# *Understanding*

# IRA and Retirement Plan Distributions

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## What You Will Learn

- Learn the latest rules that affect retirement plans
- How to calculate your required minimum distributions
- Options for choosing beneficiaries for your retirement accounts
- How to "stretch" your retirement accounts so beneficiaries have the opportunity to achieve long term tax-deferred growth after you pass away
- Information about Roth IRA's

## What Are We Talking About

- Retirement accounts include:
  - IRA’s (SEP, SAR SEP, Simple, Etc.)
  - 401k’s
  - 403b’s
  - 457’s
  - Keogh’s
  - Pension Plans (Defined Benefit Plans, Profit Sharing Pension Plans, ESOP, Etc.)
  - Roth IRA’s (Different rules)

## Benefits

- Contributions reduce taxable income
- Contributions grow tax free while inside account-No income tax or capital gains
- Potential significant compounding effect

## What About Uncle Sam?

- All money in these accounts are “pre tax dollars”
  - The contributions as well as the growth of these accounts have not been taxed
- Do you think the IRS still wants their share? Even if you die?
- Not tax free-Only a tax deferral

## Important Part of Estate Planning

- Sometimes retirement plans can be the largest asset of a person’s estate
- Often missed or overlooked in estate planning
- Estate plan needs to include addressing retirement plans

# Rules During Life

## Rules During Life

- Unless an exception applies, withdrawals before age 59 ½ are subject to a 12.5% (10% Fed and 2.5% CA) early withdrawal penalty <u>in addition</u> to income tax
  - No income tax has been paid on these assets

## Rules During Life

- After age 59 ½  and before 70 ½ , you may, but you are not required to, make withdrawals/distributions
- No penalty but withdrawals/distributions are still subject to income tax
- Get a 1099-R for withdrawals

## Lifetime Required Minimum Distributions

- Starting at age 70 ½ the IRS requires you to withdraw or distribute part of the account each year
- Referred to as RMD
- No penalty but withdrawals/distributions are still subject to income tax
- IRS says you have deferred long enough

## Required Beginning Date

- With limited exceptions, RMD must start in the year you turn 70 ½
- RMD required by 12/31 of each year
- First year rule: Can delay distribution until April 1 of year following the year you turn 70 ½
  - Watch out for two distributions in same year
  - May push you into higher income bracket/taxation of social security benefits

## Required Minimum Distribution

- Can always take more
  - Does not give you "credit" for future years
- 50% penalty if too little
  - IRS is serious about getting their share!

## How to Calculate RMD

- Most banks and brokerage firms do the calculation for you and send you a letter
- You can do the calculation yourself using an IRS table
- Most of us use the same uniform table
- Must recalculate each year

## Required Minimum Distribution (RMD)

PRIOR YEAR 12/31 ACCOUNT BALANCE ÷ LIFE EXPECTANCY DIVISOR FROM TABLE = RMD

## Uniform Table

| Age | Divisor | Age | Divisor |
|---|---|---|---|
| 70 | 27.4 | 79 | 19.5 |
| 71 | 26.5 | 80 | 18.7 |
| 72 | 25.6 | 81 | 17.9 |
| 73 | 24.7 | 82 | 17.1 |
| 74 | 23.8 | 83 | 16.3 |
| 75 | 22.9 | 84 | 15.5 |
| 76 | 22.0 | 85 | 14.8 |
| 77 | 21.2 | 86 | 14.1 |
| 78 | 20.3 | 87 | 13.4 |

