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Industry Insider: Tweaks would smooth the road to retirement

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After putting four kids through college, David and Emily are ready for some "me" time.

The Hunterdon County couple are gearing up for retirement, and they want to know what they need to do to be ready.

"We plan to downsize, move to a less-expensive state and pay cash for our next home, unless we choose to carry a mortgage for tax benefits," says Emily. "Hopefully, this will allow us to travel and do some volunteer work."

David, 52, and Emily, 56, have socked away $427,500 in 401(k)s, $104,000 in IRAs, $55,000 in a brokerage account and $18,000 in mutual funds. The couple, whose names have been changed for publication, also have a money market fund worth $23,000, and $1,000 in a checking account. And starting in 2010, David will receive a pension of about $4,000 a month from a former employer.

The Star-Ledger called on Marnie Aznar, a certified financial planner with Aznar Financial Advisors in Morris Plains, to run the numbers and look at the couple's overall financial health.

"David's pension is an important part of their retirement income," Aznar says. "They need to be sure to make the appropriate elections so that Emily will continue to receive benefits in the event that David predeceases."

Aznar says it's vital, when the time comes, to determine if it makes sense to opt for a 50 percent joint and survivor annuity, a 100 percent joint and survivor annuity or something in between, depending what the pension plan allows.

The retirement outlook is good -- depending on when they would like to stop working. If David and Emily each retire at age 65, they're on easy street and no changes to their current savings rate need to be made. But if they want out at 60, they would need to find a big chunk of extra cash to save. From now until retirement, Aznar says, they would need to set aside another $25,000 a year.

One area the couple should examine is the expenses they pay for the management of their investments. The majority of their 401(k) assets are in a plan held by David's former employer. Aznar says they should consider rolling that 401(k) into an IRA to maximize his available investment options and possibly reduce overall investment costs.

That 401(k) presents other challenges. A total of $129,000 worth of his former company's stock is in that 401(k) plan. Aznar suggests the couple may want to look into using a technique called net unrealized appreciation, or NUA, to reduce the overall tax burden. Also, she says this big stake in David's former company is way too high and way too risky, and the couple should look to reduce the holding to no more than 10 percent of their portfolio.

Aznar says if David purchased the stock over the course of his employment at a low cost basis, NUA might be worthwhile.

"This would involve taking a distribution of the stock and paying taxes at ordinary income tax rates on the cost basis, as opposed to the current value," she says. "David would then be able to sell the stock and pay taxes at low long-term capital gains rates on the difference between the market value and the cost basis at purchase."

Of course, with choosing this option, David would lose the ability to earn tax-deferred income on this portion of his 401(k) going forward.

To take advantage of this strategy, David would need to elect a lump-sum, in-kind distribution from the plan and elect to take some or all of the company stock holdings directly. In other words, some can be rolled into the IRA and some distributed.

Aznar says he should look at the cost basis of the various lots of employer stock to determine which shares have the lowest cost basis -- to take directly -- and which have the highest -- to possibly roll over into the IRA. Also, she says, if he does this when he's under age 55, there may be a 10 percent penalty on the direct distribution of employer stock, but only on the original cost basis, not on the full value of the distribution.

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