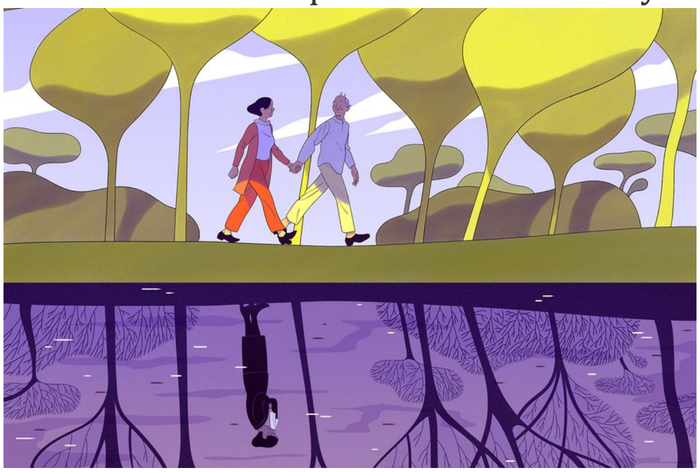
THE WALL STREET JOURNAL.
English Edition ▾ | Print Edition | Video | Podcasts | Latest Headlines

How to Prepare Financially for the Death of a Spouse

You and your spouse did everything right, financially. Except you didn't consider the consequences when one of you dies first.



There are things you can do to help prepare financially for the death of a spouse while you're both alive. ILLUSTRATION: BIANCA BAGNARELLI

By Neal Templin
June 3, 2021 12:07 pm ET

You've done everything to prepare for a financially secure retirement as a couple except one thing: What will the financial picture look like after one of you dies?

A lack of preparation can imperil the finances of the surviving spouse.

Consider how much income may be lost. If you're collecting two Social Security checks in retirement, the smaller one effectively goes away after the first spouse dies. If one of you has a pension without survivorship rights, that, too, expires when you do.

Even though the income of the surviving spouse is usually lower, he or she is often hit with a higher tax bill. That is because the survivor will be filing as a single person instead of married filing jointly. High tax brackets kick in at lower income levels for single people.

“When that plan is disrupted by the tragic death of a spouse, there isn’t a lot you can do besides cut expenses or go back to work,” says Jennifer Murray, a financial adviser in Morristown, N.J., many of whose clients are widows.

How to prepare

The good news is there are things you can do to help prepare financially for the death of a spouse while you’re both alive. These include delaying Social Security for one spouse to make the survivor’s check as big as possible. Another key is doing Roth conversions or spending down tax-deferred accounts to reduce the mandated withdrawals—known as required minimum distributions, or RMDs—that will force the survivor into high tax brackets.

As for pensions, when employees are offered pensions they usually have a choice between those with or without survivorship benefits for their spouses. The responsible thing is usually to choose survivorship rights, even though the payout will be lower.

“I hear all the time, ‘Let me take the bigger pension and call it a day, and if I die, it’s my wife’s problem,’” says David Frisch, a certified public accountant and financial planner in Melville, N.Y.

Many people underestimate the likelihood of spending many years as a widow or widower. Women on average live two to three years longer than men. But when it comes to couples, most spouses die more than a few years apart.

Two economists studied the life expectancies for a husband and wife when a 62-year-old man is married to a 60-year-old woman. Wives who survived their husbands (a 62% probability) lived 12 to 14 years on average before dying. Men who survived their wives (a 38% probability) lived nine to 11 years.

“The chance that you’ll be widowed for 20 years is not insignificant,” says Janice Compton of the University of Manitoba, a co-author of the study. “There is a huge range [of possibilities] that makes it difficult to plan. If your plan is based on your projected life expectancy, there is a good chance you’ll run out of money.”

One couple’s mistake

Jared Hoole, president of Lakeside Financial Planning in suburban Boston, advised a newly retired couple that was living off two Social Security checks, investments and rental income from a property owned jointly by the wife and her mother, who was in her 90s and in poor health. The wife assumed she would outlive her mother and inherit the property.

