of the IRA owner, and someone deemed less than 10 years younger than the IRA owner.

The following is an oversimplification and isn't technically accurate, but it is easy to remember. If you're 72, the government assumes under the new life expectancy factors that you will live for roughly 17 more years and then tacks on another 10 years to determine the Lifetime Table life expectancy factor. So, let's look at how your first RMD will be calculated.

Start by looking at how much money you had in your retirement plans as of December 31 of the previous year. To keep the math simple, I'm going to assume that you had exactly $1 million. To calculate your first year's RMD, divide the $1 million by the factor in Table III that matches your age. For this example, I will assume the IRA owner is 72, so the factor is 27.4. Dividing $1 million by 27.4 equals $36,496. That's how much you must withdraw from your IRA and how much additional income will be added to your other existing income.

Here's another way of looking at it. Your first RMD at age 72 will be a little less than 4% because the 27.4 divisor is a little larger than 25. If the factor were 25, it would be 4% exactly. And as you age, the distribution period that you must divide into your IRA balance gets smaller, which means you are required to take out even larger RMDs. If you have $1 million in your IRA at age 90, your divisor is only 12.2, which will cause an RMD of $81,967. Many of our clients have a lot more than a million dollars in their retirement accounts which really equates to massive future taxation.

But that age of 72 for the date when RMDs must begin may not be written in stone. Legislation being considered in Congress as the SECURE Act 2.0 shifts the age for RMDs, depending on the date of birth. For retirement plan owners who turn 72 after 12/31/22 (born between 1951 and 1959), RMDs will begin at age 73. If you turn 74 after 12/31/33 (born in 1960 or later), your RMDs will not start until age 75.

These forced withdrawals cause headaches for many retired professors, not just because they are taxable distributions but because they have an impact on your entire tax return. The distributions can throw you into a higher tax bracket, increase the percentage of taxable Social Security benefits, raise your Medicare B and D premiums, and trigger the Net Investment Income ('NII') tax of 3.8% on investment income. But, notwithstanding the problems you face when you are forced to withdraw money from your retirement plans, the advantages of years of tax deferral usually far outweigh the disadvantages of not saving money in the tax-deferred environment.

Please note that Table II, used if your spouse is more than 10 years younger than you, gives you a much higher divisor resulting in a lower RMD and a lower tax. Additional details about these rules and a description of how your RMD is calculated based on your life expectancy factor can be found in *IRS Publication* 590-B, available online at **https://www.irs.gov/pub/irs-prior/p590b.pdf**.

When mandatory distributions are added to wage income and Social Security benefits, it is not uncommon for us to see the taxable income jump up one full bracket and sometimes two. If you do not need the income to live on, most people are much better off deferring withdrawals from Traditional retirement plans for as long as they can. I'll go into more details about RMDs in Chapter 6.

What if You Work Beyond Age 72

If you are still working full-time at age 72 (and potentially beyond) you will not have to take RMDs from your employer sponsored retirement accounts. Since university professors often continue to work long after their peers in the private sector have retired, they do not have to start their RMDs until they retire. Traditional IRAs do have mandatory RMD requirements at age 72 whether you are working or not, so that may invoke additional planning.

Professors used to be notorious for delaying retirement. I might ask a professor client when he planned to retire. He would say in five years. I meet with the same professor five years later and asked him when he is going to retire? He says in five years. To be fair, I tend to work with the professors who are at the top of their field.

Though this is strictly anecdotal, since Covid and amidst a growing dissatisfaction with some of the changing conditions, I see professors retiring that I would have guessed would have kept working longer. That said, many professors still work beyond age 72. If your university allows it, the IRS allows you to defer RMDs in your 403(b) or 401(k) plan as long as you continue to work. So, if you plan to continue to work beyond age 72, it may make sense to defer distributions from your 403(b) plan until such time that you retire.

What is Retired for the Purpose of Delaying Your RMD?

