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Retirement Planning Considerations for a Stay-at-Home Spouse



Women often live longer than men, which can heighten their risk of outliving a family's retirement assets.

Married couples often decide together that one spouse should be the primary breadwinner while the other stays home to take care of family members. Although this often works out well for childrearing or eldercare responsibilities in the short term, it can present long-term retirement-planning risks for the stay-at-home spouse. For this reason, couples should familiarize themselves with a few spousal rules related to retirement plans.

Pension decisions for married couples

Typically, in a traditional pension plan, a worker is entitled to a normal benefit, which is payable for his or her lifetime and equal to a percent of final pay, assuming the plan participant works for a certain number of years and retires at a certain date. For example, a plan might stipulate that the participant will get 50% of his or her final pay for life, given a 30-year work history and retirement at age 65. If the participant works fewer years, the benefit will be less. If the participant retires earlier than age 65, the benefit will also be less because it's paid for a longer period of time.

To illustrate, let's assume Joe is covered by a pension plan at work, and his plan contains the exact formula described above. Joe retires at age 65. He worked for 30 years, and his final pay was \$100,000. He's entitled to a normal benefit of \$50,000 per year, payable over his lifetime and ending at his death (a single-life annuity).

But in order to protect nonworking spouses, federal law generally provides that if Joe is married, the plan can't pay this benefit to Joe as a single life annuity unless his spouse, Mary, agrees. Instead, the benefit must be paid over Joe and Mary's joint lives, with at least 50% of the benefit continuing to Mary for her remaining lifetime if she survives Joe. This is called a qualified joint and survivor annuity, or QJSA — it's qualified because it meets the requirements of federal law.

However, a couple may choose to forego the QJSA feature as long as the spouse who is not the pension plan participant (in this case, Mary) signs off on the decision. Basically, the question comes down to this: Should you elect a benefit that pays a higher amount while both spouses are alive and ends when the participant dies (a single life annuity), or a benefit that pays a smaller amount during the joint lives of both spouses but continues (in whole or in part) to the surviving spouse after the participant's death (a QJSA)?

Now, here's where it gets a little more complicated. Because the QJSA benefit is potentially paid for a longer period of time — over two lifetimes instead of one — the participant's normal benefit will typically be reduced. Actuaries determine the exact amount of the reduction based on life expectancies, but let's assume that Joe's annual benefit, if paid as a QJSA with 50% continuing to Mary after Joe's death, is reduced to \$45,000. This amount will be paid until Joe dies. And if Mary survives Joe, then \$22,500 per year is paid to her until she dies. But if Mary dies first, the pension ends at Joe's death and nothing further is paid.

The plan will usually offer the option to have more than 50% continue to the surviving spouse. For example, the couple may be able to elect a 75% or 100% QJSA. However, the larger the survivor annuity, the smaller the benefit the couple will receive during their joint lives. So, for example, if 100% continues after Joe's death, then the payment to Joe might now be reduced to \$40,000 (but Mary will continue to be paid \$40,000 annually after Joe's death if she survives him).

Rest assured that the QJSA option will be at least as valuable as any other optional form of benefit available to the surviving spouse — this is required by federal law. In some cases, it will be even more valuable than the other options, as employers often subsidize the QJSA. Subsidizing occurs when the plan doesn't reduce the benefit payable during your joint lives (or reduces it less than actuarially allowed). For example, a plan might provide that Joe's \$50,000



normal benefit won't be reduced at all if he and Mary elect the 50% QJSA option, and that she'll receive the full \$25,000 following Joe's death. It's important to know whether the plan subsidizes the QJSA so that you can make an informed decision about which option to select. Other factors to consider are the health of both spouses, who's likely to live longer, and how much other income the surviving spouse expects to receive.

Prior to the participant's retirement, you'll receive an explanation of the QJSA from the plan that should include a discussion of the relative values of each available payment option. Carefully read all materials — one spouse should not waive his or her rights without fully understanding the consequences. And don't be afraid to seek qualified professional advice, as this could be one of the most important retirement decisions you'll make as a couple.

Qualified domestic relations orders

While we all hope our marriages will last forever, that's not always the case. The issue of how retirement benefits will be handled in the event of a divorce is especially critical for spouses who may have little or no retirement savings of their own. Under federal law, employer retirement plan benefits generally can't be assigned to someone other than the plan participant (unless, of course, the participant dies and the proceeds pass to his or her beneficiary). One important exception to this rule is for qualified domestic relations orders, commonly known as QDROs. If you and your spouse divorce, you can seek a state court order awarding you all or part of your spouse's retirement plan benefit. Your spouse's plan is required to follow the terms of any order that meets the federal QDRO requirements.

For example, you could be awarded all or part of your spouse's 401(k) plan benefit as of a certain date, or all or part of your spouse's pension plan benefit. There are several ways to divide benefits, so it's very important to hire an attorney who has experience negotiating and drafting QDROs — especially for defined benefit plans where the QDRO may need to address such items as survivor benefits, benefits earned after the divorce, plan subsidies, cost of living adjustments, and other complex issues. (For instance, a QDRO may provide that you will be treated as the surviving spouse for QJSA purposes, even if your spouse

subsequently remarries.) The key takeaway here is that these rules exist for the benefit of a nonworking or lower-income-earning spouse.

A stay-at-home spouse *can* have an IRA

While it's obviously important for both spouses to try to contribute towards their own retirement, your options are limited if you're a nonworking spouse. But there is one tool you should know about. The "spousal IRA" rules let a nonworking spouse fund an IRA even with no earnings. With regular contributions over time, a spousal IRA could become an important source of retirement income.

How does it work? Normally, to contribute to an IRA, you must have compensation at least equal to your contribution. But if you're married, file a joint federal income tax return, and earn less than your spouse (or nothing at all), the amount you can contribute to your own IRA isn't based on your individual income; it's based instead on the combined compensation of you and your spouse.

For example, Mary (age 45) and Joe (age 50) are married and file a joint federal income tax return for 2022. Mary earned \$100,000 in 2022 and Joe, at home taking care of ill parents, earned nothing for the year. Mary contributes \$6,000 to her IRA for 2022. Even though Joe has no compensation, he can contribute up to \$7,000 to an IRA for 2022 (that includes a \$1,000 catch-up contribution), because Mary and Joe's combined compensation is at least equal to their total contributions (\$13,000).

The spousal IRA rules only determine how much you can contribute to your IRA; it doesn't matter where the money you use to fund your IRA actually comes from — you're not required to track the source of your contributions. And one spouse does not need the other's consent to establish or fund a spousal IRA.

The spousal IRA rules don't change any of the other rules that generally apply to IRAs. You can contribute to a traditional IRA, a Roth IRA, or both, provided you don't exceed the annual contribution limits. And your ability to make annual contributions to a Roth IRA may be limited depending on the amount of your combined income.

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