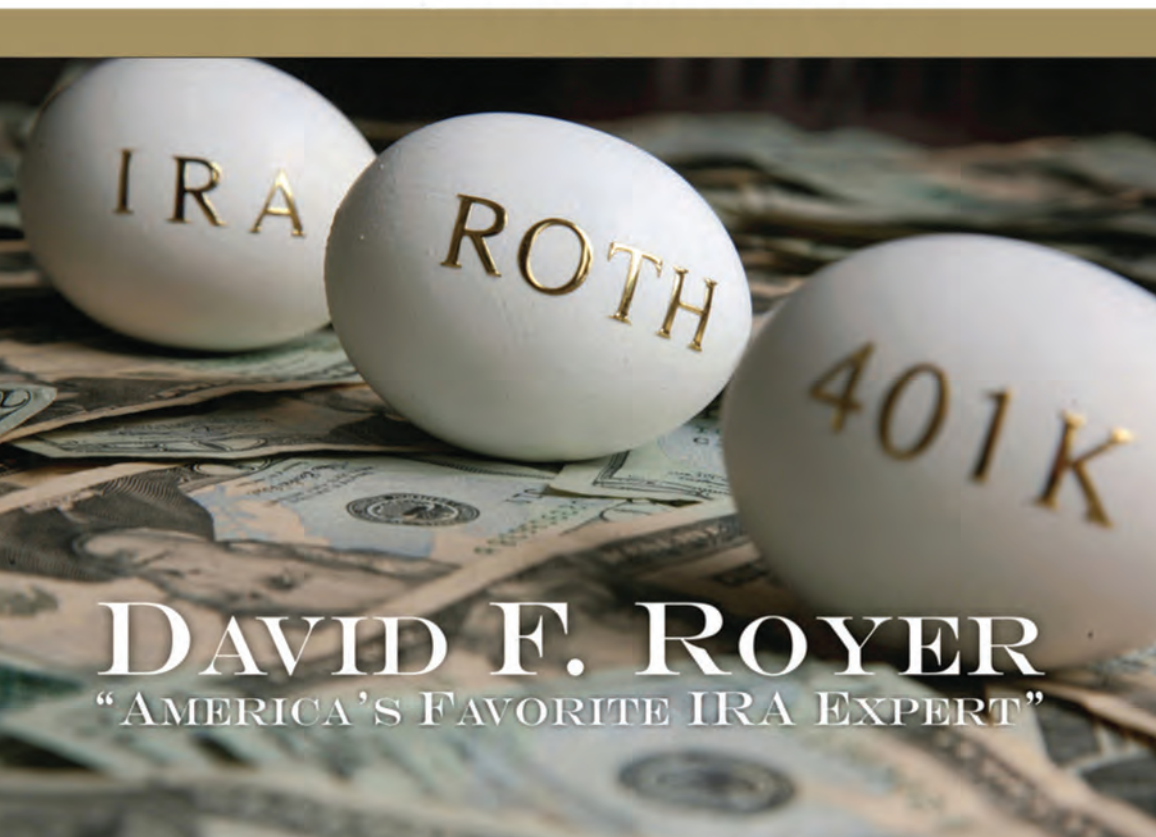


# TOP 10 IRA MISTAKES

“HOW TO AVOID  
IRA TAX TRAPS”



DAVID F. ROYER  
“AMERICA’S FAVORITE IRA EXPERT”

Provided by:



American Network of  
Financial Education



**Jim Billington, (CES)**  
**360-567-5697**  
Jim.billington@ANOFE.org



**Rick Eason**  
**503-548-3454**  
rick.eason@ANOFE.org

As independent wealth preservation and distribution specialists, our mission is to help people just like you create and secure a confident retirement.

We help you answer the question that is on almost everyone's mind as they approach retirement; "Do I have enough money, or will I run out?"

Jim has over 30 years of experience as a 2nd generation financial consultant and Certified Estate and Trust Specialist.

Rick also comes from a family of financial/insurance consultants and is quickly gaining his professional experience from working on the team.

We are both passionate about simplifying complex financial solutions to provide transparent and reliable guidance.

Our goal is to help you preserve, protect, defend and grow safely the wealth you've spent a lifetime accumulating and can't afford to lose.

Together, we build a personalized financial road map intended to give you the clarity and peace of mind you deserve. You've worked your entire life and now it's time to enjoy it.

Let's connect and dive into the ways in which we can help you achieve your ideal retirement.

***"Our strong belief in education and planning has been the foundation of our clients' success" – Jim & Rick***

**Certified Estate & Trust Planning Specialist (CES)**

**360-567-5697 direct / 360-256-9795 fax**

[www.ANOFE.org](http://www.ANOFE.org)



# **Top10 IRA Mistakes**

**Avoiding Mistakes Can Save Owners of IRA's 401(k)s,  
403(b)s, TSPs, and other Retirement Plans a Fortune in  
Taxes, Penalties, Fees and Loads....**

**David F. Royer**



**Published by DLCA Enterprises, LLC**

***Top 10 IRA Mistakes***

Copyright © 2023 by David F. Royer Library of Congress Control Number:  
2011930210

All rights reserved. Printed in the United States of America. No part of this book may be used or reproduced in any manner whatsoever without written permission, except in the case of reprints in the context of reviews. Published by DLCA Enterprises, LLC. For information about DLCA Enterprises, LLC, send inquiries to 3472 Cumberland Lane, Frisco, Texas 75033.

This book is intended to help owners of IRAs, 401(k) plans, 403(b) plans and other retirement accounts make informed decisions, avoid costly mistakes, and get the maximum benefits from their retirement savings. The author and publisher have used their best efforts in preparing this book. It is not intended to offer specific financial advice or to replace the advice of your financial advisor, accountant, or attorney. Your financial circumstances and retirement goals are unique. You should consult a financial advisor or other professional advisors before implementing any of the tax-saving ideas presented in this book.

**Acknowledgments**

***Editing***

Leslie J. Thompson – Senior Editor

Carrie N. Royer – Assistant Editor

***Interior Art and Layout***

Ken Small/Digital Book Designs

***Cover Art and Graphic Design***

Digital Book Designs

***Photos***

Franklin D. Roosevelt Library, courtesy of the National Archives and Records Administration.

The Republican Company. All rights reserved. Reprinted with permission.





**David F. Royer** entered the financial services industry after completing his military obligation. He has over four decades of experience and in 2002 he began studying the growing IRA and 401(k) distribution market. Today he is a nationally recognized speaker and trainer in qualified plan distribution. He has trained thousands of financial advisors and agents in the discipline of retirement plan accumulation and distribution. David's many articles on IRAs, 401(k)s and other qualified retirement plans have been published in leading national financial periodicals. He is a frequent guest on financial radio shows and is a best-selling author.

Today he is focused on helping those who are retired or planning for retirement, to keep their retirement accounts safe and make them aware of ever-changing rules that could affect their retirement savings.

In 2004 David developed the ultimate IRA distribution training course *"The Keys to the IRA Kingdom"*®, that he teaches nationally. He educates financial advisors in the art of helping their clients get the most out of their IRAs, 401(k) plans and other qualified retirement accounts. In 2020 David founded *The American Network of Financial Education* with the mission of empowering every American to take control of their financial and retirement future

David teaches a simple lesson:

***"The IRS has given IRA/401(k) owners and their beneficiaries complex rules and guidelines that must be followed to avoid additional taxes and penalties. "They just need a little help to navigate them."***



# *Navigating the Retirement Maze*

The sense of being lost and alone is among the most terrifying feelings imaginable. Picture yourself in a rental car, driving in a major city for the first time. It's the middle of a stormy night, you are completely lost and the only tool you have to find your way is the address of your destination. You are in a bad part of town, there is no one in sight to offer directions, and your cell phone battery just died.

Just ahead, through the heavy rain, you can barely make out a fork in the road. You must make a decision and you sense that if you take the wrong turn you might find yourself in a dangerous situation. In that moment you remember the agent behind the rental car counter asking whether you wanted to pay an additional \$19.95 to have a navigation system (GPS) included in your rental agreement, and you declined. As the fork in the road draws nearer, you realize that you must make a choice right now and you have no way of knowing which way to turn. This nightmare could have been avoided if you had chosen to get the GPS to help you find your way.

Planning for a secure retirement can also become a nightmare for many people, with today's complexities of IRS regulations and hidden tax traps. Navigating the IRS minefield of rules, deadlines, penalties, and over-taxation is similar to trying to find your way in a strange place without a GPS. Hidden tax traps lurk around every corner, and finding help to get good directions is more challenging today than at any time in the past. When you are retired or planning for retirement, taking the wrong fork in the road can result in costly mistakes that cannot be reversed. This book is your retirement planning GPS and will help you navigate the IRS minefield and avoid making wrong turns that could result in a retirement nightmare.

# IRA Myths:

## **Myth #1- You Own Your IRA**

Nothing could be further from the truth! The reality is that you have a partner, the IRS, aka Uncle Sam. For example, if you have \$300,000 in your IRA and you are in a 32% federal income tax bracket, the IRS owns approximately \$100,000 of your account, leaving only \$200,000 for you. This is the contract IRA owners made with the IRS when they tax-deducted their contributions. It was a simple agreement: you save the tax on the seed but you must now pay the tax on the crop. Your IRS partner will dictate when you will pay the tax and how much you will pay. If your tax bracket is increased to 50%, the IRS will own half of your IRA. Anything over 50%, the IRS becomes your senior partner. The same rules apply to 401(k)s, 403(b)s, 457 plans and most other qualified retirement accounts.

## **Myth #2 – You Can Beat the Tax**

Also not true. The only way out of an IRA is through the IRS. The contract with the IRS is air tight. You must begin taking taxable distributions by April 1 of the year after you turn age 73. Even at death the IRS will get its pound of flesh. If you die while owning an IRA or other qualified retirement account, your heirs will inherit the IRA taxes. Either way the taxes must be paid and the IRS will tell you when they must be paid and how much the taxes will be. Fortunately, strategies exist that can help put the IRA owner back in control so they can determine when and how much tax will be paid.

### **Myth #3 - There's Nothing You Can Do About It**

This is the biggest myth of all. Even though the IRA owner does not own the entire account and there is no way to beat the taxes on IRA distributions, account holders can still take strategic steps to increase the income from their IRA and ease the tax burden. This is where the Trained IRA Advisor can play a big role in guiding you through the IRS maze of regulations, deadlines, and penalties and help you get the most out of your IRAs, 401(k)s, and other retirement accounts.



# Table of Contents

Introduction.....	13
Not Understanding the SECURE Act of 2019-2022.....	17
Missing A Required Minimum Distribution.....	23
Not Properly Designating Beneficiaries.....	31
Not Knowing The IRA-401k Rollover Rules.....	39
Too Much of Your IRA at Risk.....	43
Overpaying Fees and Loads on IRAs, 401(k) and 403(b) Plans....	53
Not Taking Advantage of Tax Saving Strategies.....	59
Not Rolling 401(k) or 403(b) Plans to an IRA.....	69
Too Many Retirement Accounts.....	73
Not Getting a Second Opinion.....	81
Bonus Chapter for The Boomer Generation.....	91
Summary.....	93



# INTRODUCTION

## ***BRIEF HISTORY OF RETIREMENT PLANS IN AMERICA***

**On August 14, 1935 President Roosevelt signed the  
Social Security Act into law**

This piece of legislation was intended to help Americans supplement their personal retirement savings, not replace it. Federal legislators recognized that American workers were not saving enough and might need government support to ensure they had the basic living necessities during their retirement years. It was never the government's intention to return our income tax dollars so we could retire comfortably at Uncle Sam's expense. In fact, government leaders have struggled with this issue throughout history. Below is a famous quote that demonstrates how far back in history this attitude is rooted.

*"The national budget must be balanced. Public debt must be reduced. The arrogance of authorities must be moderated and controlled. Payments to foreign governments must be reduced if this nation doesn't want to go bankrupt. People must again learn to work instead of living on public assistance."*

—Marcus Tullius Cicero, 55 B.C.

To ensure that the money would be available for its intended purpose, President Roosevelt promised that as long as he lived, Americans would pay no income tax on their Social Security benefits. In 1983, Congress broke that promise and today, if you have an income of \$25,000 and are single, or a combined income of \$32,000 and are married, you will pay income tax on 50% of your Social Security benefit. It gets worse: if you have income of \$34,000 and are single, or an income of \$44,000 and are married, you will pay income tax on 85% of your Social Security benefit.

Working Americans pay their Social Security tax, and those who are receiving benefits and continue to have income over the thresholds are also paying income tax on their Social Security benefits. Uncle Sam gets to double dip, while senior citizens struggle to make ends meet and are left without the safety net the federal legislators originally intended.

The better people do to earn income to support themselves during their retirement years, the more likely they will end up paying income tax on their Social Security benefits. This is important because distributions from a traditional IRA are taxed as ordinary income. Increases in your taxable income can increase the tax on your Social Security benefits.

### **In 1974 Congress passed The Employee Retirement Income Securities Act (ERISA)**

This act marked the birth of the modern retirement plans to which many of us have been contributing for 30 years or more. Out of this landmark legislation grew IRAs, 401(k)s and other company sponsored plans, SEPs, 403(b) plans used by educators, and most other qualified retirement plans. ERISA was designed to encourage Americans to prepare for retirement and be less dependent on Uncle Sam.

### **The government gave Americans four attractive incentives to save:**

1. Participants were allowed to deduct their contributions from their income taxes.
2. Their gains were tax deferred.
3. These retirement accounts were exempt from creditors.
4. Payroll deduction for company employees made it much easier to save for retirement.

With all of these enticements, saving for retirement was practically irresistible, and Americans began to put away millions in IRAs and other retirement accounts. But, there was

a catch! These accounts ultimately became a TAX PRISON!

