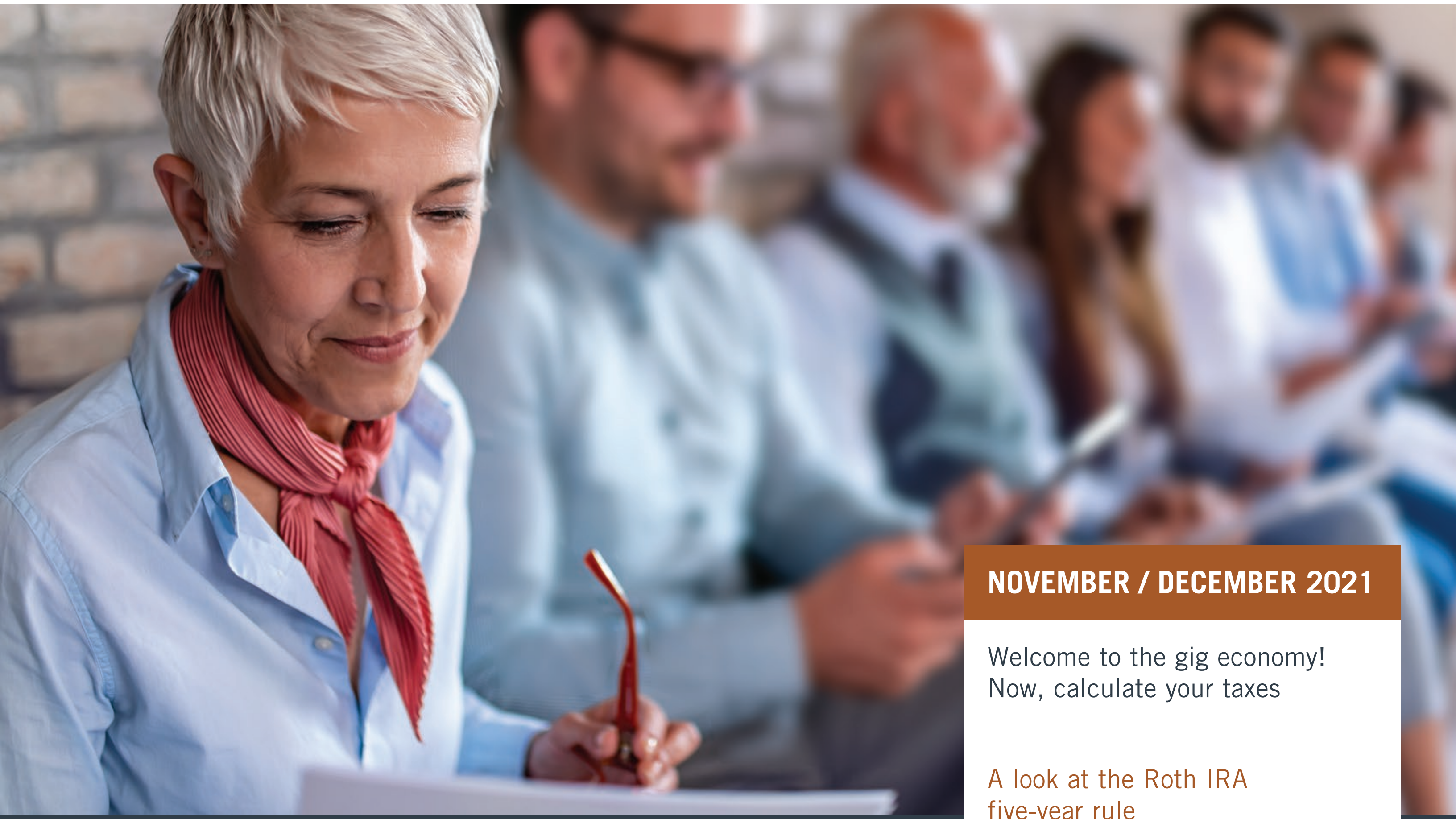
WEALTH MANAGEMENT ADVISOR



NOVEMBER / DECEMBER 2021

Welcome to the gig economy! Now, calculate your taxes

A look at the Roth IRA five-year rule

Why investors should care about market cap

WORRIED YOU DON'T HAVE ENOUGH TO RETIRE?