Over the years, our office has received the question, *'What if I continue to remain an adjunct professor or participate in a phased retirement or even just teach a course after I retire? Can I still defer taking my RMD because technically I'm still working?'*

This is an interesting question and unfortunately sounding like an attorney (again) the answer is it depends. Each institution negotiates its own contract with TIAA or other provider so some universities may have more restrictive rules. You could even have different rules for different contracts with the same university. Professors are unique in that the determination as to what constitutes retirement is how each university defines retirement, and it is up to the university to determine when a professor is deemed retired.

We recommend you contacting the university's HR Department *and* TIAA or the other provider directly about your specific situation as this is a complex area and some of the information is unclear and you may not receive the correct advice.

The IRS does not define how many hours are considered *'still working'* for the RMD exception. As long as your employer considers you as an employee and you are *eligible* to participate in the employer plan and you remain employed after December 31, meaning January 1st, you MAY qualify for the still-working exception.

An important distinction to know—even if you work through the end of the year and retire on December 31, you are required to take your RMD by April 1 of the following year even though you were working through December 31. In addition, you would need to be employed by your current employer into the next year to possibly qualify for this exception (meaning, receive a W-2 the following year *for hours worked* in the following year).

If you defer receiving your accrued sick pay or vacation pay into the following year, this will not qualify *for hours worked.* We are referring to *earned income* that is reported on a W-2 or possibly a 1099 form from the same university you are retiring from.

You can get even more bang for your tax-deferred buck by rolling any IRAs that you may have accumulated over the course of your career into your current work plan assuming your employer permits it.

The rules are designed so you cannot *'retire'* on a certain date, take distributions from your 403(b) plan, and then decide to work as an adjunct professor and say, by the way, I'm working now and am no longer required to take my RMD. There is a lot of complexity in the rules surrounding this exception, so we caution you to plan carefully as there can be some unique tax planning opportunities and blunders if not handled correctly.

You can get even more bang for your tax-deferred buck by rolling any IRAs that you may have accumulated over the course of your career into your current work plan assuming your employer permits it. That way, you can avoid taking RMDs on your old retirement plan or IRA money, too.

Most advisors are anxious to have you roll your retirement plan at work into an IRA but sometimes this actually hurts you because it accelerates income. If you decide to employ this strategy, we strongly recommend a *'trustee-to-trustee'* transfer of the IRA monies into your current work plan since there are limitations on the number of rollover transfers permitted in a given year.

Two quick anecdotes before jumping back into the content. First, I have been working with faculty members for over 35 years, and though I never did a formal study, faculty retirement dates seem to be changing. Earlier in my career, it seemed that many faculty members would just keep working indefinitely.

I always found it interesting that the motivation for working or retiring was usually not financial, but whether they were still productive and still enjoying it. Since so many faculty members that I work with love what they do—and that included my mother—they would often work well past 72.

That trend seems to be diminishing in recent years, with more and more faculty members retiring earlier. I was with a client who I thought was a professor, and I mentioned this phenomenon. I said I had heard that the reason a lot more professors were retiring early was because the administration was getting more and more difficult to work with. The client gave me a stern look and said, *"I am the administration."* Oops.

Also, I fear the consequences of Covid-19 on the entire university environment—remote teaching, faculty cuts, budget cuts, etc., will spur even more *"early"* retirements. Again, anecdotally, I have had a lot more discussions with professors regarding retiring in the short term than I can ever remember for the last 35 years.

Once you do stop working, subject to exception, you should limit your taxable withdrawals to the RMD. The exception is when you are trying to reduce what will become an Inherited IRA because you know that your kids are going to get clobbered with taxes after you die. That is a possibility that we evaluate for all our clients, especially since the SECURE Act eliminated the stretch IRA.

Now that your children are required to distribute their entire Inherited IRA within 10 years of your death, it may make more sense for you to pay tax on the withdrawals. *But paying taxes sooner rather than later is still the exception, not the rule.* An analysis of your future tax bracket (s) and state of residence as well as those of your children also becomes a consideration. I will cover more about evaluating those factors in Chapter 11.