For many, IRAs, 401(k)s and other qualified retirement accounts are the bulk of their retirement savings. These savers made systematic, tax deductible contributions during most of their working lives, and after turning age 73 they must take systematic, fully taxable, withdrawals. It's not uncommon for the current balance in a retirement account to be two or three times the amount deposited over the account holder's working years. The miracle of compound interest can grow tax-deductible contributions into sizable and taxable IRS Nest Eggs. With all of the great tax incentives to save for retirement, Uncle Sam accomplished his goal.

**“You saved the TAX on the SEED, but now you must pay the TAX on the CROP.”**

The good news is that you can take steps to regain control of your IRAs and other retirement plans. This book will help you avoid the IRS tax traps and find the gold nuggets in the tax code that you can use to reduce your tax burden and get the most out of your retirement savings.



# MISTAKE #1

## SECURE ACT OF 2019 AND 2022

If there is money left in your IRA, who do you want to leave it to and how much do you want to leave to the IRS?

In December of 2019, Congress passed “The Setting Every Community Up for Retirement Enhancement Act of 2019” also known as the “SECURE Act”.

The SECURE Act is one of the most important pieces of retirement legislation in over a decade. There are a number of enhancements designed to help savers be better prepared for their retirement years. People are living longer and there is the potential for some to outlive their retirement savings. In this chapter we will go over new rules and contrast them with the old rules for your retirement accounts.

### **Let’s start with the 2 most important changes:**

1. Under the old rules you could not make any contributions to your traditional IRAs after turning age 70½. Under the SECURE Act you can now continue to make contributions as long as you have earned income. This is particularly important for those who wish to continue working into their 70s or even their 80s. The ability to continue to make pre-tax contributions after age 70½ will allow you to continue to grow your IRA and there will be more money in the account when you need it.
2. Under the old rules you were forced to begin taking Required Minimum Distributions after turning age 70½. Under the new SECURE Act rules you are not forced to take any distributions until age 73. For those who don’t need income from their IRAs, this allows more time for

your money to grow. While the age limit for making IRA contributions is eliminated, earned income is still required to make IRA contributions for you and your spouse.

Both of these new enhancements will help you grow your accounts and make your retirement savings last longer.

### **Is there a catch? Always!**

Prior to the new rules put into place by the SECURE Act, your inheriting beneficiaries had the right to stretch their distributions over their individual life expectancies. This was referred to as the STRETCH IRA Option.

### **Example:**

If your 30 year old child inherited some of your IRA, 401k, TSP, 403b or any other qualified retirement account they had the option to spread their taxable distributions over their individual life expectancies. In the case of the 30 year old child that would amount to 53.3 years of distributions and tax deferral. If your inheriting child was age 40 they would be able to stretch the taxable distributions over 43.6 years. The stretch IRA option allowed your non-spousal beneficiaries to enjoy a lifetime of income from their inheritance and also extended tax deferral.

### **Sounds good right? Well the SECURE Act eliminated that option.**

Under the new rules these same non-spousal beneficiaries will now have only 10 years of tax deferral. Said differently; your non-spousal beneficiaries will be required to pay the tax on the entire inherited account by the end of the 10th year.

### **If death occurred BEFORE the owners Required Minimum Distribution Date Your beneficiaries have 3 options:**

1. They can pay all of the tax when they inherit and do what

they desire with what is left over. The unattractive part of using this approach is that the inherited IRA will then be treated as income and could push them into a higher tax bracket during their most productive earning years. Let's assume that your beneficiary is married and filing a joint return and the current joint income is \$125,000. They would be in a 22% tax bracket. If the inherited IRA is \$250,000 and they paid the tax in the year they inherited their joint income would jump to \$375,000 and their tax bracket would increase to 32%. That would amount to a 10% tax increase.

2. They could opt to spread the taxes over ten years. Using the same scenario as above (joint income of \$125,000 inheriting a \$250,000 IRA) spreading the taxes out over ten years might be more attractive. They would only have to report \$25,000 of additional income each of the ten years and would remain in the 22% tax bracket. That would take a lot of the sting out and save them approximately \$25,000 in taxes.
3. They have the option to wait until the end of the 10th year to settle with the tax man. The advantage of this approach is their inheritance could continue to earn interest for 10 years before they will need to pay the tax. Using this approach could have the same negative tax effect as option one.

### **If death occurred AFTER the owners Required Minimum Distribution Date (Usually age 73 or older)**

Your beneficiaries will need to take Required Minimum Distributions (RMDs), based on their life expectancy, years 1 through 9 and all funds in the inherited IRA must be withdrawn by the end of the 10<sup>th</sup> year after death.

If your beneficiary/beneficiaries live in a state that has a state income tax that will make options 1 and 3 even less attractive. Taking tax brackets into consideration when

deciding how to settle with the IRS will now be an important consideration now that the STRETCH IRA is no longer available.

There are 6 Classes of Designated Beneficiaries (exempt from the 10-year post-death payout rule).

1. Surviving Spouse
2. Minor children up to majority
3. Disabled individuals
4. Chronically ill
5. Beneficiaries not more than 10 years younger than the IRA owner (or plan participant)
6. Beneficiaries who inherited prior to January 1, 2020

It's important to note #1 above (Surviving Spouses). If your spouse inherits your IRA, 401k, TSP or 403b plan, they are exempt from the 10 year rule. Your spouse can become the account owner and spread out their Required Minimum Distributions (RMDs) over their remaining life expectancy and enjoy a lifetime of income from their inherited IRA.

## **The Secure Act 2.0**

Congress didn't stop there. In Dec of 2022 the Secure Act 2.0 was signed into law.

The new provisions in the SECURE Act 2.0 further enhanced your ability to save longer. There were three major changes that will affect IRA owners beginning in 2023.

1. The age you must begin taking your Required Distributions was changed from age 72 to age 73 beginning in 2023. Over the next 10 years it has provisions to ultimately increase the age to 75. A lot could change between now and 2033, so we will have to wait and see.

*NOTE: If you are currently taking Required Distribution, this change will not affect you. You must continue to take your distributions.*

2. The penalty for missing a Required Minimum Distribution was reduced from 50% of the missed distribution to 25% of the missed distribution. That's still a big penalty but also a big improvement.
3. Enhancements to the Qualified Longevity Annuity Contract (QLAC)

A Qualified Longevity Annuity Contract (QLAC) is a type of deferred annuity that is funded by a qualified retirement account - such as a 401(k), a 403(b) or an IRA - to be converted into a deferred annuity. A QLAC is protected against stock market downturns and provides a guaranteed income for life.

Under the SECURE Act 2.0 the 25% of asset limitation was repealed and the new maximum limit you can contribute to a QLAC was increased from \$145,000 to \$200,000. ***When you contribute from your qualified account to a QLAC, you can postpone Required Distributions to as late as your age 85.***

For those who don't want or need their taxable Required Distributions beginning at age 73, the new rules for QLACs can be a current tax blessing.

### **In Summary:**

The Secure Act of 2019 and 2022 will enhance your ability to contribute longer and start taking required minimum distributions later. This is a great one-two punch intended to punch up your retirement accounts so there will be more money available when you need it to supplement your retirement income.

Unfortunately this is at the expense of your children who will need to pay the taxes on inherited retirement accounts in a compressed time period (10 years).



## MISTAKE #2

### MISSING A REQUIRED MINIMUM DISTRIBUTION

This is the #1 and most costly mistake made by IRA owners and their beneficiaries. The first taxable Required Minimum Distribution (RMD) must be taken by April 1 of the year after the IRA owner turns age 73. This is called the Required Beginning Date (RBD). Future required distributions are based on the account value as of December 31 of the prior year and must be taken by December 31 of the current year. This is how the IRS dictates when the IRA taxes must be paid.

Extreme penalties are charged if the IRA owner fails to take the full RMD by the deadline.

**In addition to paying income tax, the owner will also owe an Excise Tax equal to 25% of the missed distribution!** This could create a tax burden of more than 50% on missed Required Minimum Distributions.

#### Example:

Richard is 79 years old, and his IRA account balance was \$500,000 at the end of the prior year. Richard is in a 24% federal income tax bracket. His Required Minimum Distribution (RMD) at age 79 is 5.13% of the \$500,000 account balance, as of December 31 of the prior year. That means he must take a taxable distribution of **\$25,650 (5.13% × \$500,000 = \$25,650)** before December 31 of the current year. Richard knew the rules and had every intention of taking his required distribution well before the December 31 deadline. He usually waited until November or early December to take the distribution, so he could earn as

much interest as possible before giving the IRS its share. This particular year Richard had some health problems and spent much of his time going back and forth to the doctor's office. In early December, Richard was admitted to the hospital for a needed surgery. All focus was on Richard's health and the last thing on the family's mind was his retirement account. After surgery Richard needed several weeks to recover. Unfortunately, while he was recovering, the December 31 deadline to take the current year's distribution had passed, and Richard failed to withdraw the required amount. This created a big payday for the IRS. Richard now must pay an additional 25% Excise Tax for missing the December 31 deadline, and he will still owe the income tax when the missed distribution is finally taken.

### **Let's do the math:**

\$ 25,650.00 Missed Distribution  
-\$ 6,156.00 Income Tax (24%)  
-\$ 6,412.50 Excise Tax(25%)  
=\$ 13,076.50 Net Distribution for Richard

The \$25,650 missed distribution minus \$6,156.00 Income Tax (24%), minus \$6,412.50 Excise Tax (25% of the missed distribution) means that \$12,569.00 belongs to the IRS. Richard is left with only \$13,081.00 of the \$25,650 required distribution.

"The IRS becomes the IRA owner's Senior Partner!"

### **Case in Point:**

In 2009, when the penalty was still 50%, I received a call from a financial advisor, Alex, who attended my IRA distribution training course a few months earlier. He wanted to discuss a client he was working with that attended one of his recent financial planning workshops. His client, Mike, was age 77 and had a little more than \$600,000 in his IRA. Most

of the IRA money had accumulated in his 401(k) while he was working as a supervisor at a sizeable manufacturing plant. When he retired he decided to convert his 401(k) to an IRA, and he set up the IRA in a CD at a local bank. Mike chose the CD so that, unlike his 401(k), there would be no risk. Mike was going to play it safe and make sure his IRA would be there when he needed it.

After Mike retired at age 65, he started a small real estate firm. The real estate market was booming at that time and Mike was making more money selling real estate than when he was employed at the plant. Alex, his new advisor, noticed something unusual on his tax returns. There were no withdrawals coming out of his \$600,000 IRA and no IRA distribution taxes were paid. Mike had no need to take income from his IRA, so he didn't take the required distributions. Alex pointed this out to Mike and explained that he should have taken his Required Minimum Distribution beginning when he turned 70½ more than six years ago.

Mike replied that the clerk at the bank who sold him the CD years ago said he could keep his money in the bank as long as he wanted to, but didn't explain that he would need to take at least his required distribution each year after turning age 70½. The bank probably sent Mike the annual statement to remind him of his Required Minimum Distribution, as required of IRA custodians, but Mike received so much junk mail from the bank, he threw most of it away unopened.

Mike missed six Required Minimum Distributions that added up to a little more than \$150,000. He now owed income tax on the missed distributions (roughly \$50,000). The income tax will be due when the missed distributions are finally taken. Mike also owes the IRS nearly \$75,000 in Excise Tax (50% of the missed distributions) in addition to the income tax. The total expense came to more than \$125,000, including additional penalties and interest. When all was said and done, Mike got to keep less than \$25,000 of the \$150,000 of his missed distributions.

Mike owed the IRS approximately 83% of the missed distributions in taxes and penalties. This hefty bill from Uncle Sam could have been avoided had Mike received proper advice and set up a formal IRA distribution plan. Not planning may cost Mike over \$75,000 of IRS penalties that could have been avoided. Unfortunately, in this case, there was nothing the advisor could do to help Mike beat the taxes and penalties. The deadlines for taking Required Minimum Distributions are not flexible and Mike now owed the IRS its pound of flesh.

If you miss the deadline to take your RMD, the best course of action is to take the distribution as soon as you discover your mistake. You can also request a waiver of the 25% Excise Tax by filing a waiver request along with IRS form 5329 explaining the reason for the missed distribution. Some examples of reasons for missing the distribution include:

- The custodian did not process your request before the December 31 deadline.
- The custodian miscalculated the distribution amount.
- The request for the distribution was lost in the mail. (Good luck with that one.)
- The account owner is elderly or was ill during the year that the RMD was due.
- The IRA owner's spouse usually handled this and he/she was ill or passed away.

The more Required Minimum Distributions you miss, the less likely the IRS will grant you a waiver of the 25% Excise Tax. Don't wait for an audit. After the audit process begins, there is little chance that the IRS will consider a waiver of the penalties.

## **Beneficiaries also make the mistake of failing to take a Required Minimum Distribution from an inherited IRA**

**If the beneficiary is your spouse** he or she must decide whether to become the owner of the inherited IRA or remain a beneficiary. Making this choice will determine when distributions are required. If the inheriting spouse chooses to become the owner, distributions can be delayed until he or she reaches age 73. Additionally, as the new owner, the inheriting spouse can make any needed beneficiary changes.

If an inheriting spouse chooses to remain a beneficiary, he or she must begin taking distributions based on his or her life expectancy, by December 31 of the year following the year of the IRA owner's death, or when the original IRA owner would have turned age 73, whichever is later. There are times when remaining a beneficiary offers the spouse an advantage. If the spouse is under age 59½ and needs to take distributions prior to age 59½, they will not need to pay the 10% pre-59½ distribution penalty if they remain a beneficiary. Making the decision to become the new owner or remain a beneficiary is an important planning tool for spouses who inherit an IRA.

**If the beneficiary is not your spouse**, for example if a child, grandchild, or anyone other than the IRA owner's spouse is the beneficiary, they do not have the option of becoming the owner of the inherited IRA. They must remain a beneficiary for the IRA to continue to have tax-deferred status. This is where a non-spousal IRA beneficiary can make an enormous IRA mistake and find themselves in the jaws of one of the most costly IRS tax traps.

Let's consider Jim who was the beneficiary of his father's \$200,000 IRA. Jim had great respect for the sacrifices his father made to save for his retirement years so, when his father died and Jim inherited his father's IRA, he made a commitment not to squander the inheritance that his father worked so hard for. Jim decided to deposit the inherited IRA into his own IRA, and like his father, he would save it for his retirement years.

