

The Law and You

IRA and Retirement Plans

IRAs and other qualified retirement plans have become pervasive. These plans have enjoyed substantial success because of the tax advantages. Contributions to such plans are made before taxes. This means that taxes on contributions and realized gains in such plans are deferred until withdrawal.

Many of us rely on these plans to supplement Social Security benefits during our retirement years.

But if you are like me, you may not have given much consideration to the beneficiary named on your plan or how and when distributions will be made to you.

You can make withdrawals from your IRA or other qualified plan before you reach the age of 59½, but you will have to pay a 10% penalty plus income tax on the amount of withdrawal.

Under certain circumstances you may be able to avoid the penalty for early withdrawal. Some exceptions are: your disability, medical care, higher education, loss of job after the age of 55, or up to \$10,000 for the down payment of a residence for you or a family member.

Taxes on contributions to these plans are deferred. So, those taxes must be paid when you make withdrawals. It is generally best to defer withdrawals as long as possible or until distributions are absolutely needed to support your life style.

Delaying distributions defers taxes and will often reduce the amount of taxes when paid. This is because income generally declines with age. With reduced income, tax rates are also lower. As a consequence, taking distributions later in life will often result in lower taxes paid.

The IRS wants the taxes paid, the sooner the better. Therefore, you must begin taking distributions when you reach 70½. Failure to do so can result in a 50% penalty!

The minimum amount of these distributions is based on your age and is determined from tables provided by the IRS. For example, during the year when you are 73 years of age, approximately 4% of your retirement balance must be distributed to you.

Upon your death, distributions depend on who your beneficiary is. Beneficiaries must be determined by September 30th of the year following the year of your death.

When a spouse is named as beneficiary, the spouse can choose to rollover the distribution into an IRA. By doing so, distributions can be postponed until your spouse reaches 70½.

Alternatively, the spouse can treat the distribution as an “inherited IRA.” Distributions are then based on the life expectancy of your spouse.

For all other beneficiaries, distributions are based either on the life expectancy of the beneficiary or on the “Five Year Rule.” For life expectancy, the Single Life Tables from the IRS are used to compute the minimum required distribution.

Under the Five Year Rule, the beneficiary must fully take the retirement asset no later than December 31st of the year that is five years after the year of death.

If no beneficiary is specified and your estate becomes the beneficiary, there is no specific age for the estate. In that case, the Five Year Rule applies, if your death occurred prior to the date when distributions would have been required had you not died.

If your death occurs after the date when distributions would have been required, then the recipient of the retirement assets may elect to take distributions based on the life expectancy tables for you had you not died.

You might consider naming a trust as beneficiary of your retirement accounts. Some

reasons to name a trust include:

- Special Needs Beneficiaries
- Spendthrift Beneficiaries
- Minor Beneficiaries
- Children from Previous Marriage
- Asset Protection for Beneficiaries

Most IRA and retirement plan administrators should be able to guide you through the various options you have. But you may want to review the beneficiary named on your retirement accounts. In light of the information contained in this column and your particular family situation, you may want to change the beneficiary designation.

If you need additional information beyond what your plan's administrator provides, you should consult with an Elder Law Attorney. To locate an Elder Law Attorney, check your local Yellow Pages or the National Academy of Elder Law Attorneys at (520) 881-4005, or on their web site at www.naela.com.