Another exception to the *"pay taxes later"* maxim is that it sometimes makes sense to distribute IRAs before other funds when you can take advantage of an income tax bracket that is temporarily lower than normal. When I run into that situation, I also think about Roth IRA conversions—especially now. The Tax Cut and Jobs Act of 2017 (TCJA) reduced income tax brackets temporarily and that can make Roth IRA conversions much more favorable for more people.

Comparing Current and Future Tax Brackets

In 2017, the 25% income tax bracket topped out at $153,100 for a married couple. In 2023, the 24% tax bracket tops out at $364,200. To oversimplify, income tax rates for most taxpayers were *much* higher in 2017 than they are now, and for a large number of higher-earning families tax rates were much higher in 2017 than they are now.

This means that many individuals who looked into Roth conversions in the past and found that they would not be cost-effective may find that that is no longer true. Because of the *"sunset"* provisions of the 2017 TCJA, these reduced tax rates are scheduled to revert to the higher 2017 rates (plus inflation) starting in 2026. Please see the chart on the next page.

Still, you might be thinking, *"What are you talking about, Jim? My income isn't anywhere near $364,200 now that I am retired."* Maybe so, but if your normal taxable income is $100,000, that means you can now either withdraw more

Comparison of 2017 and 2023 Tax Rates for "Married Filing Jointly"

2017			2023		
$ 0 – 18,650	x	10%	$ 0 – 22,000	x	10%
18,651 – 75,900	x	15%	22,001 – 89,450	x	12%
75,901 – 153,100	x	25%	89,451 – 190,750	x	22%
153,101 – 233,350	x	28%	190,751 – 364,200	x	24%
233,351 – 416,700	x	33%	364,201 – 462,500	x	32%
416,701 – 470,700	x	35%	462,501 – 693,750	x	35%
470,701 *and above*	x	39.6%	693,751 *and above*	x	37%

Notes: Make Roth conversions at 24% now. Otherwise, you might pay 28% or 33% on RMDs later.

from your retirement plans (or better yet, make a Roth IRA conversion of up to $264,200) and still be in the 24% tax bracket assuming you aren't taking additional Medicare premiums and other issues into account. Please see Chapter 16.

In 2017, that same withdrawal would have put you in the 33% bracket. So, before you say that taking more than your RMD from your IRA (or, better yet, making a series of Roth IRA conversions) isn't for you, please be open-minded and examine the data. (In God We Trust, all others bring data.) And if taxes go up in the long run, Roth IRA conversions will be even more profitable for you and your family.

One very valuable service that we provide for our assets-under-management (AUM) clients is our annual running of the numbers. *"Running the numbers"* is our shorthand affectionate term for preparing a detailed quantitative analysis of a client's finances to optimize financial decisions. We test the tax implications of a variety of different scenarios based on varying assumptions.

For example, we were relatively sure that the SECURE Act (or something like it) was coming, which would likely include accelerating income taxes on Inherited IRAs, so we included those assumptions in many of the different scenarios in our projections even before the SECURE Act passed.

Correctly foreseeing the likely changes in the law led us to make more and bigger Roth IRA conversions which in hindsight worked out extremely well. Then, those numbers become the basis for a Financial Masterplan. Please see the back of the book for more details.

Many financial professionals who neither *"run the numbers"* nor understand critical concepts assume that it does not make sense for retired individuals to make Roth IRA conversions. But after we "ran their numbers," we found ourselves recommending that many 72-year-old+ clients continue executing Roth conversions—even though they were already taking RMDs and receiving Social Security benefits. And if you are not yet retired, many universities now allow you to execute Roth conversions inside your 403(b) plan, assuming the plan document allows in-service conversions.

This is not a *"one-size-fits-all"* proposition, because every taxpayer has unique circumstances. But it is an interesting idea to consider making Roth conversions while you are in the 22% tax bracket that will push you into the 24% bracket if you project that your future RMDs will be taxed at 24% or a higher tax rate.

Three Reasons Your Taxes Will Likely Increase

The recommendations we make to our clients that are based on tax rates increasing are based on three factors we think are likely to occur. First, our current low tax rates are set to expire at the end of 2025, and unless Congress votes to extend them, tax rates will automatically go up. This isn't even to mention the fiscal problems the United States has. The money needed to pay even the interest on our debt must come from somewhere.