Jim's intentions, admirable as they were, resulted in a tax feast for the IRS.

The moment Jim deposited his father's IRA into his own IRA the entire inherited IRA became immediately taxable. This not only generated a big tax bill for Jim, it also pushed him into a higher tax bracket. Only an inheriting spouse has the option to roll an inherited IRA into their own IRA or become the owner of an inherited IRA. Jim was not informed about the complex IRS rules, regarding inheriting an IRA, and made the worst possible decision.

***For doing something that seemed reasonable, Jim was severely punished. He paid the income tax and a big chunk of his inherited IRA was now the property of the IRS.***

**Jim should have been better informed about  
two significant IRS rules:**

1. Non-spousal IRA beneficiaries may not become the new owner of an inherited IRA or roll the inherited IRA into their own IRA. If either of these mistakes is made, the inherited IRA will become taxable. Also, unlike spouses who inherit an IRA, non-spousal beneficiaries may not delay taking distributions until they reach age 73. They must take their first Required Minimum Distribution no later than end of the tenth year after they inherit. They can take taxable distributions any time during the ten year period or wait until the end of tenth year. If they chose to wait until the end of the tenth year to take the full distribution, they may find themselves in a higher tax bracket.
2. If the IRA owner was over age 73 at death and did not take the required distribution during the year of death, the non-spousal beneficiaries must take a taxable distribution equal to the required distribution the owner would have taken if still living. If the IRA owner did take the distribution for the year of death, the beneficiaries first Required Distribution will be due at the end of the tenth year. If this deadline is

missed, the non-spousal beneficiaries may also be subject to the 25% Excise Tax.

Many non-spousal beneficiaries are not aware of their right to wait until the end of the tenth year to take any distribution and keep the inherited IRA in a tax-deferred status. Waiting until the end of the tenth year will allow the non-spousal beneficiary to enjoy tax deferred growth before being forced to pay the tax on the inherited IRA.

With all of the important dates, deadlines, and rules to remember, it is no wonder that failing to take a Required Minimum Distribution is the #1 mistake made by IRA owners and their beneficiaries.

### **If you miss a Required Minimum Distribution, you have three options:**

1. Do nothing and pray you do not get audited by the IRS. If you choose this option and you are audited, the likelihood of the IRS waiving the 25% penalty is slim.
2. Pay the 25% penalty and move on with your life. Giving a large amount of the missed distribution to the IRS does not appeal to most IRA owners or their beneficiaries.
3. Take the missed distribution now and request a waiver of the penalty by filing your request, including the reason for missing the distribution, along with IRS form 5329.

### **Then just wait and keep your fingers crossed**

All of these less-than-attractive options can be avoided with proper planning, including a formal distribution plan for your IRAs and other qualified retirement accounts. Lack of consumer awareness can result in big IRS penalties, additional interest, and over-taxation. Planning now can ensure that you, and your beneficiaries, will not become the junior partner when it's time to take some of your hard-earned money out of your IRAs and other qualified retirement accounts.



## MISTAKE #3

### NOT PROPERLY DESIGNATING BENEFICIARIES

The beneficiary form is the single most important document in the estate plan. A common mistake made by retirement plan owners is in the area of beneficiary designations. You would think that choosing who will inherit the money left in your IRA or 401(k) would be simple. The reality is that many children and grandchildren who inherit a qualified plan will be forced into rapid distribution causing rapid taxation due to beneficiary mistakes. Here are a few common beneficiary mistakes.

#### **Too Much, Too Fast**

Younger or less experienced beneficiaries sometimes inherit too much, too fast. *In such cases, the inherited money can do more harm than good!* If the beneficiary has limited experience handling money or has a spendthrift problem, they can squander the funds that were intended to support them throughout their lifetime.

***Those who save money are usually better equipped to handle money than those who inherit money.***

Let's face it, the world holds many temptations, and often beneficiaries will quickly burn through their share of the inheritance. It is estimated that the average inheritance in the U.S. is spent within 90 days to 17 months. It's no comfort to the diligent saver to imagine a big chunk of their savings winding up on the tables in Las Vegas or the showroom floor of a new car dealership.

A simple planning tool can prevent this from occurring. IRA owners can choose to restrict a beneficiary, rather than allowing them the option of receiving a fully taxable, lump sum distribution. In other words, the IRA owner can specify how the money will be paid to a particular beneficiary. Many custodians of retirement funds offer beneficiary documents that allow the owner to choose a payout period. These payout periods can range from five to 10 years. In some cases it may be necessary to use a trust, if your custodian doesn't offer the option of restricting a beneficiary or you desire more control over when and how your beneficiaries can access the funds.

### **No Contingency Plan**

It is common for IRA/401(k) owners to name their spouse as the sole beneficiary of their qualified accounts. As a matter of fact, some states and some custodians require the spouse's consent to name anyone other than the spouse. Naming a contingent beneficiary is also a vital part of effective estate planning. If both the IRA owner and the inheriting spouse are gone, who will receive the balance left in the account? Business Week Investor addressed this issue in April 2001:

***“It’s a little known fact that individual retirement accounts, 401(k)s, and other tax-deferred plans aren’t governed by wills or state inheritance laws. Instead, the disposition of your retirement funds depends on two things: the fine print of your Bank or Fund Company’s custodial agreement and the tiny lines where you listed beneficiaries.”***

If the IRA owner fails to designate contingent beneficiaries, the account balance may wind up in probate. Probate can be lengthy and expensive, and during probate the funds are in lock down.

## **Blending Individual Beneficiaries with Charities**

There are four options to consider if you choose to leave all, or some, of your IRA to a qualified charity. Choosing the wrong option can cause big problems for your other non-charity beneficiaries.

### **1. Name the Charity as 100% IRA Beneficiary.**

If you or your family will not need income from your IRA, you may choose to leave the entire amount to the charity of your choice. The charity's advantage is that it will not have to pay taxes on the IRA when it receives the benefit. This way, 100% of your IRA will be available to the charity free from income tax. This is a highly tax-advantaged way for senior IRA owners to fulfill their charitable commitments. Some states and some IRA custodians may require the spouse's consent if the IRA is left to a charity rather than the spouse.

### **2. Split the Beneficiaries between a Charity and Individual Beneficiaries.**

If you want to leave some of your IRA to a charity and the rest to your spouse or children/grandchildren, you could use a single IRA and divide the proceeds with the beneficiary form. This approach could backfire for the children and grandchildren. If the charity does not take full distribution of its share by September 30 of the year after the IRA owner's death the children and grandchildren could lose the advantage of the new 10 year payout option. September 30 is the deadline to determine "Designated Beneficiaries" for the purpose of distributions to the beneficiaries. If the charity fails to take a full distribution by the deadline, the "10 year payout option" could be lost for your other beneficiaries.

### **3. Split the IRA into Two IRAs.**

This makes a lot more sense than using one IRA for the benefit of a charity and your children, as described above. You can divide your IRA into one IRA for the charity and a second IRA for your other beneficiaries. Using this approach, your children and grandchildren will be able to take advantage of the “10 year payout option” without regard to the September 30 deadline for the charity. One less deadline is one less opportunity to make a critical IRA mistake.

### **4. Set up a Charitable Remainder Trust.**

This can be a useful tool if you want to leave income for your spouse as long as he or she is living, and you want whatever is left to go the charity of your choice. Your spouse will have a lifetime of income from your IRA and at the second death; you will have fulfilled your charitable wishes.

## **Using a Will to Name Your Beneficiaries**

If you use a will to name the beneficiaries of your IRA, the beneficiaries will not be considered “Designated Beneficiaries” for the purpose of distributions. Instead, if a will is used to name beneficiaries or the IRA owner names their estate, the account may be forced into probate.

## **Not Keeping Your Beneficiary Documents Up-to-Date**

Failing to update beneficiary documents is the most common IRA beneficiary mistake.

Circumstances change and when they do, your beneficiary forms may need to be revised. Not keeping your beneficiary forms up-to-date can result in disaster. Here are a few of the triggering events that should alert you that you need to get a beneficiary check up.

## **You divorced or remarried**

It's not uncommon for an ex-spouse to get an unexpected and pleasant surprise when the IRA owner dies. Why? Because the IRA owner failed to change the beneficiary document. In this case a new spouse or the IRA owner's children could be disinherited.

### **A designated beneficiary died or a new potential beneficiary is born**

Either way, it's time for a beneficiary checkup

### **A beneficiary becomes disabled or incompetent and will not be able to manage their inheritance**

You may need to consider a trust for the benefit of that beneficiary.

### **One of your beneficiaries is financially well off or a beneficiary becomes financially indigent**

You may want to adjust the percentages to accommodate real life situations, so you can best provide for loved ones who need financial assistance the most.

### **A beneficiary has a spendthrift problem**

You may want to restrict the compulsive shopper so they can't receive all of their inheritance at one time. You could dictate that they will receive their portion over 10 years. Keep in mind that a lump sum distribution from your IRA to a beneficiary also means immediate taxation and a big payday for the IRS.

The safest way to make sure your IRA goes to the beneficiaries of your choice is to have your beneficiary forms reviewed annually or when a triggering event occurs.

## **The Beneficiary Form Trumps All Other Documents**

In a ruling on January 26, 2009, on Plan Beneficiary Form in the case of Kennedy vs. Dupont Savings and Investment Plan, the U.S. Supreme Court unanimously ruled that William Kennedy's ex-spouse would receive his \$402,000 retirement plan because she was the named beneficiary. Mr. Kennedy died in 2001. Under the divorce decree of 1994, his ex-spouse waved her rights to any benefits from his retirement plan. Mr. Kennedy wanted the proceeds to be paid to his daughter. So what could go wrong? Simple, Mr. Kennedy failed to change the beneficiary form. Mr. Kennedy believed because his ex-spouse waived her rights in the divorce decree, he did not need to do anything else.

You might ask, why didn't the attorney who handled Mr. Kennedy's divorce advise him to make the appropriate change on his retirement plan's beneficiary form by naming his daughter as primary beneficiary? The answer is simple, like Mr. Kennedy, his attorney believed that because the former Mrs. Kennedy signed the divorce papers, forfeiting any rights to Mr. Kennedy's retirement plan, nothing more needed to be done. This was a \$402,000 mistake.

The moral of the story? The beneficiary form is the single most important document in the estate plan. It trumps everything, regardless of what a will, trust, divorce decree or any other signed documents might say!

### **Here is a list of what to look for to make sure your beneficiary document will get the job done**

1. Do you have a copy?
2. Does it match the copy the Custodian has on file?
3. Does it address Simultaneous Death?
4. Are there multiple primary or contingent beneficiaries?
5. Does it allow for the restriction of a beneficiary?

6. Does it redirect the IRA proceeds if your beneficiary predeceases you?
7. Does it address beneficiaries under the age of 18?
8. Is it up-to-date?

If it has been a year or longer since the last time you had your beneficiary forms reviewed, it is time to revisit them now. A beneficiary check-up will help you determine whether your beneficiary documents are up-to-date and will accomplish what you want done with your IRAs and other retirement accounts. This simple service will ensure that your family will not have to endure the delay and expense of probate and that the balance of your IRAs and other accounts will go to your intended heirs.



## MISTAKE #4

### NOT KNOWING THE IRA - 401K ROLLOVER RULES

It's not uncommon for owners of IRA/401k and other qualified retirement accounts to choose to move their accounts to a new financial institution. There are a number of reasons why you might make that decision:

1. Older account owners may be concerned about risk and decide to move their accounts to a safer place. This can be a logical decision if there is concern about a market correction like we witnessed in 2008-2009.
2. Your current custodian may not be offering a competitive interest rate while the new custodian may be offering a higher rate of return.

**Example – Your current bank is paying you interest rate of 1% and another institution is offering you 2.5%.**

3. Your current financial institution is showing signs of insolvency and you are concerned about losing money.
4. You want to turn your account into a guaranteed lifetime income stream but your current custodian doesn't offer that option.
5. You are tired of paying Wall Street's fees and think that it's time to switch to a no fee account.

**There could be many other reasons or it could be a combination of reasons prompting you to make a change.**

When you move a retirement account to a new institution; this is called a rollover. ***Here is where it gets tricky and making the wrong rollover decision can be a costly and irreversible.***

***There are two methods of making a rollover from one institution to another:***

### **1-Indirect Rollover**

An indirect rollover is when you transfer money from one retirement trustee to another, but the money passes through your hands in between. For example, an indirect rollover is one in which the funds from your IRA are first sent to you personally, after which you then write your check to the new IRA account.

Under IRS rules, it is permissible to do this, as long as you complete the transfer within 60 days, from beginning to end. So if your current financial institution issues your check on April 1, you'll have to complete the transfer of the funds into the new IRA account no later than May 30. (60 Days).

***If you miss the 60 day window the funds will become taxable and you may have to pay an additional 10% penalty if you are under age 59 1/2.***

***Beginning in 2015 you are allowed only one indirect rollover in a 365 day period. This is where it's easy to make a costly and irreversible tax mistake.***

### **A working example of an Indirect Rollover Gone Wrong**

John has an IRA in the amount of \$50,000 and a IRA for \$250,000. Both accounts are in Mutual funds and John is not comfortable with the current market fluctuations. In January John decided to do an indirect rollover of his \$50,000 IRA. He received the check for \$50,000 and sent his check to the new financial institution to open up his new IRA within the 60 day limit. So-far-so-good.

Three months later, in March, John decided to do the same thing with his other \$250,000 IRA. The IRA plan custodian sent John a check and he wrote a personal check for the same amount to the new financial institution. John just fell into one of the many IRA Tax Traps. He will now have to pay the

income tax on the second indirect rollover. He will need to pay tax on the entire \$250,000 and may have to pay a penalty on top of the tax. John did two indirect rollovers in the same twelve month period and the second rollover (\$250,000) is no longer an IRA. In addition to the income tax, John lost many years of tax deferral.

