

Avoid Bad Ideas When Planning Retirement

Smart retirement planning involves a lot more than just choosing investments. The best planning ideas could help you tremendously. Mistakes, however, could be very costly to you and your family.

”One of the biggest mistakes is not filling out the beneficiary form for your IRA or other retirement plan or not filling it out in conjunction with your total estate plan,” says Natalie Choate, Esq., author of the book “Life and Death Planning for Retirement Benefits.”

“Another mistake is when your provider loses the beneficiary form. Even though you fill out your beneficiary form perfectly and it is just what you want, you need to check with the institution every couple of years to make sure it still exists.” It could get lost, Choate says, “when your IRA provider gets acquired by another institution (and) they shred information from the old company.”

What happens if your heirs find out the provider lost the beneficiary form? “If you have a good copy and a receipt for it, you should be OK. But if there is no form and you can’t prove who the beneficiary is, then it is paid to your estate. Expenses are high, and distribution options are very unfavorable,” says Choate.

Choate offers vital information you should consider for Individual Retirement Accounts (IRAs), 401(k)s and other retirement plans. Here are a few of the best and worst planning ideas:

Taking lifetime minimum required distributions (MRDs)

Best Idea - Don't postpone the first year's MRD

For IRAs, the “distribution year” (year MRD is required) is the year the participant reaches age 70 ½. While the first year MRD can be postponed until April 1 of the following year – unless your income tax bracket is significantly higher in the first year or special Social Security circumstances apply – take the first year's MRD.

Here's why:

First, it avoids a double distribution in the second year. Second, you will have different deadlines. The first year's distribution must be withdrawn by April 1 and the second year by Dec. 31. Third, the two MRDs will be computed using different account balances.

The first year MRD is based on your age as of your birthday in the first distribution year and the account balance as of the end of the year preceding the first-year distribution. The second- year MRD is based on your age as of your birthday in the second distribution year and the account balance at the end of the first distribution year.

"It is not like it is bad to wait, but it will make life complicated," says Choate.

Worst Idea - Keep IRA investments liquid to cover anticipated MRDs

This is unnecessary and could result in a lost investment opportunity or additional costs to sell securities.

There is no requirement that MRDs be paid in cash.

Company stock

Best Idea - Take a lump sum distribution

If you own company stock in your retirement plan, you can qualify for special favorable tax treatment by taking a lump sum distribution of this account.

Seek professional advice before selling the stock while it is still in the plan or rolling it over to an IRA. Either of these activities would cause a permanent loss of the potentially favorable tax treatment.

Choice of Beneficiary

Worse Idea - Name a Trust for Spouse

While there are many valid estate planning reasons to name a trust for spouses as beneficiary of his/her retirement benefits, it comes with a price. A trust for a spouse generally must start taking distributions the year after the participant's death, not age 70 1/2, and must take MRDs on the spouse's single life expectancy. Still, it may make sense if the spouse spends excessively, is subject to creditors' claims, drug addiction, etc. If not, a spousal rollover allows for income tax deferral and the benefit of compounding.

Estate Tax Reduction

Best Idea - Convert to a Roth IRA

Converting to a Roth IRA before death can help reduce estate taxes, by removing the income taxes due on the Roth conversion from the gross estate. The beneficiaries can then take a life expectancy payout of the Roth IRA at the participant's death income tax free. To be eligible to convert to a Roth, the participant must not have more than \$100,000 of adjusted gross income (not counting the income resulting from the conversion).

"Estate planning attorneys are trained and skilled in planning for the disposition of your estate on your death. What they are not trained to do is to figure out if you have enough money to live on," says Choate.

"Some attorneys will design the perfect scenario if you die. But if you live, it creates a problem if you give away too many assets or leave your IRA in a trust (to save estate taxes), but your spouse does not have enough income. It is important to make sure the attorney is dealing with the lifetime issues as well as the death plan," she adds.

Retirement benefit planning can help you avoid the worst ideas and implement the best ideas – and that is smart planning.

Note: This article is for informational purposes only. Consult your financial advisor, tax advisor or attorney to determine what is appropriate for your situation.