Second, we also know that your RMD will increase as you age, which will increase your taxable income, your tax rate, and thus, your taxes.

Finally, for couples currently filing income tax returns using the *'married filing jointly'* status, there is an additional future tax increase to take into consideration.

Eventually one of you will die. Excepting the year of death, the surviving spouse, whose taxable income will likely be similar to what it was in the years preceding their husband or wife's death, will have to file their taxes using the *'single'* status which subjects them to much higher rates than they had been paying while their spouse was alive. So, for many couples making a series of strategic Roth conversions before these likely tax raises occur could be extremely valuable to your surviving spouse and to your heirs, down the road.

The point is that just because you are taking minimum distributions and Social Security, do not assume you aren't a suitable candidate for Roth IRA conversions.

It should also be noted that due to the overwhelming demand of clients and prospects wanting us to *"run the numbers"* but not engage with our money management services (see the back of the book), we now do a complete Financial Masterplan on a fee-for-service basis, but the fee, subject to exceptions, starts at $12,500. Again, as demand for what we think is a better model for us and the client which is the AUM model that includes our Financial Masterplan, we may stop doing the fee-for-service work.

Important Point About Required Minimum Distributions and Annuities

TIAA investors and faculty members who own annuities inside of their retirement plans (or qualified annuities) need to be aware of one specific feature that can affect your RMD.

Specifically, if you have elected to take a lifetime income from your annuity (also called annuitizing), then the money in that annuity is exempt from the balances you must include when calculating your RMD since you are withdrawing income from your annuity. And if you have a non-qualified annuity (also called a personal or after-tax annuity), you are not required to take a minimum distribution from it at all. But these are just two more reasons why there is no *"one-size-fits-all"* answer when it comes to determining the best spending strategies for profesors and TIAA investors.

As with the old law, you will always be allowed to take out more than the minimum, at least with your CREF, IRA, and other non-TIAA retirement assets.

Assets that you have in the TIAA Traditional annuities do have relevant restrictions but are likely good assets to keep. If, however, you can afford to limit your distributions to the minimum, there are significant financial advantages in doing so. Limiting distributions to the minimum defers taxes on the IRA for the longest time available and, subject to exceptions, confers the greatest financial benefits.

The SECURE Act defers the time you are required to take your first minimum distribution until age 72 or later, depending on the year of your birth. For many people, this will allow additional time for your assets to grow tax-deferred and will likely allow an additional two years during which Roth IRA conversions will be beneficial to you and your family.

On the other hand, most professors are far more frugal in their spending than they need to be. I would hate to hear you were reducing your spending because you didn't want to withdraw more than the Required Minimum Distribution even though you could otherwise afford to spend more. Likewise, if the choice is spending more money or making a Roth IRA conversion, most of the time, I will recommend spending more money.

I remember one client saying he had to cut back on his spending and his charitable contributions because he was planning on paying the taxes on a large Roth IRA conversion that year. No. No. No. The point of the Roth conversions is to enhance the quality of your life, not restrict it.

Though I practically begged him not to cut back on his spending, he did indeed cut back on his spending, depriving himself and his family of certain pleasures they could have enjoyed. Then, he died. The difference between what he actually spent and what he could have comfortably spent in the big picture was fairly meaningless. His widow, who was left with way more money than she will ever need, referred to her wealth as *"numbers in a bank."*

So, now that we have an overview of some of the basics of saving and spending retirement assets, let's look at some specific planning issues that university faculty need to consider. Please read on.

KEY IDEAS

- Subject to exception, pay taxes later, except for Roth.
- Take full advantage of employer-provided matches in your retirement plan.
- Use a Health Savings Account if one is available to you.
- Contribute to your Roth 403(b) and Roth IRA while you are working. Also, contribute to your Roth 457(b) plan if you are eligible and can afford it.
- Subject to exception, spend your after-tax dollars before your retirement money.
- Most professors should try to limit withdrawals from retirement accounts to the minimum required by law (RMD).
- Spend your Roth accounts last.