How could he have avoided the tax on the second rollover? He could have done a Direct Rollover and avoided the tax and any additional penalties.

### **Additional Considerations:**

1. Because John's \$250,000 IRA would no longer have tax deferred status due to the Indirect Transfer; it would be added to his income and would likely push him into a higher tax bracket.
2. The higher income could also increase the cost of John's Medicare Part B
3. The increased income may increase the tax on John's Social Security.

## **2-Direct Rollover**

This is a much safer way to move your retirement accounts to a new financial institution. A direct rollover means that the funds are sent directly from your current financial institution to the new institution of your choosing. You do not receive a check so you don't need to worry about the 60 day rule. Even better; you can do as many Direct Rollovers as you want.

There is no one year rule for Direct Rollovers. Your new financial institution will send your signed transfer form to the current financial institution and it's all on autopilot from there.

If John had worked with a financial advisor who is trained in the IRA rollover rules, he would have saved the tax on his second \$250,000 IRA transfer.

This rule only applies when you are going from one IRA to another IRA of the same type in a 60 day rollover. A rollover from your employer plan to your IRA will not prevent you from doing a rollover of your IRA funds a month later.

## MISTAKE #5

### TOO MUCH OF YOUR IRA AT RISK

Albert Einstein once said, *“The most powerful force in the universe is Compound Interest.”* This is particularly true when it comes to your IRA, 401(k) and other tax qualified retirement plans. You earn interest on your deposits, you earn interest on your interest and you earn interest on what otherwise would have been paid in taxes in a non-tax-deferred account.

**This triple compounding effect can help your retirement accounts grow faster and last longer.**

If you are going to need income from your IRAs or you desire to pass on a legacy of income to your beneficiaries, too much risk can ruin the best made plans.

According to the *Investment Company Fact Book*, published by the Investment Company Institute, approximately 83% of America’s pension assets are at risk in the market. By October 2007, the nation’s pension assets had grown to a staggering \$17.6 trillion. Then the Great Market Crash of 2008 arrived unannounced and many investors’ retirement savings evaporated during the worst financial crisis that most Americans have seen in their lifetime.

Before we move further let’s look at a brief overview of the history of turmoil in the U.S. markets. The best place to begin is Black Thursday: October 24, 1929. Odds are, most readers are too young to remember “The Great Market Crash of 1929”. Fortunes were lost and by July 1932 the stock market had lost more than 85% of its value.

This resulted in massive unemployment, a run on the banks, and America’s unemployed workers were standing in soup lines. This also marked the beginning of The Great Depression.

We witnessed similar events during the Market crash of 2008 and early 2009. There were no soup lines however food pantries were stocked to help the poor and those who recently lost their jobs. Unemployment exceeded 10% nationally and was as high as 14% in some states. Although we did not experience a run on the banks, we saw many banks fail including the Fed seizure of Washington Mutual, representing the biggest bank failure in U.S. history.

### Vintage photos from the Depression Era



© The Republican Company. All rights reserved. Reprinted with permission).



(Franklin D. Roosevelt Library, courtesy of the National Archives and Records Administration).



(Franklin D. Roosevelt Library, courtesy of the National Archives and Records Administration).



(Franklin D. Roosevelt Library, courtesy of the National Archives and Records Administration).

Can you see some similarities between the Great Market Crash of 1929 and the more recent Market Crash of 2008? Today all of the windows on Wall Street are sealed to protect innocent pedestrians from desperate Wall Street jumpers.

Fast forward 55 years to Black Monday: October 19, 1987. This day represented the largest one day drop in the stock market in American history up until that time. Investors lost 22% on equity holdings, amounting to \$500 billion in one day.

Then the Tech Stock Crash arrived in March 2000, followed by the terrorist attack on September 11, 2001 (9/11). Both took their toll on the markets and Americans' retirement plans were considerably reduced. After 2002, things started to calm

down and investors began to see steady growth in the markets. The S&P 500 grew steadily during the five years between 2002 and 2007 and many investors believed the good times were here to stay.

The years ticked on. Then, without warning, came Grey Tuesday: February 27, 2007. The Dow Jones Industrial Average (DJIA) fell 416 points in one day, the biggest one-day drop since September 17, 2001, the first trading day after 9/11. The U.S. market lost 3.3% in one day because of fears about overvalued China stocks. The headlines the next day blasted the news:

*“China Market Plunges, Dow Follows”*

Chicago Tribune

*“China Volatility Sparks U.S. Sell-Off”*

USA Today

*“Markets’ Slide Spotlights Risk”*

Wall Street Journal

This began a critical and devastating turning point in the direction of the market and the American economy.

Just two weeks later, Bad Credit Tuesday arrived on March 13, 2007. The DJIA dropped 242.66 points and the headlines announced a Sub-Prime Lending Meltdown. Remember the ads? No credit, slow credit, bad credit, everyone deserves a mortgage loan. What that meant was borrowers who don't pay their bills should be able to finance homes they cannot afford. Fannie Mae and Freddie Mac were quick to get on board with unsupervised lending and high-risk mortgages. Greed was in the air and everyone was making money, but that would soon come to a very bad end for the American economy.

On September 15, 2008, we witnessed Black Monday the sequel. The DJIA dropped 504 points. This was the new, biggest one-day drop, beating the tumultuous dip of Grey Tuesday seven months earlier. Lehman Brothers filed for Chapter 11.

Banks tightened up credit, and sub-prime lending came to a screeching halt.

The short week between September 15, 2008 and September 19, 2008 was arguably *the most monumental financial crisis since the Great Depression*. Sub-prime lending rocked the financial markets. Lehman Brothers went bankrupt and the Fed seized Washington Mutual. This was the biggest bank failure in American history. On September 29, 2008, lawmakers said no to the \$700 billion bailout, causing the DJIA to drop 777.68 points in one day—a loss of \$1.2 trillion. Yet another record set for the biggest one-day point drop in American history. Then on October 3, 2008, only four days later, the \$700 billion bailout was approved and immediately signed into law, and the DJIA dropped an additional 157.47 points.

Forbes magazine deemed the second week of October 2008, “The worst week in market history.” The Dow lost 1,873 points in only five days. Many 401(k)s were transformed into 201(k)s. Most IRAs and other qualified accounts took a major beating. The \$700 billion bailout had done little to restore confidence in the market and, almost daily, the FDIC added new names to the watch list of banks that could fail. In the automotive industry, Detroit’s “Big Three” were feeling the pain and looking for bailout money.

On March 10, 2009, Anthony W. Ryan, Assistant Secretary of the U.S. Department of the Treasury, reported, “*The total value of our nation’s retirement savings has been estimated at \$11 trillion.*” That represented a loss of nearly \$7 trillion of America’s savings and created a financial crisis for retired workers, who were depending on their savings to have a comfortable retirement. Many retired Americans found it necessary to try to rejoin the workforce at a time when unemployment was as high as 10%. Others who were planning to retire were forced to delay their plans.

A week prior to Ryan's comments, on March 2, 2009, the Dow Jones Industrial Average closed under 7,000 points, representing the lowest close in more than 11 years. Then the market began to bounce back. On October 14, 2009, the Dow broke through 10,000 points and on April 13, 2010 it broke through 11,000 points. On February 28, 2012 the Dow closed over 13,000 points, but that was still lower than the highs of 2007. On January 26th, 2017 the Dow closed over 20,000 for the first time in the Dow's history.

By the end of 2019 the markets were at an all-time record high. The over 10 year bull market took the Dow to over 28,000. Many economists are predicting there will be a correction and some are predicting a worse correction than we witnessed in 2008. Historically when the markets hit all-time highs, the correction is just around the corner. We are all hopeful that the market will retain its recent growth, but the question is:

### **Would you bet your life savings that it will?**

Imagine the number of workers who had plans to retire between 2008 and 2012 but were forced to remain on the job trying to rebuild their IRAs and 401(k) plans. If you had \$100,000 invested from January 1, 2000 through December 31, 2019 and your investment performed identically to the S&P 500, you would have \$219,992 left at the end of that 20 year period. If you invested the same \$100,000 compounding at only 4% for the same period of time, it would have grown to \$219,112 by the end of 2019.

The following chart compares the performance of the S&P 500 vs. a fixed account earning 4% compounded annually. Notice that, although during thirteen out of twenty years the S&P showed positive growth, the S&P account performed only marginally better than the fixed account earning only 4% by the end of 2019.

**Comparison of S&P 500 Performance  
vs. Fixed Account Earning 4%**

<u>YEAR</u>	<u>S&amp;P 500</u>	<u>S&amp;P ACCOUNT*</u>	<u>FIXED ACCOUNT (4%)**</u>
2000	-10.14%	89,860	104,000
2001	-13.04%	78,142	108,160
2002	-23.37%	59,880	112,486
2003	+26.38%	75,676	116,985
2004	+8.99%	82,480	121,665
2005	+3.00%	84,954	126,531
2006	+13.62%	96,525	131,856
2007	+3.53%	99,932	136,856
2008	-38.49%	61,468	142,331
2009	+23.44%	75,877	148,024
2010	+12.80%	85,598	153,945
2011	+0.00%	85,598	160,103
2012	+13.41%	97,066	166,507
2013	+30.00%	126,186	173,167
2014	+11.40%	140,571	180,094
2015	-0.70%	139,588	187,298
2016	+9.45%	152,905	194,790
2017	+19.42%	182,599	202,581
2018	-6.59%	170,537	210,684
2019	+29.00%	\$219,992	\$219,112

\*Assumes 100% gain or loss based on S&P 500 \*\*Assumes 4% compounded

This 20 year snapshot clearly illustrates the power of compound interest and how easily the Stock Market's ups and downs can have a negative and lasting effect on Americans' retirement accounts. The fixed account and the S&P account performed almost identically at the end of the 20 year period. There was only one year that the S&P account was higher than the 4% compounded fixed account. That was in 2019 when the markets hit record highs.

Beginning in 2020, in response to the Covid Pandemic, the government printed trillions of dollars to avoid an all-out economic meltdown and held interest rates at all time lows. Stimulus checks were everywhere. The combination of trillions pumped into the economy and low interest rates was a blessing for Wall Street and the markets saw record highs in 2020 that continued into 2021. Many economists agreed that

the infusion of trillions of dollars left the market overpriced and poised for a correction.

***The question is; when the stimulus money ends and interest rates and inflation begin to rise, will the market take a nosedive?***

I'm not suggesting that the market is a bad choice for everyone or that it's time to hide your money under your mattress. My point is, retired Americans and those planning for retirement will need to depend on their savings to be there when they need it. Having too much of your IRA, 401(k), and other retirement accounts at risk could ruin or delay your retirement plans.

**Legendary investor Warren Buffett said it best:**

**Rule #1 "Never lose money!"**

**Rule #2 "Never forget Rule #1"**

Unfortunately the great market crash of 2008 came without warning, and Mr. Buffett's rules became difficult to follow.

### **In or Out?**

When determining how much of your retirement savings to hold in the stock market, the two most important issues to consider are your ***time horizon and risk tolerance***. Your time horizon is when you will need to take income from your savings to maintain a comfortable retirement. The older you are the shorter your time horizon will be. Calculating your risk tolerance is simple: Don't gamble with more than you can afford to lose.

When considering risk tolerance and time horizon, age is a big factor. A 45 year-old planning to work another 20 years will normally have a greater risk tolerance and a longer time horizon than a 65 year-old retired worker. This makes sense, because the 45 year-old will continue to earn income and can continue to invest in their retirement account for 20 plus more years. The market will go up and down, but over the long haul

the market has been proven to grow, and those who are young and still working will normally invest in good or bad market conditions. Their age lets them enjoy the advantages of long-term growth and dollar cost averaging.

Dollar cost averaging is a fundamental strategy to maximize gains, regardless of market conditions. When the market is down, you can buy more shares for the same yearly investment. When the market goes back up, those bargain buys will have a greater value, and can compensate for market losses. This is one of Wall Street's best arguments for keeping your retirement money invested with them.

The 45 year-old investor, in most cases, will not need to tap into their retirement account until their working years are over. Their longer time horizon—the time until they need to spend their retirement money—combined with the advantages of dollar cost averaging make investing in the market attractive.

For the 65-year-old retired person, it's a very different ball game. After retirement many savers are no longer able to contribute to their IRAs and 401(k) plans. They no longer have earned income from their employment, so continued investing may not be an option. The advantage of dollar cost averaging will be lost unless they have earned income and can afford to continue to invest. The other problem facing retired workers is their time horizon is shorter. Social Security and company pensions alone may not produce enough income to keep pace with inflation or to deal with unexpected financial needs. In other words, they may need income from their retirement savings sooner.

### **My point is this:**

The best custodian for a retirement plan may be very different for a 45 year-old worker than for a 65-year-old retired person. When you leave the accumulation phase and enter the distribution phase, it's a good time to consider choosing the custodian best suited for the preservation and distribution of your retirement savings.

---

## MISTAKE #6

---

### OVERPAYING FEES AND LOADS ON IRAs, 401(k) AND 403(B) PLANS

The cost of doing business on Wall Street can be more than exposure to risk. The market crash of 2008 and the first quarter of 2009 gave many investors good reason to rethink their approach to a comfortable retirement. For most Americans living today, this was the biggest financial crisis in their lifetimes. Now that the market has made a recovery, many investors are looking more closely at the fees and loads that can erode their nest eggs substantially over time.

An article in the Wall Street Journal, “The Hidden Costs of Mutual Funds”, pointed out doing business on Wall Street can cost investors significantly more than they anticipate. The average expense ratio for mutual funds, according to the article, is 1.31%, but is that the total cost for owning a mutual fund? The hidden costs can be as much, or in some cases, greater than the advertised cost. The buying and selling of securities in the portfolio can add an additional 1% to 3% of undisclosed expenses to the owner. Currently the Securities and Exchange Commission does not require these commissions to be factored into the expense ratio, so the average fund owner who thinks they are paying 1-2%, may be paying 3% or more to own a particular fund.