## Required Minimum Distribution (RMD)

$100,000 ÷ 27.4 = $3,650

| Age | Divisor | Withdrawal Rate % | Age | Divisor | Withdrawal Rate % |
|---|---|---|---|---|---|
| **70** | 27.4 | 3.65% | **85** | 14.8 | 6.76% |
| **71** | 26.5 | 3.77% | **86** | 14.1 | 7.09% |
| **72** | 25.6 | 3.91% | **87** | 13.4 | 7.46% |
| **73** | 24.7 | 4.05% | **88** | 12.7 | 7.87% |
| **74** | 23.8 | 4.20% | **89** | 12 | 8.33% |
| **75** | 22.9 | 4.37% | **90** | 11.4 | 8.77% |
| **76** | 22 | 4.55% | **91** | 10.8 | 9.26% |
| **77** | 21.2 | 4.72% | **92** | 10.2 | 9.80% |
| **78** | 20.3 | 4.93% | **93** | 9.6 | 10.42% |
| **79** | 19.5 | 5.13% | **94** | 9.1 | 10.99% |
| **80** | 18.7 | 5.35% | **95** | 8.6 | 11.63% |
| **81** | 17.9 | 5.59% | **96** | 8.1 | 12.35% |
| **82** | 17.1 | 5.85% | **97** | 7.6 | 13.16% |
| **83** | 16.3 | 6.13% | **98** | 7.1 | 14.58% |
| **84** | 15.5 | 6.45% | **99** | 6.7 | 14.93% |

## More Than One IRA?

- If more than one IRA, RMD must be calculated separately for each account but total RMD can be taken out of one account

## Qualified Charitable Distribution

- The Qualified Charitable Distribution rules allow a taxpayer to distribute money from their IRA and gift it directly to charity without including the IRA distribution in their income

## Qualified Charitable Distributions

- Without the Qualified Charitable Distribution rules, a taxpayer who wanted to withdraw money from an IRA and give it to a charity would have to add the distribution to their income (AGI) and hopefully offset that income with the deduction for the gift to the charity
- Issues:
  - No deduction for taxpayers who do not itemize
  - Including the income can affect the taxability of Social Security benefits
  - Including the income can affect several other tax breaks related to AGI such as deductions, passive losses, etc.

## Qualified Charitable Distributions

- **Benefits of the Qualified Charitable Distribution**
  - **The distribution is excluded from your income**
  - **The distributions will count towards your required minimum distribution**
- **Rules:**
  - **Limited to $100,000**
  - **Must be age 70½ or older**
  - **Distribution must be made directly to the charity**
  - **Unless extended again, only good for 2013**

## Choosing Beneficiaries and Rules After Death

## Concepts

- Concept 1: During life, you get to pick the beneficiary for your retirement accounts by completing a beneficiary designation form with the institution that holds your retirement account-
  - Contact to pay at death/No probate
  - Change at any time
  - Unless your trust is listed as a beneficiary, your trust is separate and does not control these asset when you pass away-The beneficiary designation form controls
- Concept 2: After death, a designated beneficiary can continue to deferred income tax until money is distributed/withdrawn
- Concept 3: IRS still wants their share and requires your named beneficiary to withdrawal money, based on the beneficiary's own life expectancy, from the account so the IRS can collect the tax (IRD)

## IRD

- Income in respect of a decedent
- No income tax has been paid on the money in the retirement account
- Beneficiary has to pay the tax as it is withdrawn
- The IRS has a "mortgage" on the account
- Watch out for double taxation-both income tax and estate tax!
  - IRD Deduction

## Concepts

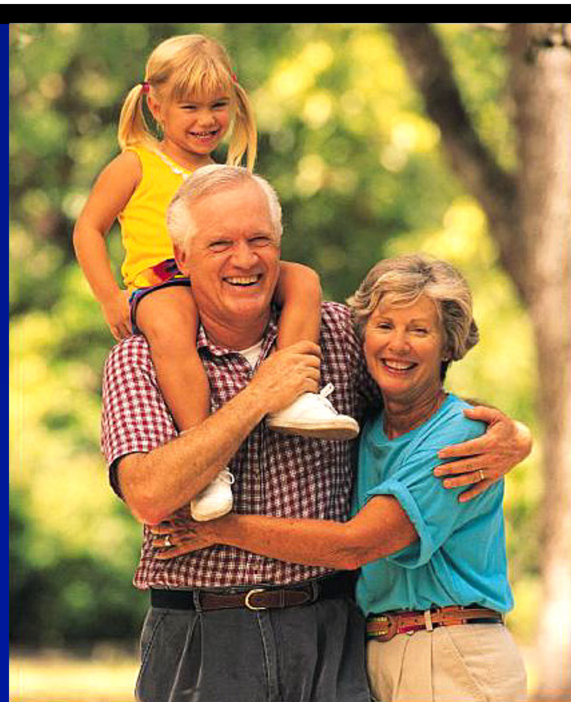
- Concept 4: From a tax standpoint, it is preferred that your beneficiary avoid taking a lump sum distribution (Lose tax deferred growth and pay higher taxes)
- Concept 5: Generally, the strategy is to try to make the beneficiary's withdrawal period as long as possible (Stretch)
- Concept 6: The time period for and amount that a beneficiary has to make withdrawals is dictated by who is named as a beneficiary