Consider working a little longer

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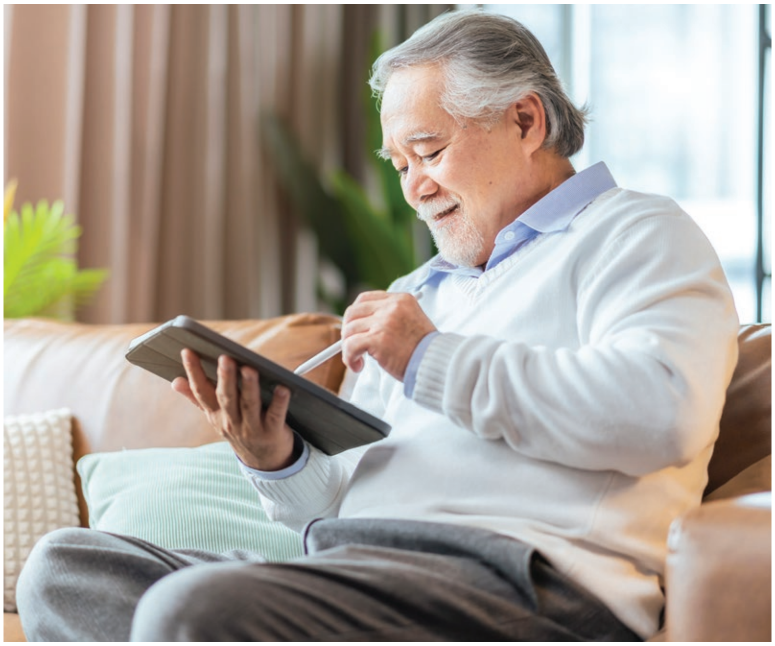
If you're concerned about funding your retirement, consider working a little longer. A recent study confirms what financial advisors have been saying for years: Extending your work life — even for a short time and even at a reduced salary — can have a major impact on your desired lifestyle once you do retire.



A case study

"The Power of Working Longer," from the National Bureau of Economic Research (NBER) found that working just a few months longer can have the same impact on a person's retirement standard of living as saving an additional 1% of work earnings for 30 years. How can this be true?

A simplified example shows how: Rachel is contemplating retirement at age 65, with a $2 million portfolio. Let's assume that the maximum amount she can safely withdraw from her portfolio at age 65 is 4%, or $80,000. (This figure is based on the "4% rule," but the actual safe withdrawal rate varies depending on market conditions and each individual's circumstances. See "Is the 4% rule all it's cracked up to be?" on page 3.)

Suppose, instead, that Rachel decides to delay her retirement to age 70. She works part-time, earning enough to maintain her lifestyle without tapping her retirement savings — but not contributing to them either. Assuming a 7% rate of return, her portfolio grows to approximately $2.8 million when she retires in five years. Let's also assume that at age 70 she can safely withdraw 4.5% of her portfolio, or $126,000. In this example, working an additional five years increased Rachel's retirement income by more than 50%.

Other benefits

Boosting your retirement savings is just one of several benefits of working longer. You might also be able to:

Reduce the length of your retirement. Delaying retirement not only allows you to increase your savings but also reduces the amount of time you'll need to rely on those savings. This minimizes the risk that you'll run out of funds.

Maximize Social Security benefits. For most people getting close to retirement, full retirement age (FRA) for Social Security purposes ranges from 66 to 67, depending on the year you were born. Once you reach FRA, you're entitled to your standard benefit. That benefit is reduced if you file for Social Security before your FRA and it's increased if you delay benefits beyond your FRA. If working longer allows

IS THE 4% RULE ALL IT'S CRACKED UP TO BE?

The "4% rule" is used to estimate the maximum amount someone can withdraw from their retirement portfolio while maintaining sufficient savings for life. It's originally based on a study of stock and bond returns from 1926 to 1976.

This rule can help you gauge your potential standard of living in retirement, but you shouldn't rely on it. There's no guarantee that future stock returns will follow historical patterns. And, as with all investments, there's always a chance that yours will lose value. Plus, the calculation depends on your particular circumstances — including your life expectancy, your investment portfolio's risk profile and the future rate of inflation.

Relying on the rule, you risk outliving your retirement savings if you *over*estimate how much you can withdraw. If you *under*estimate withdrawals, you could sacrifice your enjoyment of retirement. A better approach is to work with your advisor to determine a withdrawal rate that's right for you and to revisit and adjust that rate annually.

you to wait until later, you'll increase your benefit by 8% per year (with a maximum 32% increase over the standard benefit). So delaying Social Security benefits can create a substantial benefit if you or your spouse live a long life.