California Congressman, George Miller, Chairman of The Committee of Education and Labor, proposed legislation in 2008 that would require full disclosure of hidden fees and loads in 401(k) plans. Wall Street, according to Congressman Miller, opposed the proposed legislation with ferocity.

According to the Investment Company Institute, 83% of American's retirement savings are at risk to market fluctuation and the high fees charged by Wall Street's middlemen. In March 2009, when the DJIA dropped under 7,000, the lowest close in 11 years, all eyes were focused on Wall Street's instability. After two years, and after close to a trillion dollars of taxpayers bailout money was unleashed, on February 1, 2011, the DJIA closed over 12,000 points and IRAs and 401(k) plans saw much awaited growth. Today, retirement savings in America is estimated to be in the \$29 trillion range, of which approximately 80% is in mutual funds and other securities. Assuming an average of only 2% combined fees and loads, Wall Street will pocket a whopping \$464 billion annually of money intended for Americans' retirement years.

### **A Missed Opportunity**

Wall Street's appetite for the fees and loads tied to mutual funds is a lost opportunity for IRA owners. Why a lost opportunity?

***“Because fees and loads are gone from your account forever.”***

### **The following example illustrates the long-term financial impact of mutual fund fees:**

Bob is age 50 and will not need money from his retirement account until he retires at age 65. This means Bob has 15 years of potential growth for his retirement nest egg before he will need income to supplement his Social Security and company pension plan. Let's assume that Bob starts out with \$300,000 in retirement savings and that the account will earn 5% compounded interest. Doing the math, \$300,000 earning 5% for 15 years will grow to \$623,678.

Now let's see what would happen if Bob earned 5% in a mutual fund that charged 2% in fees and loads. The same \$300,000 would have grown to only \$467,390 in Bob's

retirement account by age 65 because the net rate of return would be 3%. That represents a difference of \$156,288 less savings at retirement time. The 2% that Bob gave up in fees and loads represented the lost opportunity to earn compound interest. If the total cost of owning the fund averaged 3% to 4%, the negative impact at retirement time would have grown exponentially.

### **It Doesn't End There!**

Fast-forward 15 years, when Bob has reached age 65. He has suffered the loss of \$156,288 of savings, due to the loss of compounding of the fees and loads that were systematically extracted from his retirement accounts. Now it's time to begin the distribution phase. The game plan is to transform what is left into a reliable stream of retirement income.

This is where the lack of compounding only further compounds the retiree's frustration. As long as Bob's savings remains in his 401(k) or mutual funds, the fees and loads will continue to eat away the potential gains. If there are no gains, the fees and loads will begin to erode the principal.

If Bob needs only 5% annually from his remaining account balance of \$467,390, he will still be paying Wall Street its 2%. That will generate a drain of 7% when Bob only needed 5% to maintain his lifestyle in his retirement years. The extra drain due to the cost of doing business with Wall Street is 40% more than Bob needed to reduce his nest egg.

Lets do the math. Bob is now 65 years old, with \$467,390 left in his IRA or 401(k). If the account continued to earn 5% and he took only 5% for income, his savings would remain the same (\$467,390). But if the account remained under The Street's management, the 2% load would begin to eat away at the principal and the account would be reduced by 2% annually. Wall Street, in this case, is Bob's 40% partner during the distribution phase.

## **The more the mutual fund owner makes, the more they pay**

If you own a fund with a current value of \$500,000 and the total cost of owning that fund is 2%, your annual cost is \$10,000. This money is unceremoniously removed from the IRA owner's account each year. In the above scenario, assume that Bob's account has grown from \$500,000 to \$600,000 after several years of market gains. The same 2% load will have gone from \$10,000 to \$12,000.

Try to visualize someone reaching into your retirement savings and removing \$10,000 or more each year. Next imagine that same person using that money to take a lavish vacation or buy an expensive watch. At this point you might say, "They can't do that!" Unfortunately they can do that, and that is exactly what they are doing.

### **The Solution:**

Get help to uncover the hidden costs of owning your mutual funds. Look beyond the expense ratio and dig into the turnover ratio and other hidden trading and advertising expenses.

Understand how these fees, loads and other expenses are taken out of your accounts each year. Consequently less than 100% of your money is working for you.

Also, understand the long-term effect due to the lack of compounding interest on the money that has been removed from your accounts. Calculate how the fees and loads will impact your retirement income or could reduce the inheritance to your heirs.

### **The End Result:**

You may be comfortable with the cost of owning a particular fund, or you may have just gone into shock after learning about the hidden fees and loads. The key issue is that if you are aware of the real cost of owning a particular fund, you can make informed decisions about positioning your retirement assets.

The current turbulence on Wall Street and the high cost of investing in mutual funds are reason enough for anyone to reassess their investment choices, reduce expenses, and take the appropriate steps to guarantee a comfortable and risk-free retirement.



## MISTAKE #7

# NOT TAKING ADVANTAGE OF TAX SAVING STRATEGIES

Two strategies can transform taxable IRAs into tax-free income or a tax-free inheritance. You have the option to pay the tax on the seed now and save the tax on the crop when it comes time to harvest some of your retirement savings. For many owners of qualified retirement plans, the Roth IRA Conversion or IRA Arbitrage can offer an effective way to fire the IRS and take full control of your retirement accounts.

### **The Roth IRA Conversion**

Never pay income tax before you have to. Sound familiar? This was a good strategy for most people until the Roth IRA was born on January 1, 1998, as a result of the Taxpayer Relief Act of 1997. The Roth concept is simple: You don't get a tax deduction when you make a contribution to your Roth IRA, but future growth and distributions are income tax free. For those with traditional IRAs, 401(k)s, 403(b)s, SEPs, and other qualified retirement plans, future growth and distributions are fully taxable. You have the option to convert these plans to a tax-free Roth IRA. The Roth IRA Conversion offers an opportunity to pay the income tax now and have your nest egg grow free from income tax, and qualified distributions can be taken income tax free. Until recently, the Roth conversion was only available to those who had joint or single incomes of less than \$100,000. Effective January 1, 2010, under the Pension Protection Act, all IRA owners, including those with incomes over \$100,000, can take advantage of the Roth IRA Conversion.

You can choose to convert all or a portion of your IRA to a Roth IRA. If you choose to convert to a Roth IRA, you will owe income tax, both federal and state, on the amount you converted. For example, if you convert a \$100,000 IRA to a Roth IRA, and your combined federal and state income tax is 30%, you will owe \$30,000 in total conversion taxes.

It may seem counterintuitive, but converting a traditional IRA or other qualified retirement plan to a Roth IRA is one of the best strategies to protect your retirement assets from excessive taxation. From the moment you made your first contribution to your qualified retirement plans, Uncle Sam became your partner. The unfortunate aspect about this partnership is that after you take all of the investment risk, Uncle Sam can determine what percentage of your retirement account belongs to him. This is done simply by raising income tax brackets. Converting your traditional plans to a Roth IRA can sever your unwanted partnership with the fewest dollars possible. It's a way to take full ownership of your retirement savings.

Of course, the only way out of an IRA is through the IRS and Uncle Sam is going to hold you to your original agreement. Under the traditional IRA, your contributions were not taxed, but all of the gains and future distributions are fully taxable. You saved the tax on the seed, but when it comes time to harvest that hard-earned savings, you must pay the tax on the crop.

Although you will have to pay that tax bill now if you convert your account to Roth IRA, you likely will pay less now in taxes than if you wait another 5, 10 or 15 years. If your IRS partner chooses to raise the tax rates which most economists agree is just over the horizon the long-term tax implications for your retirement savings could be substantially more than what you will pay if you convert to a Roth now.

The Roth Conversion will be most effective for IRA owners who won't need income from their IRAs, and who desire to

pass more on to their heirs and eliminate the income tax. After converting to a Roth IRA, the owner and surviving spouse are no longer forced to take required distributions after turning age 73. Think of the advantage for the children and grandchildren. The account is still earning interest but there are no required distributions, so the Roth account grows faster.

When distributions are finally taken, they are income tax free! There is also a tax benefit for your heirs. If your children inherit a Roth IRA their distributions will also be income tax free!

### **Five-Year Holding Period**

There is a five-year holding period after a Roth conversion. If any distributions taken within the five-year holding period include investment earnings, taxes must be paid on the earnings only.

The amount that was originally converted to the Roth IRA can be withdrawn, income tax free, even during the five-year holding period. For example, if you convert a \$200,000 IRA to a Roth IRA you can take a tax free withdrawal of up to \$200,000, during the five-year holding period, income tax free.

### **Required Minimum Distribution in the Year of Conversion**

If you are age 73 or older when you convert to a Roth IRA, the Required Minimum Distribution for the current year, must be taken prior to the Roth Conversion.

#### **Example Age 79:**

\$500,000 IRA Balance as of December 31  
- \$26,650 Current Year's RMD (5.13%)  
\$473,350 Eligible to Convert to a Roth IRA

In this same example, if you were less than age 73, you would have been able to convert the entire \$500,000 to a Roth IRA.

Before you convert your traditional IRA to the Roth IRA, you should be aware of some important considerations. The Roth IRA Conversion can be very attractive to some IRA owners and a big mistake for others.

### **5 Signs that You May Be a Good Candidate for the Roth IRA Conversion:**

1. You are 59½ or older and do not plan to take distributions within five years after the conversion.
2. You expect to live long enough to recoup the conversion tax. If you convert a \$300,000 IRA to a Roth IRA and pay 32% total tax, the cost of the conversion will be \$96,000. How long will it take, at a reasonable rate of return, to earn back the conversion tax inside the Roth IRA?
3. You have non-qualified funds to pay the conversion tax. Paying the conversion tax out of the IRA will mean less money in the new Roth growing income-tax free and less tax-free income. Paying the conversion tax with non-IRA money means you can leave more money in your Roth IRA and leave a larger nest egg to your beneficiaries, free of any income tax.
4. You believe your tax bracket or your surviving heir's tax brackets will be higher in the future. Ask yourself this question: do you think income tax rates are more likely to go up or down? If you think you, or your heirs, will be in a higher tax bracket than you are in today, the Roth IRA Conversion makes sense.
5. Your goal is to pass more money to your heirs, income tax free. One of the greatest benefits of the Roth IRA Conversion is using it as a wealth transfer tool. Your children and grandchildren can enjoy tax-free income. That puts the IRS completely out of the picture.

## 5 Signs that You Are Not a Good Candidate for the Roth IRA Conversion:

1. You are under age 59½ and will need to take distributions within five years after conversion. You will pay an additional 10% penalty for any distributions taken prior to turning age 59½.
2. You are at an advanced age or in poor health and you are not likely to live long enough to recoup the conversion tax.
3. The conversion tax will need to be paid out of the IRA and you are younger than 59½. The portion of the IRA that is used to pay conversion taxes will generate a 10% pre-59½ penalty. Even though that portion is going to the IRS, it is still considered a pre-59½ withdrawal.
4. You believe your tax bracket will be similar or lower in the future. This is a sure sign not to convert. Why pay a higher tax rate to convert than you would pay if you simply took your required distributions?
5. The conversion will raise your marginal tax bracket. When you convert, the amount converted is considered income and could push you into a higher tax bracket, making it less attractive to move your retirement savings into a Roth IRA. In this case, a partial conversion would make more sense. Convert only the amount that will keep you in a comfortable tax bracket.

### IRA Arbitrage

IRA Arbitrage is nothing more than converting your IRA into life insurance. You might ask, why would anyone want to pay the tax on their IRA and put what is left into life insurance? The answer is that it can be a smart estate planning move.

Many IRA owners are affluent and will not need much, if any, of their IRA funds to produce post retirement income. For these owners, IRA Arbitrage may be the best way to pass more

tax-free dollars to the next generation.

Consider the retired engineer who has a defined benefit pension plan that will provide him with \$160,000 annually for life, or the retired physician who has saved money in an SEP/IRA and sold his practice for \$2 million. Will either of these IRA owners need their IRAs to provide income for their retirement years?

One solution for those who have this type of financial security is to use the after-tax value of their IRA to purchase life insurance. Life insurance will increase the money left to the heirs and eliminate the income tax.

### 5 Strategies for IRA Arbitrage:

- 1. Cash out the IRA and purchase a single premium life insurance policy.** The following chart is an example of a 65-year-old male who owns a \$300,000 IRA and will pay a total of 40% in taxes to cash it out. \$120,000 (40%) will go to taxes and \$180,000 (60%) will be left to purchase a single premium life insurance policy. Assuming the owner is in reasonably good health, the \$180,000 left after paying the IRA taxes would be enough money to generate a \$400,000 income tax-free death benefit using life insurance. If he kept his money in the IRA, the after-tax death benefit to the heirs would be \$180,000, at age 65, increasing to \$235,294 by age 85 if the IRA owner withdraws only his Required Minimum Distributions. Purchasing a life insurance policy, in this case, will increase the after-tax benefit to the heirs by \$220,000 (\$400k life insurance minus \$180,000 after tax IRA = \$220,000 more for the beneficiaries). By age 85 the total benefit to the heirs would have grown to more than \$670,000, income tax free.

The following chart illustrates the difference in the after tax inheritance between keeping the IRA or cashing it out and putting the after tax money into a single-premium life insurance.

Assuming the IRA owner is age 65 when the life insurance is purchased, it compares the benefits to the beneficiaries at age 65, 75, and 85.