## Choosing Beneficiaries

- The rules/options for distribution of the account will depend on who you designated as your beneficiary
- With this in mind, the selection of beneficiaries is very important

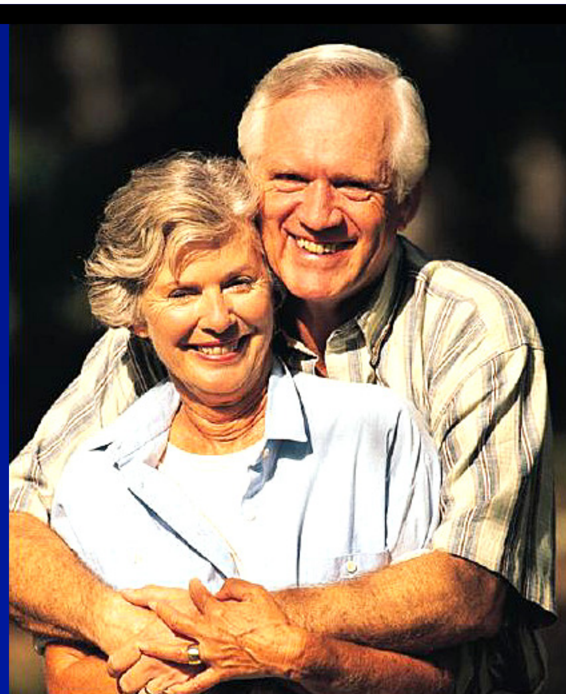
## 5 Beneficiary Options

- Spouse
- Children, grandchildren, others
- Trust
- Charity
- Some or all of the above



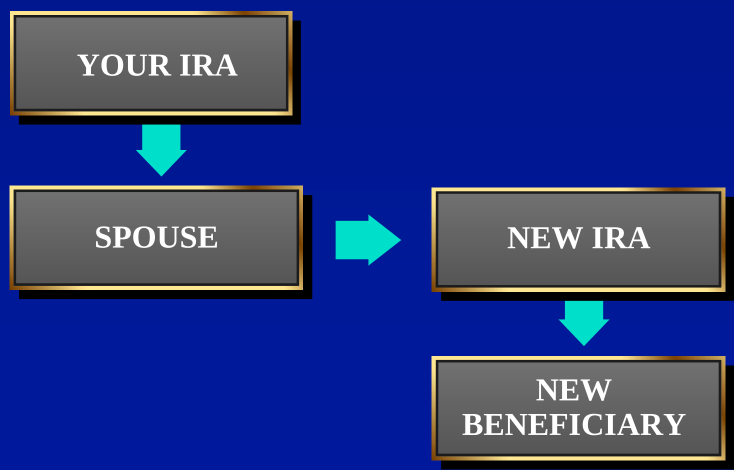
## Option 1. Spouse as Beneficiary

- Benefits
  - Money available to spouse
  - Special Rule: Spousal rollover option



*Option 1. Spouse*

## IRA Spousal Rollover Example




*Option 1. Spouse*

## Disadvantages

- Spouse has control of money
- Possible issue with a blended family

## Option 2. Children, Others as Beneficiary (Adults)

- **Benefits**
  - **Uses beneficiary's actual life expectancy**
  - **Potentially many years of tax-deferred growth**

*Option 2. Children, Others*

## Stretch Example

- **John dies with an IRA account**
- **John's son Frank is named as sole beneficiary of IRA**
- **Frank opens an Inherited IRA account and receives assets**
- **Frank is 50 years old**
- **Frank's life expectancy is 34.2 (See Table)**
- **If value if IRA was $100,000, Frank's RMD would be $2,923.97 ($100,000/34.2)**