Reduce health care costs. If you're eligible for employer-provided health insurance, working longer can reduce your health care expenses. Even if you're covered by Medicare, Medicare Part B and prescription drug premiums can be significant, especially if you're subject to high-income surcharges. The longer you can postpone these premiums, the lower your health care expenses will be during retirement.

Delay RMDs. If you participate in an employer's 401(k) or similar plan, the plan may permit you to delay required minimum distributions (RMDs) until you stop working.

Increase pension benefits. If your employer provides you with a traditional pension plan, it's likely that the longer you work, the higher your monthly benefit will be. Since these benefits are typically paid for life, any increase will affect your standard of living during retirement.

Health advantages

Not all of the benefits of working longer are financial. According to Harvard Medical School, the mental stimulation and social engagement provided by working longer is associated with a lower risk of dementia and death and improvements in overall health. And remote and flexible work arrangements make it easier than ever for those approaching retirement to continue working while improving their quality of life.

Not everyone experiences these benefits, though. It depends on the person and the type of work. For example, if a job is highly stressful or dull, continuing to work can harm your mental and physical health. If a job is physically demanding, the risk of injury may offset some of the other benefits of working longer.

Crunch the numbers

If you're concerned about outliving your retirement savings, consider working a few more years — or even a few more months. Your advisors can help you crunch the numbers to get an idea of how working longer potentially might improve your retirement outlook. ■

Welcome to the gig economy! Now, calculate your taxes

The COVID-19 pandemic is likely to have significant, long-term effects on the U.S. economy. Already, one of the most dramatic is the increase in popularity of gig or freelance work. Many gig workers carried out essential jobs during the lockdown, such as delivering groceries to socially distancing consumers. According to independent talent provider MBO Partners, gig workers contributed $1.2 trillion to the U.S. economy in 2020.

It should come as no surprise then, that gig workers are expected to pay their share of income tax. But calculating income tax as an independent contractor isn't always simple.

No free ride

The U.S. Bureau of Labor Statistics estimates that, as of May 2021, 36% of the U.S. population participated in gig work. Whether you drive for a ride-sharing app, deliver packages, sell home crafted goods online, perform freelance home repairs or some other gig job, your income is subject to tax.

Gig workers typically are considered self-employed — and because an employer isn't withholding money from your paycheck to cover tax obligations, you're responsible for making federal income tax payments. Depending on where you live, you also may have to pay state income tax.

The U.S. tax system is considered "pay as you go." Self-employed individuals typically pay both federal income tax and self-employment taxes four times during the year: generally, on April 15, June 15, and September 15 of the current year, and January 15 of the following year. If you don't pay enough over these four installments to cover the required amount for the year, you may be subject to penalties. To minimize the risk of penalties, pay either 90% of the tax you'll owe for the current year or the same amount you paid the previous year.

1099 economy

You may have encountered the term "the 1099 economy" or been called a "1099 worker." This is because, as a self-employed person, you won't get a W-2 from an employer. You may, however, receive a Form 1099-MISC from any client or customer that paid you at least $600 throughout the year. The client sends the same form to the IRS, so it pays to monitor the 1099s you receive and verify that the amounts match your records.

If you use a portion of your home for work, you may be able to deduct some home-related expenses.

If a client (say, a ride-sharing app) uses a third-party payment system, you might receive a Form 1099-K. Even if you didn't earn enough from a client to receive a 1099, or you're not sent a 1099-K, you're still responsible for reporting the income you were paid. Keep in mind that typically you're taxed on income when it's received, not when you send a request for payment.

Business-related expenses

Because gig workers are self-employed, their taxes are based on the profits left after they deduct business-related expenses from their revenue. Your expenses may include payment processing fees, investments in office equipment and specific costs required to provide your service, such as advertising.

Also, if you use a portion of your home for work, you may be able to deduct some home-related expenses. But note that if you also have income from an employer, you can deduct only home office and other self-employment business expenses from your gig work income.

Don't go it alone

To make accurate deductions, it's essential that gig workers keep excellent records of revenue and expenses. And even if in the past as an employee you prepared your own income tax return, consider working with a professional now. You want to ensure you pay no more in tax than required. ■

A look at the Roth IRA five-year rule

The Roth IRA can be an attractive, flexible retirement savings vehicle. Contributions are nondeductible, but qualified withdrawals of both contributions and earnings are tax-free, and there are no required minimum distributions during the owner's life. To ensure that withdrawals are tax- and penalty-free, however, it's critical to comply with the so-called five-year rule.