<b><u>IRA vs. Single Premium Life Insurance</u></b> \$300,000 IRA — 40% Combined Tax to Heirs						
Age	IRA Value*	Cum RMD	Income Tax	Net to Heirs	Life Premium	Net to heirs
65	\$300,000	\$0	\$120,000	<u>\$180,000</u>	\$180,000	<u>\$400,000**</u>
75	\$415,349	\$83,119	\$166,140	<u>\$249,209</u>	\$0	<u>\$400,000**</u>
85	\$392,157	\$310,269	\$156,863	<u>\$235,294</u>	\$0	<u>\$672,692**</u>

Life Insurance Doubled the Tax Benefit to the Heirs  
\*5% Rate of Return \*\*Indexed UL 6.9% Return Less Insurance Charges

2. **Use a combination approach with Roth IRA Arbitrage.** This strategy uses life insurance to pay the Roth IRA conversion tax after the IRA owner's death. For example, assume Robert has a traditional IRA valued at \$1,000,000 and the conversion tax is estimated to be 35%, or \$350,000, and he does not have sufficient liquidity to pay the conversion tax. A more affordable option would be to purchase a \$350,000 life insurance policy and use the tax-free proceeds to pay the conversion tax at death. Robert's surviving spouse will have tax-free money to pay the conversion tax and would then own a \$1 million tax-free Roth IRA.
3. **Use the IRA value to purchase a 7 Pay life insurance policy.** This will spread the distribution tax over seven years and may help the owner remain in a lower tax bracket.
4. **Use after-tax RMDs to purchase life insurance.** If the IRA owner doesn't need the required distributions for income purposes, they can be used to pay ongoing life insurance premiums and increase the tax-free benefits to the beneficiaries.

- 5. Use annual withdrawals from an IRA Annuity to purchase life insurance.** Most annuities have a 10% free withdrawal feature that can be used every year. The free withdrawal feature can be used to purchase tax-free life insurance. This is an effective strategy for those wanting to leave an income tax free legacy for their spouses, children/grandchildren, or other beneficiaries.

All five approaches to converting IRAs to life insurance will increase the inheritance and eliminate the income taxes for the IRA owner's heirs. Best of all, you will have fired your unwanted partner, Uncle Sam, with the fewest dollars possible and prevented the IRS from becoming the senior partner in your retirement plan.

### **5 Additional Advantages of Life Insurance:**

- 1. Access to Cash Values** – Your premium is not gone; it is now in the form of life insurance cash values that you can access when you need some of your money for income or unexpected expenses.
- 2. Income Tax Advantages** - Permanent life insurance offers three major income tax advantages: tax deferred build-up of cash values, tax-free access to the cash values via low net interest loans, and tax-free death benefits for the beneficiaries. Think of the advantages for the life insurance owner and their beneficiaries. The cash value grows tax deferred and can provide the owner a steady stream of tax-free retirement income and, at the owner's death, the beneficiaries will receive a tax-free death benefit. Here is the best part.

When you borrow from a life insurance policy you will pay only a small net loan interest because you will continue to earn interest on the borrowed amount. If you take a loan from a life insurance policy that is earning 5% interest and the loan interest rate is 6%, you will only pay a net 1% interest on the borrowed amount.

### **Example:**

Jack borrowed \$10,000 from his life insurance policy to supplement his retirement income. The policy has a 6% loan interest rate so he would owe \$600 of loan interest. However Jack is being credited 5% (\$500) on the borrowed amount. Consequently his net loan interest rate is only 1% (\$100). Jack pays no income tax because this is considered a loan rather than a taxable withdrawal. If Jack withdrew the same \$10,000 from any other interest bearing account, he would pay income tax on the interest withdrawn. In this case, the cost of using the cash value of his life insurance is only 1% as compared to as much as 37% if he were forced to pay income tax.

Now for the icing on the cake, Jack will never need to repay the loan. One reason is that the cash value already belongs to Jack, so he is borrowing his own money and doing so tax free. The second reason is the death benefit will pay the loan off when Jack is gone.

For many, just like Jack, life insurance can be the most tax advantaged retirement plan imaginable.

With tax increases just over the short-term horizon, the unique tax advantages of permanent life insurance are gaining increased importance.

3. **Nursing Home Waiver** – This feature is available with some carriers and eliminates future premiums in the event you are confined to a nursing home.
4. **Terminal Illness Riders** – This benefit allows you to withdrawal some or all of the death benefit if you are diagnosed as being terminally ill and death is expected within one year.
5. **Long-Term Care Riders** – This is a tremendous benefit for those who don't own Long-Term Care insurance and is available with some carriers. Using the life insurance benefit to fund Long-Term Care expenses eliminates the

need to pay large annual Long-Term Care premiums. Approximately 85% of Americans over age 65 have no Long-Term Care insurance, and it is estimated that 60% of us will incur some Long-Term Care expenses. In 2019, the average annual cost of nursing home care was over \$90,000 annually. Imagine how quickly your retirement savings can be depleted if you or your spouse have need for care. These Long-Term Care riders offered by some life insurance contracts can be a cost-effective way to prevent your life savings from being spent on nursing home expenses.

The Roth IRA Conversion and IRA Arbitrage can put you back in control of your IRAs and other retirement accounts. Both strategies let you, as the owner, determine when the IRA taxes will be paid and also offer some control over what the tax rates will be.

## MISTAKE #8

### NOT ROLLING 401(K) TSP OR 403(B) PLANS TO AN IRA

Participating in a company-sponsored 401(k), 403(b) or TSP plan has long been viewed as the best game in town for two reasons:

1. Contributions were not taxed and are deducted directly from your paycheck, so you hardly miss the money.
2. Most plans offer company matching funds, some as high as 100% of the employee's contribution. What could beat that? You double your money up front!

For many retired workers, their 401(k) plans represent the majority of their retirement savings, and for some, their 401(k) is worth more than the equity in their home. However, after retirement both reasons to remain in the 401(k) or 403(b) are gone forever. You can no longer make tax-deductible contributions and there are no longer company matching funds. Now is a good time to roll the 401(k), 403(b) or TSP to a more flexible IRA and take control of your retirement savings.

#### **4 Good Reasons to Move Your 401(k) or 403(b) When You Retire:**

1. **Most 401(k)s, 403(b)s and other company plans have limited investment options.** They may offer 50 different mutual funds and other investment vehicles, but most of the options are subject to market fluctuations. Many company plans lost as much as 40% in 2008 alone. Those individuals who chose to play it safe and moved their 401(k) money into bond funds or funds invested in CDs

and other short-term investments were rewarded with little or no growth, while inflation and management fees ate away at their principal. Moving the 401(k) or 403(b) to an IRA will offer the owner unlimited investment options. Some of these options can guarantee the principal, offer a competitive rate of return, and generate an income that cannot be outlived.

- 2. Plan guidelines can restrict the owner's access to their money.** The plan document is essentially the 401(k) rule book. If it is not in the book, you can't do it! You never know when you may need access to your retirement accounts. IRAs offer greater flexibility, allowing the owners to make their own rules if they are willing to pay the tax on the distributions.
- 3. Direct rollovers avoid the 20% mandatory withholding.** It's critical that the funds are moved as a trustee-to-trustee transfer. If a check is written to the 401(k) owner, you can count on the custodian withholding 20% for the IRS. I have worked with several advisors who have encountered this problem, and they are still battling with the IRS to get the 20% withholding back where it belongs.
- 4. Many 401(k) and 403(b) plans do not allow the Roth IRA Conversion.** New legislation, The Small Business Jobs Act of 2010, now allows 401(k) participants to roll their traditional 401(k) to a Roth 401(k); however, until their plan documents are amended, some plans will not permit this maneuver. Beginning in 2010, IRA owners with adjusted gross incomes over \$100,000 could, for the first time, convert their traditional IRAs to the Roth IRA. After the conversion tax is paid, the new Roth will grow income tax free, and distributions after the five-year holding period will also be income tax free. The Pension Protection Act simplified Roth conversions from 401(k)s and other company sponsored plans. Beginning in 2008, owners could convert company sponsored plans directly to a Roth IRA. They no longer needed to convert to a traditional IRA

before converting to a Roth IRA.

The good news is that you may not have to wait until you retire to move your 401(k), 403(b), and TSP plans to an IRA.

Approximately 70% of 401(k) plans allow for an In-Service Transfer. That means there is a 70% chance you can move the 401(k) to an IRA while you are still working, making contributions, and enjoying company matching funds. Most of the plans that allow the transfer require the employee to be at least age 59½. You will need to check with your plan administrator or your HR department to see whether your plan allows for the In-Service Transfer. You should also make sure that there is no blackout period. A blackout period is a period of time after making the transfer that you may not be able to continue to make contributions or receive company-matching funds.

There is a special gold nugget in the tax code for those who are employees or retired employees of non-profit organizations, such as hospitals, museums, public foundations, churches, research organizations, or public educational systems, and who made contributions to their 403(b) or Tax-Sheltered Annuity (TSA) plans.

Most 403(b) plans and TSAs allow the owners to switch to an IRA if they are over 59½, have a break in service, or transfer to a new school district. In our current economic environment, many educators are being forced into early retirement. This is another opportunity to move their restrictive 403(b) plans and other teachers' retirement plans to a more flexible IRA.

If you currently have a 401(k), 403(b), TSP, or other company sponsored plan, you should examine all of your options to decide whether rolling the plan to the more flexible IRA is consistent with your overall retirement goals.



## MISTAKE #9

### TOO MANY RETIREMENT ACCOUNTS

People saving for their retirement years commonly find themselves with more accounts than they know what to do with. How does this happen? Throughout our working years, we have sporadic opportunities to save for retirement and we are told diversification is the key to retirement success. As a result many savers find themselves with multiple retirement accounts; for example, three CDs, a Money Market Account, two annuities, an IRA, a 401(k) or 403(b), and two brokerage accounts. That would be a total of 10 separate retirement accounts and for some, this can be retirement mess.

Having too many retirement accounts is a high quality problem, but a problem nonetheless. When it is time to convert some of your savings into an income stream, several important considerations must be taken into account.

Here are just a few challenges caused by having too many retirement accounts:

#### **Determine which account you should spend first and how you should withdraw the money**

When the time comes to use some of your savings to supplement your retirement income, the more retirement accounts you own, the more difficult it will be to make good choices. One of the biggest and most common retirement mistakes is withdrawing the interest only from your non-qualified CDs, annuities, Money Market accounts, and other interest bearing accounts. Taking the interest only may seem like a good idea, because you will still have your entire principal.

The problem is that all of the interest you withdraw will be considered taxable income. With CDs and Money Market accounts, the interest is currently taxable whether or not you take it out. Your non-qualified savings accounts can be consolidated into one tax-deferred account that will only be taxed when you choose to withdraw some of your interest earnings. These types of accounts, with few exceptions, use the “Last in First out Rule”.

This means when you choose to take withdrawals, they will be considered taxable interest until the entire amount of your interest earnings has been removed. The advantage of tax deferral is you can decide when the tax is due by making withdrawals when it best fits your plans.

Controlling your taxable income after retirement has additional tax benefits. The more taxable income you have, the more likely you will find yourself in a higher tax bracket. If your taxable income exceeds the Social Security income limit, you may be forced to pay income tax on more of your Social Security benefits. Choosing the right account will be less of a challenge if you consolidate some accounts and use income strategies that will lower your overall tax bill.

### **Determining how to calculate Required Minimum Distributions from multiple qualified accounts**

This can be tricky if you own more than one type of retirement account. For example, you may own an IRA, a 401(k), and a 403(b) plan. That would be three different types of qualified retirement plans. In Mistake #2 we discussed the importance of taking Required Minimum Distributions after turning age 73. Let’s assume that each of your three plans has a balance of \$100,000. That comes to a combined total of \$300,000. To keep the math simple, let’s assume your RMD for the current year is 5%. You will need to take a total distribution of \$15,000 (\$5,000 per account) for the current year’s RMD. You must take the required amount from each of the three

accounts. In other words, you cannot take \$15,000 from just one account to satisfy the RMD for all three accounts, even though the total distribution would be the same either way.

If all three accounts were IRAs, you would then have the option to choose the account from which you take your RMD. You could choose to take the entire \$15,000 from one of the accounts allowing the others to continue to grow tax-deferred. You can also choose to roll the 401(k) and 403(b) into your IRA and then you would only need to manage one qualified retirement account. If you are retired and still have some of your money in a 401(k) or other company sponsored plan, it's time to roll the plan to an IRA. This will give you greater flexibility and simplify your choices when it's time to take your Required Minimum Distributions. The more retirement plans you own, the greater your chance of making big retirement mistakes.

### **Determining whether you will have enough money for a comfortable retirement**

This is a big concern for those who are not fortunate enough to have retirement income from a company-sponsored retirement plan. Consider the retired worker who has a Defined Benefit Pension Plan and will receive more than \$100,000 a year for life. Unfortunately, the days of the big company pension plans are all but gone. As these types of plans continue to disappear, each year more retiring Americans will need to depend on their IRAs, 401(k)s and other plans to supplement their Social Security. Having these accounts spread all over the place just compounds the problem. Before determining the amount of income you can take from your savings, you need to know how much you have in these accounts. Some accounts may be growing, while others are shrinking. These fluctuating account balances need to be taken into consideration when making income decisions. If you take too much income too fast, you run the risk of running out of income during your retirement years. When the account is empty, the income

from that account will stop. Consolidating your accounts can simplify this process and make income decisions less of a task.

### **Determining whether your beneficiaries are up-to-date in all of your retirement accounts**

In Mistake #3 we discussed the many tax traps that IRA owners must navigate when properly setting up beneficiaries. If you have only one IRA, it is difficult enough to get everything set up properly to avoid costly mistakes that can result in accelerated taxes. Even worse, your retirement savings could end up in the hands of an ex-spouse or ex-son/daughter-in-law if your beneficiary forms are not kept up-to-date. If you have 10 retirement accounts, the chance of making costly beneficiary mistakes is multiplied tenfold!

### **Determining what to do with old life insurance policies**

Consolidation also can be beneficial in the area of life insurance. Statistics show that Americans commonly own three or more life insurance policies. Most people nearing retirement bought life insurance when they were young and still raising their families. The purpose of life insurance, at that time, was to provide income for the family if they died prematurely. If you are reading this and your children are grown and on their own, that reason is gone.

For many people, the cash values of their life insurance policies have grown to the point that they are substantial nest eggs. This can represent a golden opportunity. In many cases, the cash value of your life insurance may be very close to the death benefit. For example, if you bought a whole life policy 20 or 30 years ago with a \$100,000 death benefit and the cash value has now grown to \$70,000, the net death benefit is only \$30,000 (\$100,000 death benefit minus the \$70,000 that already belongs to you).