SINGLE LIFE EXPECTANCY

| AGE | DIVISOR | AGE | DIVISOR | AGE | DIVISOR | AGE | DIVISOR | AGE | DIVISOR |
|---|---|---|---|---|---|---|---|---|---|
| **0** | 82.4 | **23** | 60.1 | **46** | 37.9 | **69** | 17.8 | **92** | 4.9 |
| **1** | 81.6 | **24** | 59.1 | **47** | 37 | **70** | 17 | **93** | 4.6 |
| **2** | 80.6 | **25** | 58.2 | **48** | 36 | **71** | 16.3 | **94** | 4.3 |
| **3** | 79.7 | **26** | 57.2 | **49** | 35.1 | **72** | 15.5 | **95** | 4.1 |
| **4** | 78.7 | **27** | 56.2 | **50** | 34.2 | **73** | 14.8 | **96** | 3.8 |
| **5** | 77.7 | **28** | 55.3 | **51** | 33.3 | **74** | 14.1 | **97** | 3.6 |
| **6** | 76.7 | **29** | 54.3 | **52** | 32.3 | **75** | 13.4 | **98** | 3.4 |
| **7** | 75.8 | **30** | 53.3 | **53** | 31.4 | **76** | 12.7 | **99** | 3.1 |
| **8** | 74.8 | **31** | 52.4 | **54** | 30.5 | **77** | 12.1 | **100** | 2.9 |
| **9** | 73.8 | **32** | 51.4 | **55** | 29.6 | **78** | 11.4 | **101** | 2.7 |
| **10** | 72.8 | **33** | 50.4 | **56** | 28.7 | **79** | 10.8 | **102** | 2.5 |
| **11** | 71.8 | **34** | 49.4 | **57** | 27.9 | **80** | 10.2 | **103** | 2.3 |
| **12** | 70.8 | **35** | 48.5 | **58** | 27 | **81** | 9.7 | **104** | 2.1 |
| **13** | 69.9 | **36** | 47.5 | **59** | 26.1 | **82** | 9.1 | **105** | 1.9 |
| **14** | 68.9 | **37** | 46.5 | **60** | 25.2 | **83** | 8.6 | **106** | 1.7 |
| **15** | 67.9 | **38** | 45.6 | **61** | 24.4 | **84** | 8.1 | **107** | 1.5 |
| **16** | 66.9 | **39** | 44.6 | **62** | 23.5 | **85** | 7.6 | **108** | 1.4 |
| **17** | 66 | **40** | 43.6 | **63** | 22.7 | **86** | 7.1 | **109** | 1.2 |
| **18** | 65 | **41** | 42.7 | **64** | 21.8 | **87** | 6.7 | **110** | 1.1 |
| **19** | 64 | **42** | 41.7 | **65** | 21 | **88** | 6.3 | **111+** | 1 |
| **20** | 63 | **43** | 40.7 | **66** | 20.2 | **89** | 5.9 | | |
| **21** | 62.1 | **44** | 39.8 | **67** | 19.4 | **90** | 5.5 | | |
| **22** | 61.1 | **45** | 38.8 | **68** | 18.6 | **91** | 5.2 | | |

*Option 2. Children, Others*

## Disadvantages

- **May not follow you wishes to "stretch" the account**
- **Money exposed to irresponsible spending, creditors**

## Option 3. Trust as Beneficiary

- Can name a trust as a beneficiary
- Trust must meet certain IRS requirements and include special provision regarding retirement accounts

## Option 3. Trust as Beneficiary

- Benefits
  - Provides control
  - Can protect assets from courts, creditors and irresponsible spending

*Option 3. Trust*

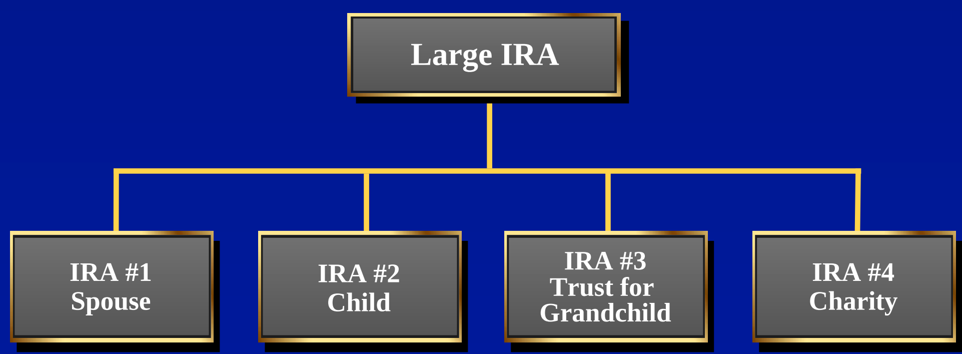
## Disadvantages

- No spousal rollover available
- If a single trust has multiple beneficiaries, may have to use age of oldest trust beneficiary to calculate withdrawals for all beneficiaries
- Higher income tax rates if distributions stay in trust
- Administratively complex
- Expense