Unfortunately, this rule is widely misunderstood. And it doesn't help that there are actually two separate five-year rules: One for withdrawals of *earnings* and one for withdrawals of *converted principal*. (Special rules, not discussed here, apply to inherited Roth IRAs.)

Second requirement is tricky

Unlike traditional IRAs, contributions to Roth IRAs are nondeductible — they're made with after-tax dollars. Thus, you can withdraw contributions to a Roth IRA any time, free of taxes and penalties, regardless of your age or how much time has passed since you opened the account.

For withdrawals of *earnings* to be tax- and penalty-free, however, they must:

1. Be made after age 59½ (with certain exceptions), and
2. Satisfy a five-year holding period.

You can withdraw contributions to a Roth IRA any time, free of taxes and penalties, regardless of your age.

The second requirement can easily trip people up if they're accustomed to withdrawing traditional IRA funds once they reach age 59½. If you're over 59½, you won't owe penalties on earnings withdrawn from a Roth IRA, but you may owe taxes if you haven't met the five-year rule.

The five-year holding period doesn't begin on the contribution date to your account, but on January 1 of the tax year for which you made your *first* contribution to *any* Roth IRA. Suppose, for example, you opened a Roth IRA in March 2018 but designated your initial contribution for the 2017 tax year. Your five-year holding period begins on January 1, 2017 and ends on December 31, 2021. Assuming you're over 59½, then starting January 1, 2022, you may withdraw earnings tax- and penalty-free from any Roth IRA you own.

Converted principal is different

A different five-year rule applies to converted principal — funds in a traditional IRA that you convert to a Roth IRA. When you convert, you're immediately taxed on the converted amount (except for funds attributable to nondeductible contributions). Even though this converted principal has been taxed, it must nevertheless be held for at least five years to avoid a 10% early withdrawal penalty. The reason for this rule is that without it, owners of traditional IRAs who are under age 59½ would be able to avoid early withdrawal penalties by converting to a Roth IRA.

The five-year holding period begins on January 1 of the year the conversion takes place. And each Roth IRA conversion triggers a separate five-year holding period. So if you perform multiple conversions over several years, you'll need to handle withdrawals very carefully to avoid unexpected penalties.

Keep in mind that this five-year rule exposes you to only early withdrawal penalties that would otherwise apply. If you've reached age 59½, or another penalty exception applies, then you won't be penalized — even if the five-year holding period hasn't yet expired. Also, this rule applies only to converted principal. *Earnings* on converted principal are subject to the same five-year rule as earnings on contributions.

Tips on tracking

Obviously, you shouldn't be put off from contributing to a Roth IRA simply because the rules can be complicated. Talk to your financial advisor about whether this savings tool is appropriate for you and for tips on tracking investment and withdrawal dates to avoid tax penalties. ■

Why investors should care about market cap

Diversification is one of the most powerful tools for reducing investment risk — particularly in times of extreme market volatility. With a diversified portfolio, poor performance of one type of asset potentially can be offset by better performance of another.

There are many ways to diversify. But one important diversification strategy that some investors overlook is size. The size of companies, as measured by market capitalization (or market cap), can dramatically affect how their stocks perform under various conditions.

Stocks sticking together

Market cap is the total dollar market value of a company's outstanding shares of stock. So, for example, a company with 100,000 shares selling for $10 each has a market cap of $1 million. And a company with 10 million shares selling for $100 each has a market cap of $1 billion. Apple, the largest company in the world as measured by market cap, is worth more than $2 trillion.

Generally speaking, companies with a market cap greater than $10 billion are considered large-cap, while mid-cap companies have market caps between $2 billion and $10 billion, and small-cap companies have market caps under $2 billion. Large-cap companies tend to be more mature, and thus can offer more stable returns but limited growth potential. Small-cap companies typically offer greater growth potential, but because they have fewer financial resources and less access to capital, their stocks can be more volatile. Mid-cap companies, not surprisingly, tend to fall somewhere in the middle.

Of course, other factors, including industry and specific company characteristics, help determine the performance of a stock. But in the short term, stocks often move in blocks by market cap based on investor sentiment about the economy, political developments and other issues.

No guarantees

Although there are no guarantees, diversifying your portfolio among large-cap, mid-cap and small-cap stocks can help reduce risk. Many mutual funds and exchange-traded funds that are managed to focus on specific market caps are available. You could also work with a financial advisor to pick securities of different caps.

Just keep in mind that such diversification strategies can never fully protect you from the risk of losing your investment money. For a risk-reduction strategy that accounts for your specific situation, consult a knowledgeable advisor. ■