People are living longer, and the cost of life insurance has decreased. You are allowed to do a tax free exchange of your \$70,000 cash value to a new life insurance policy, and that could increase your death benefit from a net of \$30,000 to as much as \$200,000, depending on your age and health. The death benefit will be greater and it will be paid income tax free to your beneficiaries. This is a huge gold nugget in the tax code.

If you have several old life insurance policies, they can all be consolidated into one larger policy. Here is the best part; when you do this, in most cases, you will no longer need to pay life insurance premiums. The new policy will have cash values, just like the current policies. These cash values can be used for emergencies, to provide retirement income, or for any other purpose. If you need to make a beneficiary change, you only have to do it once. This decreases the chance of making beneficiary mistakes.

### **Simplification through Consolidation**

Having too many accounts is just too much to worry about, but there is a simple solution. Multiple retirement accounts can be consolidated into two basic categories: Qualified and Non-Qualified.

Qualified accounts include IRAs, 401(k)s, 403(b)s, 457(b)s, SEPs, and similar accounts where you did not pay income tax on your contributions. All of these qualified accounts can be consolidated into one easily managed IRA. The Non-Qualified category includes everything else. Many retired workers, or those planning to retire, can consolidate multiple accounts into two easily managed retirement accounts (and a third account for those who own a Roth IRA).

If you choose to consolidate some of your retirement accounts to make life a little simpler, you will need to consider how you will transfer funds from one account to another. There are two methods of transferring retirement accounts, and there are different rules for each.

- 1. Trustee to Trustee Transfer:** This is the safest way to transfer your retirement accounts. Using this method, the funds are moved directly from the current financial institution to the new one that you choose. You simply complete the transfer request and the rest is on autopilot. You will not receive a check or need to create a paper trail to prove to the IRS that this is a transfer and not a taxable distribution. Another advantage is you can make these types of transfers as often as you like, so if you change your mind you can transfer your savings somewhere else. This method may take a little more time, usually 20 to 45 days, but you don't run the risk of needing to prove that the transfer did not trigger a taxable event.
- 2. Indirect IRA Rollover:** This method is faster, but there are two major tax traps. When doing an indirect IRA rollover, the current custodian will send you a check and you must reinvest the funds into a new IRA within 60 days. If you pass the 60 day deadline and fail to reinvest the money into a new IRA, the IRS will have a big payday. The funds will lose their tax-deferred status and will become taxable immediately. The second tax trap is that you may only do one rollover in a 12-month period.

Even if you have more than one IRA, you are still limited to one indirect rollover per year. If you do more than one rollover during the 12-month waiting period, the IRA would become taxable. If after completing an IRA rollover, you decide to move your IRA again, the only safe option will be to do a trustee to trustee transfer, or wait until the 12 months have passed.

## **Here are two examples of how easily you can step into these tax traps:**

### **Tax Trap 1 – “The 60 Day Limit”**

Jim, age 63, owned a \$200,000 IRA in a brokerage account. He had lost a little over \$8,000 in the past year and was ready to take an early retirement. He decided he had lost enough and he initiated an indirect IRA rollover. His plan was to move the account to a bank CD to keep his money safe. He received the check from the brokerage firm on March 1, 2019, so he had until April 30, 2019 (60 days later) to deposit his IRA at the bank.

On March 19 Jim retired from his company and he and his wife took a long and well deserved vacation. When they returned from vacation, three weeks later, Jim’s wife began to have some health issues and he was focused on getting her the best care available. The 60-day deadline to reinvest his IRA had passed unnoticed, and the tax trap was triggered. Jim’s entire \$200,000 IRA became taxable.

### **Tax Trap 2 – “One IRA Rollover per Year”**

Elizabeth, a widow age 66, was married to a very conservative investor who believed in one motto, “Never take chances with money.” His \$400,000 IRA was in a money market account that was paying a low interest rate. The money was safe, but the earnings were poor. Elizabeth had always been more of a risk taker than her husband and, many times, she encouraged him to take a little more risk to increase the potential earnings. After her husband’s death, Elizabeth chose to become the new IRA owner. The stage was set and she was ready to reposition the IRA for better growth. At that time the six-month bank CD interest rates were much higher than her money market account so she instructed the financial institution to send her a check for the entire \$400,000, which she deposited into the CD within the 60 day limit. Elizabeth was pleased with her decision.

Several months later, a friend told Elizabeth that she had earned more than 14% in a mutual fund last year. That is the kind of growth Elizabeth was looking for. After the six-month CD matured, Elizabeth went to the bank and withdrew the CD, placing the money in the mutual fund, again within the 60-day limit. What did Elizabeth do wrong? She made two IRA rollovers within the 12 month period and triggered a tax trap. Elizabeth now owed income tax on the entire \$400,000.

As bad as both of these tax traps are, they could have been much worse. If Jim in tax trap 1, or Elizabeth in tax trap 2, were under age 59½, they would have paid an additional 10% penalty for taking a pre-59½ distribution from their IRAs.

For Elizabeth, who was 66, the additional taxable income generated from her IRA mistake, would easily be sufficient to push her into a higher tax bracket and increase the tax on her Social Security benefits.

IRA mistakes are easy to make with only one account. If you own multiple retirement accounts, the chance of triggering an unwanted taxable event is significantly increased.

For many years, financial pundits have touted the maxim that diversification is the best way to prepare for retirement. *“Don’t put all of your eggs in the same basket.”* During the accumulation years, that made perfectly good sense; however, when you decide to retire, diversification needs to give way to preservation. It’s all about having enough income for a comfortable retirement. Here is the simple truth: ***You cannot have a guaranteed income from a non-guaranteed account!*** A drop in the market, like we saw in 2008, for many retirees can mean reduced retirement income. Consolidating retirement accounts in a safe place can help avoid costly and irreversible retirement mistakes.

## MISTAKE #10

### NOT GETTING A SECOND OPINION

Failure to seek counsel from a second source is the granddaddy of all retirement planning mistakes. It is how many investors and retirees find themselves taking financial losses, and paying unnecessary taxes, penalties, fees and loads. The IRA owner's worst enemy is bad advice offered by the unskilled and untrained advisor. Getting a second opinion regarding your wealth is equally as critical as getting a second opinion about your health.

Imagine during a routine checkup your family doctor discovers something doesn't sound quite right with your heart. How would you feel if he said, "Make an appointment with my nurse to come in next week for open heart surgery?" You might faint at the thought of a family practitioner wanting to perform a surgery he or she has no training to perform. The doctor is more likely to recommend that you visit a cardiologist to get a second opinion before anyone pulls out the chest cutter. This process is designed to get you to the right professional who is trained to perform the needed procedure.

In the financial services industry, finding that right professional to give you a second opinion can be a bit tricky. The reality is that the fees, loads and commissions associated with managing the trillions of dollars of Americans' retirement savings is big business. You can be sure that most advisors have no intention of referring you to an IRA distribution specialist. They will not run the risk of losing your account, even if it is in your best interest to make the referral.

Before choosing an advisor to get a second opinion, understand that most advisors are not trained in the complex arena of IRA distribution planning. As with open heart surgery, you want to find the right advisor for the job. To accomplish this, you should first understand the different types of financial professionals you may encounter.

## 7 Basic Categories of Financial Advisors:

1. **Bank Advisors** – Most of us have some experience with banks. We use them for checking accounts, savings accounts, loans and credit cards. Usually, when you choose to save money in a bank, your money will wind up in a CD, Money Market account, or other bank product. Bank employees are trained to advise you to put your IRA in a CD or other bank product, because that is what they sell. They will assure you that your retirement funds will be safe. However, although CDs and Money Market accounts are generally considered safe, the trade-off for safety is typically a lower rate of return.

Similarly, they will assure you that you will get a fair rate of return, but a fair rate of return may not be enough when you're taking Required Minimum Distributions from your IRA. When you turn 73 your first required distribution is just under 4% of the IRA account balance as of December 31 of the prior year. If the CD is earning less than 4%, your IRA will begin to shrink. As you get older, the required distribution percentages will increase. If the CD rate is consistently lower than the Required Minimum Distribution, your IRA will shrink fast and there will be less (if any) money left in your IRA to be passed on to your heirs. Bank advisors, with very few exceptions, are not trained in the IRA distribution rules and are not in a position to help you develop winning IRA strategies.

Moreover, in 2008 we learned that banks are not always financially sound and many banks were involved in high

risk mortgage loans. As a result of banks granting loans to consumers with bad credit or even no credit, nearly 30 banks failed in 2008, leading the federal government to take action. On September 25, 2008, the Fed seized Washington Mutual. This was the biggest bank failure in American history. Congress swiftly passed legislation to provide billions of dollars in “bailout” money to other ailing banks to keep them from turning upside down. Despite the government’s involvement, however, things continued to fall apart for the next two years. In 2009, more than 140 banks failed, and more than 200 failed in 2010. A big chunk of the bailout money went to big banks, like Citigroup of New York, NY, and Bank of America, headquartered in Charlotte, North Carolina, the two largest banks in the United States. Both were considered **“too big to fail.”**

- 2. Securities Only Advisors** –Wall Street is a little different than the banking community, but their advisors have more in common than one might think. What do you think securities only advisors will recommend you do with your IRA? They will do the same thing the bank advisor would do; they will advise you to use the products they are paid to sell and recommend that you invest your IRA in securities. They will continue to recommend buying, holding, and trading securities in all market conditions, because that is what they do. If you are young and still building your IRA account, this might be good advice. You have the luxury of time on your side, so you can ride out Wall Street’s storms and hope that the market will grow over the long haul. This is the buy-and-hold approach investors commonly used in the past. After the 2008 Wall Street collapse, many experts are now saying that the buy and hold strategy is no longer a sound approach.

If you are retired or close to retirement, investing all of your IRA in securities could lead to IRA disaster. If you will need income from your IRA in the next five to ten years,

investing all of your IRA in securities could be a costly mistake for most senior Americans. When you begin taking distributions from your retirement accounts, a drop in the market means taking a reduced income or running the risk that you will outlive your savings. In the case of an IRA, you will be forced to take Required Minimum Distributions no matter what the market conditions are.

The one exception to this occurred in 2009. IRA owners were allowed to skip the Required Minimum Distributions for that year only. IRA owners who were forced to take a distribution in 2008 from accounts that had lost as much as 40% of their value know that a market meltdown can ruin the best laid retirement plans. In short, much like the bank advisor, most securities only advisors sell what they are paid to sell. Most are product oriented and don't have adequate training in IRA distribution planning.

3. **Certified Public Accountants** – CPAs are a great resource when it comes to tax preparation and tax planning. For many tax payers, their CPA is their most trusted advisor. The CPA or tax preparer hands them Form 1040, says “Sign here and write a check for this amount to the IRS”, and without hesitation, they do it. That takes a great deal of trust.

Some of the larger CPA firms have developed an in house financial services division that offers securities and insurance products in addition to their tax preparation practice. For the most part they do a good job balancing investment risk for their younger clients with the need for safety for their senior clients.

This is all good but keep in mind, Form 1040 does not report what could or should have happened, it reports only what did happen. Often, what occurred was rapid IRA distribution causing rapid taxation. Do not assume that your CPA is trained to properly structure your IRA and generate the maximum income for you, your spouse, your children and grandchildren. When it comes to your IRAs

and other qualified retirement accounts, most of the IRS deadlines fall on December 31. By the time your CPA or tax preparer gets to your return, the December 31 deadline will have come and gone.

- 4. Elder Law Attorneys** – Some attorneys specialize in dealing with senior's needs. Their primary tools to help seniors transfer wealth, reduce taxes, and accomplish many other goals are the use of different types of trusts and wills designed for senior clients. Trusts can be extremely effective in controlling your wealth after you're gone. The correct use of a trust can be beneficial in IRA planning, depending on your circumstances and wishes.

For example, if you have a beneficiary who has special needs or will have difficulty managing an inherited IRA, a trust might be the best solution. Similarly, if there is the potential that one of your children or grandchildren will get divorced, you might need a trust to make sure that your IRA won't wind up in the hands of a soon to be ex-son-in-law. If you or your spouse have children from a prior marriage, a trust can be used to determine who will and who will not inherit your IRA.

Just like your CPA your attorney may not be familiar with all of the IRA rules.

- 5. Captive Advisors** – Some financial advisors are mandated to recommend whatever their employer dictates. Most bank and securities only advisors also fall into this category. Captive simply means they can only offer products and services that the bank or firm allow. They are employees of banks, brokerage firms, or insurance companies. They are restricted to the limited options offered by their employers. In simple terms, they work for their company, not for you.
- 6. Insurance Advisors** – Insurance advisors fall into two categories, Captive agents and Independent agents.

**Captive insurance agents** are employees of a particular insurance company. They typically can sell only the products offered by their company. This can be a handicap when it comes to offering the best advice for IRA distribution planning. The products offered by their company may not be the best product for you.

**Independent insurance agents** are self-employed contractors who have the ability to choose which insurance companies they want to represent. Many independent insurance agents represent 20 or more insurance companies. This gives them a broader base of products and services to choose from, putting them at an advantage when it comes to recommending the product that best fits your situation. Many insurance advisors are also licensed securities advisors. This gives them even greater flexibility when it comes to giving you the best advice for your particular situation.

7. **Independent Advisors** – This group of financial professionals has a unique advantage. They typically are licensed and trained in both insurance and securities and can offer you the entire universe of financial solutions. Many Independent Advisors are also trained and specialize in IRA/401(k) planning.

Keep in mind that for any given financial professional, your concern is not about the products they are selling. It's about their expertise in IRA distribution and retirement planning solutions from which you and your family can benefit today.

With this understanding of the basic categories of advisors, this is what you should expect the financial professional to do when you get a second opinion:

- Check beneficiary designations on all retirement accounts and life insurance policies to make sure they are up-to-date.
- Review the downside potential of all of your investments to make sure it does not exceed your risk tolerance.

- Check for hidden fees and loads that will erode your retirement savings over time.
- Make sure you are taking full advantage of tax-deferred and tax-free IRA strategies.
- Help you avoid unnecessary taxes and IRS penalties.

