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Three Common Retirement Icebergs for Microsoft Professionals (And Proactive Tips on How to Avoid Them!)

Planning for retirement involves navigating several potential pitfalls, often referred to as "retirement icebergs." Similar to a ship coming upon an iceberg, these are areas that may be overlooked and not given much attention relative to more top-of-mind areas such as how much you need to retire. The danger lurking under the surface can significantly impact your financial security if not properly managed. This article will explore three common retirement icebergs we see with Microsoft professionals and provide strategies to avoid them.

Iceberg 1: Underestimating Retirement Spending

One of the most common mistakes is underestimating how much you'll spend in retirement. Many people assume their expenses will decrease, but often, spending remains the same or even increases due to the additional time you have for activities, not to mention healthcare costs in your golden years .

We had a client describe these categories well as the go-go years, the slow-go years, and the no-go years. While the slow-go years may result in less spending due to a combination of less energy to travel and still manageable medical expenses, the go-go years (doing more activity and travel) and the no-go years (higher medical expenses) have been extended as a result of improved health care technology and people living longer.

The good news is using a detailed spending plan is highly effective in helping establish a sustainable retirement budget and prevents financial shortfalls. We have a great one-page spending plan document we'd be happy to share if you **contact us**.

Steps to Create an Accurate Spending Plan:

1. **Assess Current Spending:** Start by analyzing your current monthly and annual expenses.
2. **Identify Future Needs:** Consider additional costs such as travel, hobbies, and healthcare.
3. **Create Buckets:**
    - **Essentials:** Housing, utilities, food, transportation. [1]
    - **Discretionary:** Dining out, entertainment, vacations.
    - **One-time Expenses:** Major purchases like a new car or home renovations.

Iceberg 2: Lacking Tax Diversification

Most people are familiar with the term investment diversification; however, the term tax diversification will generally raise some eyebrows. This is the concept of having investment savings in a variety of tax characters (Roth, tax-deferred, after-tax, HSA), providing the flexibility to minimize taxes and health insurance costs in retirement – this is especially important for Microsoft professionals. Many Microsoft professionals expect to be in a lower tax bracket in life after Microsoft, but this is not always the case, especially when the majority of your retirement savings is in the form of tax-deferred accounts (e.g., regular 401(k)) and highly appreciated stock.

Steps to Tax Diversification:

1. **Increase Your Roth Bucket:** Utilize the Mega Backdoor Roth strategy to supercharge your Roth contributions. In early retirement years, consider converting traditional IRA or 401(k) funds to a Roth IRA to benefit from tax-free growth and withdrawals.
2. **Health Savings Accounts (HSAs):** Maximize contributions to HSAs for tax-free medical expense withdrawals.
3. **Strategic Gain Harvesting:** Use taxable accounts strategically to manage taxable income and avoid pushing yourself into higher tax brackets. This can include selling appreciated Microsoft stock strategically at a favorable tax rate.

A diversified tax strategy helps manage taxes more effectively in retirement and keeps more of your money working for you.

Iceberg 3: Retirement Medical Expenses

For many Microsoft professionals, this is the most treacherous retirement iceberg. Healthcare costs can be a significant financial burden in retirement, especially before becoming eligible for Medicare at age 65. This is a critical item to plan for, as taking the right actions before today can save many as much as $15,000 a year in health insurance costs in retirement!

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Managing Healthcare Costs:

1. **Early Retirement Health Insurance:**
   - **COBRA:** Maintain your existing health insurance for 18 months post-retirement using COBRA.
   - **Spousal Coverage:** Explore adding yourself to your spouse's plan if they are still working and have insurance. [1]
   - **ACA Marketplace:** Transition to the ACA Insurance Exchange after COBRA to bridge the gap to Medicare at age 65.
2. **Income Planning to Reduce Premiums:**
   - **ACA Subsidies:** Manage your taxable income carefully to qualify for ACA subsidies and lower your health insurance costs.
   - **Tax-Advantaged Accounts:** Utilize Roth IRAs, as withdrawals do not count as taxable income, keeping ACA premiums lower.

Effective planning for healthcare expenses can prevent this iceberg from disrupting your retirement. Check out **our recent article** for more detail on how Microsoft professionals can navigate early retirement health insurance.

Conclusion

Avoiding these common retirement icebergs requires proactive planning and a comprehensive approach to managing expenses, taxes, and healthcare costs. By creating a detailed spending plan, diversifying your tax strategy, and preparing for healthcare costs, Microsoft professionals can navigate these challenges and strive for a more comfortable retirement.

For personalized advice and to ensure your retirement plan is on track, **schedule a free financial check-up** with one of our Certified Financial Planners! Start planning now to plan for your financial future.

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No strategy assures success or protects against loss. Stabler Wealth Management and LPL Financial are not affiliated or endorsed by Microsoft.

Traditional IRA account owners have considerations to make before performing a Roth IRA conversion. These primarily include income tax consequences on the converted amount in the year of conversion, withdrawal limitations from a Roth IRA, and income limitations for future contributions to a Roth IRA. In addition, if you are required to take a required minimum distribution (RMD) in the year you convert, you must do so before converting to a Roth IRA.

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Contributions to a traditional IRA may be tax deductible in the contribution year, with current income tax due at withdrawal. Withdrawals prior to age 59 ½ may result in a 10% IRS penalty tax in addition to current income tax.

Although this strategy has existed since 2010, the IRS has not officially commented or provided formal guidance on whether it violates the step-transaction rule. (When applied, this rule treats what are several different steps as if they were a single transaction for tax purposes.) Experts have mixed opinions on the likelihood of this happening, but the lack of a definitive ruling means there is some risk involved. If the IRS decides that the loophole is a violation, if restrictions do come into play at some point, they could require backdoor Roth converters to pay a penalty, or they might include a grandfather clause. There's no guarantee the backdoor Roth IRA strategy will always be available. Congress recently considered legislation that would have eliminated the backdoor option. As of now, the backdoor Roth IRA is still around, but no one can predict its future. If you use this backdoor Roth strategy solely to sidestep the earnings limits on Roth, you need to be aware of the risks and seek the counsel and support of a tax professional.

Contributions to a Roth IRA are taxed in the contribution year. The Roth IRA offers tax deferral on any earnings in the account. Withdrawals from the account may be tax free, as long as they are considered qualified. Limitations and restrictions may apply. Withdrawals prior to age 59 ½ or prior to the account being opened for 5 years, whichever is later, may result in a 10% IRS penalty tax. Future tax laws can change at any time and may impact the benefits of Roth IRAs. Their tax treatment may change.