## Option 4. Charity as Beneficiary

- Benefits
  - No income taxes
  - Reduces estate taxes

## Option 5. Some or All as Beneficiary




## Mistakes

- Not naming a beneficiary
- Naming “my estate”
- Naming a minor outright
- Not naming both primary and contingent beneficiaries
- Not keeping beneficiary designations up to date
- Not keeping records of beneficiary designations
- Not considering and/or planning for the income tax issues when selecting beneficiaries-(Case by Case)

# Roth IRA's

## Benefits of Roth IRA

- No required distributions during your lifetime
- Can make contributions after age 70 $^1/_2$
- Tax-free growth
- Tax-free distributions to you and beneficiary(ies)
- Stretch out and spousal rollover okay

## Roth IRA Conversion

- Convert traditional IRA and other retirement accounts to a Roth IRA
- Everyone is eligible-No more limitations
- Must pay income taxes on conversion
- Need to do careful analysis to see if it makes sense
- It is reversible! (Recharacterization)

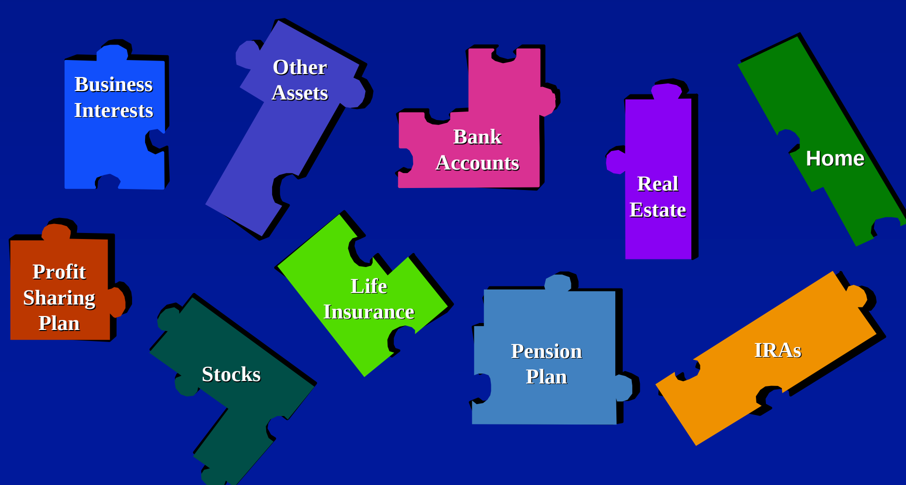
## Roth IRA Conversion Factors

- You expect your tax rate to be higher in retirement
- You do not think you will need the money for living expenses-we want money to stay in the Roth IRA
- Your investment horizon is long enough to benefit from the tax-free growth of a Roth IRA
- You can afford to pay taxes on the conversion using separate funds
- Estate planning objectives

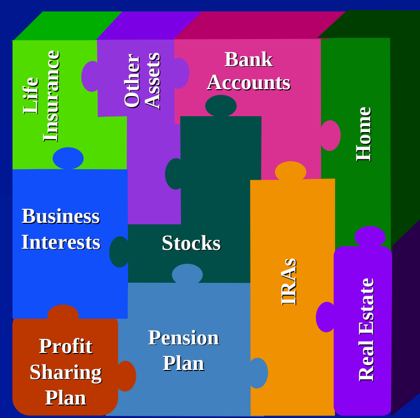
## Jump Start Your Children's (Grandchildren's) Retirement Fund

- 100% of child's earnings, up to $5,500/yr
- Over 59 $^{1}/_{2}$ : tax-free withdrawals
- Under 59 $^{1}/_{2}$ : no taxes or penalties until all contributions withdrawn
- Special breaks for college, home
- Child (Grandchild) has control

## Estate Plan Components



## Successful Estate Plan

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