Mr. Hoole says he suggested that the couple review their estate plan to make sure—among other things—that their properties were properly titled, but the couple didn’t see it as a priority.

When the wife died from a sudden illness at age 63, her Social Security checks stopped. But so did the income from the property, which was now owned entirely by the mother.

While the couple, who had no children, previously had income of $100,000, the man now had income of $72,000, which wasn’t enough to remain living in their house. The husband ended up selling it and moving to Tennessee, where the cost of living is lower.

Some surviving spouses have the opposite problem: too much money. Natalie Pine, a financial planner in College Station, Texas, represents a 67-year-old widow who inherited a $7 million tax-deferred account three years ago when her husband, an energy company executive, died unexpectedly at age 70.

If the widow did nothing, Ms. Pine calculated, she would have to take $280,000 in required minimum distributions from the tax-deferred account beginning at age 72. As a single person, this would have forced her into almost the top tax bracket.

Instead, the widow is making large Roth conversions each year to reduce the balance in her tax-deferred account before RMDs begin.

In a Roth conversion, you move investments from a pretax account to an after-tax Roth account. The amount converted is taxed as ordinary income, so it makes sense to do conversions when you are in a lower tax bracket. Many retirees are in a relatively low bracket in their mid- and late 60s, before they start drawing Social Security and making RMDs.

In addition to the Roth conversion, the widow will begin making qualified charitable distributions from her tax-deferred account at the minimum age of 70½, Ms. Pine says. You can donate up to $100,000 a year this way and it counts as part of your RMD.

When a spouse dies, the survivor might not be focused immediately on the financial picture. “Most people are not thinking about this, and if you don’t have proper planning it is kind of a punch in the gut,” says Marianela Collado, a certified public accountant and financial adviser in Plantation, Fla.

But there are some important money-saving maneuvers that can only be done the year of the spouse’s death, Ms. Collado says. When somebody dies, any capital losses they have accumulated on investments expire, too.

Spouses have the right to use these capital losses to offset gains in the year of their spouse’s death, Ms. Collado says. Suppose a widow has a $200,000 gain in her Facebook FB +2.31% stock, and her late husband had generated a $200,000 capital loss. She can sell the Facebook stock to generate a gain, and buy it back 10 minutes later if she still likes Facebook. When she eventually sells the stock down the road, she will have avoided capital-gains taxes on $200,000.
One caveat: It has to be in the same calendar year. “If somebody dies on Dec. 25, you have five days” to use the loss carry-over, Ms. Collado says.

Impact for years

The financial toll of a spouse's death often isn't clear for years. Medicare bases your monthly premium on your modified income two years earlier. Whereas a couple can have up to $176,000 a year in income and still each pay the minimum premium of $148.50 a month, the limit for singles is $88,000.

Ms. Murray, the New Jersey financial adviser, has an 85-year-old client who lost her husband in 2018. Her first tax return as a single person was in 2019.

In January of this year, the widow noticed that the Social Security Administration, which also runs Medicare, had reduced her monthly check. It turned out her Medicare premium had doubled because she was now filing as a single with lower income brackets.

The widow's Medicare premium will drop back in 2022, based on her lower 2020 income. As part of the pandemic relief legislation, Congress allowed retirees to hold off on taking RMDs from tax-deferred accounts for a year. That was enough to push the widow's income under the Medicare limit for a year. But the RMDs are back this year, and the widow's Medicare premiums are headed back up in 2023.

Mr. Templin is a former reporter and editor for The Wall Street Journal who lives in New Jersey. He can be reached at reports@wsj.com.

Corrections & Amplifications

The first name of Marianela Collado, a certified public accountant and financial adviser in Plantation, Fla., was misspelled as Marienela in an earlier version of this article. (Corrected on June 14, 2021.)

Appeared in the June 7, 2021, print edition as 'After a Spouse's Death, Finances Can Suffer.'