Using the wrong or untrained advisor can be worse than having no advisor at all. The challenge is selecting an advisor that has the training and skills to help you get the maximum benefit from your retirement plans.

Have you ever noticed how easy it is to get inaccurate or just plain bad advice? ***It's a lot like getting a bad haircut, but unlike the bad haircut, your retirement savings might not grow back.*** Before following any advisor's advice about your IRA, make sure they are qualified to give you that advice.

### **Here are two quick tips that will help you choose the ideal advisor:**

1. **Ask a lot of questions.** The ideal IRA advisor should be able to answer any questions you have about structuring your IRA or other qualified retirement plans. Asking questions is like peeling an onion: the more layers you peel off, the more transparent the onion becomes. It works the same with financial advisors. Complete transparency is what you should be looking for. The deeper you dig, the more you will find out what they do or do not know about IRA planning.
2. **Don't base your decision solely on the advisor's experience.** Experience is a good thing to look for in an advisor, but experience alone won't tell you whether this is the right advisor for your IRA or 401(k). Some advisors may tout that they have 30 or 40 years of experience in the financial services industry, but this doesn't necessarily make them IRA experts. In some cases, it indicates only that they are survivors. Their training, more than their experience, is what matters when it comes to retirement

planning. You are better off with an advisor with less experience who is a student of IRA distribution than one who has been doing the same thing for 30 years and has one year of experience 30 times. However, the advisor who possesses a combination of both experience and IRA training will be in the best position to offer you valuable advice.

**Here are five questions you can ask a potential advisor to determine whether he or she is the right choice for you:**

**1. What training do you have in IRA Distribution Planning?**

Most financial advisors are generalists—they do a little bit of everything, from auto insurance to giving investment advice. IRS regulations are complex, and many dates and deadlines must be followed to avoid additional taxes and penalties. The Trained IRA Advisor should be able to elaborate on the formal IRA training courses they have attended. How often they participate in continuing education is also important. The tax rules change often, and the savvy advisor knows the importance of staying current. They should attend updated IRA training meetings periodically to stay informed and be on their game.

**2. Do you have a copy of IRS Publication 590?** *IRS Publication*

*590* is the IRA rulebook and one of the best information sources for the trained advisor. The rulebook clarifies what you can and cannot do with your IRA. Your advisor should be able to show you all of the rules about how to properly designate beneficiaries, the correct way to do a Roth IRA Conversion, the problems related to using a will or a trust to designate your beneficiaries, and everything else that pertains to properly structuring your retirement accounts for maximum income and minimum taxes.

3. **Are you familiar with all areas of retirement and estate planning?** IRA rules are more complex than the rules for non-qualified retirement accounts, but your IRA is only part of the overall retirement picture. The ideal advisor will take into account all aspects of retirement and estate planning and should have the skills to ensure your IRA is working in harmony with your overall plans. Coordinating IRAs, 401(k) plans, non-qualified savings, and life insurance requires an advisor who is knowledgeable in all areas of retirement and estate planning.
4. **What happens to my IRA at death, the death of a beneficiary, or if one of the beneficiaries gets a divorce?** This question will help you determine whether the advisor is up-to-speed. The answers are dictated by your IRA custodial agreement and beneficiary document. Typically, at the IRA owner's death, the proceeds will be passed to the surviving spouse. If there is no surviving spouse, the IRA will likely pass to your children and/or grandchildren or other beneficiaries you have selected. If one of the Designated Beneficiaries predeceases the IRA owner, the beneficiary form will need to be amended. If one of your beneficiaries has a high likelihood of getting a divorce, this should be addressed now rather than later. For example, if your daughter inherits some of your IRA and resides in a community property state and deposits her inheritance in a joint account, the outcome could be your ex-son-in-law will wind up with half of her inherited IRA. Remember, the beneficiary document trumps all other documents, including wills, trusts and decrees of divorce. It's critically important that your beneficiary documents are reviewed annually or when a triggering event occurs.
5. **Do you use the Team Approach?** Have you heard the expression, "*Too many cooks can spoil the stew*"? This is true unless they are working in harmony and are all on the same page. Properly structuring your IRAs and other accounts often requires the services of more than

one professional. Your family may benefit from a power of attorney, a will or a trust, which will require an attorney who deals in this area of law. You may also need the services of a CPA to make sure your financial planning is in harmony with tax planning. The ideal advisor will have relationships with other professionals and seek advice in their areas of expertise. Your advisor should always have the big picture and the knowledge to call the plays. Calling the wrong play often results in financial mistakes that cannot be reversed. Having a well-trained advisor spearheading the team will help you avoid conflicting advice that can make each decision more difficult than it needs to be.

Here is a bonus question, you should ask yourself. Has your current advisor adequately explained the important IRA tax traps and opportunities discussed in this book? If the answer is no, it may be time to consider getting a second opinion. Keep in mind:

***“It is impossible to get a second opinion from the same advisor who gave you the first one.”***

A second opinion from a Trained Independent IRA Advisor can make the difference between having a guaranteed income for life and help you avoid the Top 10 Mistakes made by IRA owners and their beneficiaries.

## BONUS CHAPTER

# IRAs, 401(k)s AND THE BOOMER GENERATION

Those who were born between 1946 and 1964 have the distinction of being “Baby Boomers”. As their parents would remember World War II, the Korean Conflict and the crooning of Frank Sinatra, Boomers are more likely to be tuned-in to Vietnam, the Beatles, Woodstock and electronic gadgets their parents never dreamed of owning. The Baby Boomer generation is close to 78 million strong, and anyone who sells anything has been targeting this demographic for as long as the expression “Baby Boomer” has been around.

Approximately 10,000 Boomers are reaching retirement age every day and they control the majority of the wealth of America. How well this generation manages this money is of enormous importance to everyone!

Many Boomers will have at least one, if not several, qualified retirement accounts, such as an IRA or 401(k). If you are a Boomer, you are part of the group with the highest probability of having your own IRA, 401(k), SEP, TSP, and also inheriting IRAs or 401(k)s from your parents. The IRA you own will need to be treated differently from the IRA you may inherit. The distribution rules are different for your personal IRA vs. an inherited IRA. In this area making distribution mistakes can easily lead to costly IRS tax traps.

### **The IRA/401(k) You Own**

Most Boomers made substantial contributions to their IRAs, 401(k)s, SEPs, TSA, 403(b)s, and TSPs during their years in the workforce. Some may also have benefited from employer

matching funds and grown their retirement account into a substantial retirement nest egg. The rules for the plans you contributed to are the same as the rules for your parents—the demographic Tom Brokaw dubbed “The Greatest Generation”. You pay no income tax on your contributions and you do not have to begin taking taxable distributions until the year after you turn age 73.

Here is where it gets complicated. In addition to the IRA you own, you are likely to inherit a retirement account from one or both of your parents. Having these two different types of accounts can create income planning and distribution challenges. The distribution rules are substantially different for an IRA you own vs. an inherited IRA. When inheriting an IRA or other qualified retirement account the beneficiary will be faced with decisions that will need to be made quickly.

Managing the trillions of dollars of qualified retirement money in America is big business, and every potential custodian wants a bite of your retirement savings. Everyone will be ready to give you advice but not all advisors are skilled in the distribution rules. It’s like swimming in a shark tank and all of the sharks are saying the same thing in deep soothing voices, *“Be my friend and I’ll protect you. The other sharks just want to take a big bite out of you”*. Acting on the wrong advice could lead to one of the many IRS tax traps. Armed with the right information, you will know who is giving sound financial advice and who to send packing.

### **The IRA/401(k) You Inherit**

An inherited IRA or 401(k) must be treated differently than the IRA /401(k) you own and have contributed to. You cannot delay taking distributions from an inherited IRA or 401(k) until you are age 73. You must pay the taxes within 10 years after you inherit. This is mandated by the SECURE Act of 2019. This is where common distribution mistakes can lead to higher taxes and unnecessary IRS penalties.

## Inheriting an IRA

Fortunately, you are still in control of your money, even when you inherit an IRA or 401(k) account, and you can decide the best distribution method for your needs. You have two options if you inherited before the owner started Required Distributions:

### Option 1

If you decide to use all of the money now from an inherited IRA, you will need to pay all of the income tax now. If you are still working and have earned income, this approach could push you into a higher marginal tax bracket.

### Option 2

You can pay a portion of the tax each year as long as all of the taxes are paid within the 10 year rule. This approach will add taxable income each year but may help you stay in your current marginal tax bracket.

### **Their is an exception to options 1 and 2 above**

If you inherited an IRA after the owner began taking Required Minimum Distributions, you must begin taking distributions, based on your age, years 1 through 9 and empty the account by the end of year 10.

***You should note that after inheriting an IRA, under current IRS rules, you cannot convert the inherited IRA to a Roth IRA.***

***Unlike an inherited IRA, you do have the option to convert an inherited 401(k) to a Roth IRA and enjoy tax free growth and income tax free distributions.***

#### **4 Rules for Non-spousal Beneficiaries Avoid IRS Tax Traps:**

1. Non-spousal beneficiaries cannot become the owner of an inherited IRA or deposit it into their own IRA. Making either of these mistakes will cause the inherited IRA to become immediately taxable.
2. Non-spousal beneficiaries cannot make any contributions to an inherited IRA.
3. Non-spousal beneficiaries cannot delay taking distributions from an inherited IRA until they turn age 73. Under the SECURE Act the taxes on an inherited IRA must be paid by the 10th year after the owner's death.
4. If the deceased account owner was past their Required Beginning Date April 1 of the year after turning age 73 and had not taken the required distribution during the year of death, the inheriting non-spousal beneficiaries must take a distribution equal the distribution the IRA owner would have taken if still living.

If you are a Baby Boomer and have contributed to an IRA, 401(k), SEP, 403(b), 457(b) or any other qualified retirement plan and have inherited or expect to inherit a qualified plan, seek help from an advisor who specializes in IRA inheritance and distribution.

## SUMMARY

IRAs, SEPs, 401(k)s, 403(b)s, 457 plans, and all other qualified retirement accounts have different and more complicated rules than regular savings accounts. The tax codes governing these accounts are filled with two things: tax traps and gold nuggets. The purpose of this book is to help you navigate the minefields of rules, regulations, and deadlines and pick up all of the gold nuggets that are available to you.

Let's start by reviewing the important dates and deadlines that will affect your retirement accounts and the tax traps you can avoid.

### **While the IRA owner is living:**

60 days to complete an IRA rollover.

### **Only One indirect IRA Rollover per year.**

**Age 59½** is when the IRA owner can take distributions without paying the pre-59½, 10% early withdrawal penalty.

**April 1** of the year following the year the owner turns age 73 is the Required Beginning Date (RBD) to take your first Required Minimum Distribution (RMD).

**December 31** is the deadline for all future RMDs.

### **After the IRA owner's death:**

Spousal beneficiaries can become the new owner and take Required Minimum Distributions (RMD) over their life expectancy.

Non-Spousal beneficiaries will need to pay the taxes on the inherited IRA within 10 years.

### **Controlling Investment Risk**

If you are retired or nearing retirement, too much risk can ruin your plans. The market has the potential of great rewards,

but its counterbalance is the potential of loss. Take the time to examine the potential downside of your investments to be certain it does not exceed your risk tolerance. For additional information, review Mistake #5.

### **Controlling the Fees and Loads**

In Mistake #6 you learned that fees and loads can erode your nest egg over time. Gambling with too much of your retirement savings is bad enough, but if Las Vegas charged a fee to enter a casino, would you pay it? The closer you are to retirement, the more you may need to reduce unnecessary expenses.

### **The Roth IRA Conversion**

This is an extra-large nugget in the tax code. If you won't need your IRA for income, you should consider converting at least some of your IRA to a Roth. A small tax bite now could save thousands of tax dollars in the future. If you are going to consider converting, do it before the tax brackets are increased. Remember from Mistake #7, after a Roth IRA conversion the IRS is completely out of the picture and you can take control of your IRA. All future gains and qualified distributions will be income tax free for you and your heirs.

### **IRA Arbitrage**

One of the greatest gifts in the tax code is that life insurance death benefits are income tax free. If your goal is to pass more to your family, you can use the after tax IRA balance to leverage larger and tax-free life insurance benefits. Life insurance is the cornerstone of sound financial planning. Remember from Mistake #7, the money used to pay for life insurance does not disappear. The life insurance cash values are there if you need money for income or unexpected expenses. Review Mistake #7 for all of the additional benefits life insurance can offer, including the funding of Long-Term Care expenses.

## **Rolling 401(k) and 403(b) Plans to an IRA**

The reasons for owning company-sponsored plans are gone after you retire. The IRS allows you to move the funds in restrictive 401(k) and 403(b) plans to the more flexible IRA. Rolling your plan to an IRA opens up the floodgate of investment options and gives you and your family greater income planning flexibility. Review Mistake #8 for all of the advantages of retiring your company sponsored plans when you retire.

## **Consolidating Retirement Accounts**

This was addressed in Mistake #9. Having too many retirement accounts can become a retirement nightmare. The IRS allows you to consolidate your 401(k)s, 403(b) plans, and all other qualified investments into one easily managed IRA. The more retirement accounts you own, the more likely you will miss an important date or deadline. Consolidation is one of the most effective ways to avoid unnecessary taxes and IRS penalties. Remember, IRAs, Roth IRAs, and non-qualified savings accounts must be kept separate.

## **Getting a Second Opinion**

This is not a nugget in the tax code but it is something you owe to yourself. The IRS minefield of ever changing regulations, deadlines, and penalties is not going to go away. This was discussed in Mistake #10. If you own a qualified retirement account, you are faced with navigating the minefield while you collect all of the gold nuggets that are available to you. A second opinion from a qualified advisor will tell you if you are on the right track.

Remember, your retirement savings is your money. You don't need to let Uncle Sam become a senior partner in your IRAs and other retirement plans. By taking the time and following the steps recommended in this book to plan and structure your IRA accounts properly, you can safeguard your wealth for your retirement and provide a lifetime of income for you and your spouse.

