Section: Ask S&B
Date Written: 7/31/09
NPC#: 40765
Author: Brad Stark, 805-690-3901, bstark@missionwealth.com

Title: Retirement Account Costly Errors 6-10 (part 2 of 2)

We are expanding upon last weeks article, "Costly Errors To Avoid With Your Retirement Accounts," where we covered blunders 1-5. Retirement accounts are of specific interest to the IRS because they are subject to special handling procedures as well as estate taxes, income taxes, penalties, required minimum distributions and tax withholdings for certain transactions. So making a mistake, even something that one would think is a minor detail, can result in rather large unintended consequences.

Error 6: Inherited IRAs & Non-Spousal Beneficiaries

Last week we spoke about the "60 day" rollover rules and the avoidance of immediate taxation and penalties when you move them properly. However, if you are a non-spouse (i.e. son or daughter) and you are named as a beneficiary on a retirement account, you are taxed immediately if you take receipt of the funds as the "60 day" rule does not apply in this circumstance. For non-spouse recipients, the account must be kept in the name of the deceased owner (i.e. Jill Doe, beneficiary of the John Doe, deceased, IRA). From there, the beneficiary must take required minimum distributions based upon their life expectancy each year. Failure to follow the rules can result in substantial penalties and taxation.

Error 7 <u>BIG ISSUE</u>: Inherited IRAs Failing To Deduct Estate Taxes

If you inherit an IRA from someone subject to estate tax, you can save a substantial amount of money on the future distributions from that account. In this example, we are assuming the retirement account was subject to death taxes and those have already been paid elsewhere by the estate (normal procedure). As you take distributions from the retirement account (which are subject to income taxes), you are able to deduct a prorated amount of the estate taxes paid. Make sure you talk to your accountant about this. It is an easily missed item, especially if you do your own taxes.

Error 8: Rule 72(t) Violations

Rule 72(t) allows for penalty-free withdrawals from an IRA account prior to the age 59 1/2. The

rule requires that in order for the withdrawals to be penalty free, they must be taken as "substantially equal periodic payments." Amongst other requirements, the amount depends on the owner's life expectancy calculated with various IRS-approved methods. Failing to calculate

the proper amount and duration of the payments can lead the IRS to assess a 10% penalty on all the amounts withdrawn from day one.

Error 9: An Inherited IRA Beneficiary Not Naming a Successor Beneficiary

If you are the beneficiary of an inherited IRA, you should name successor beneficiaries as soon as possible. Otherwise, in the event of your death, the IRA will be distributed to the estate, resulting in a potentially costly probate process and having the entire amount subject to a five year mandatory distribution upon death.

Error 10: Automatic Spouse Rollover

When a person passes away, the surviving spouse is allowed to rollover the deceased retirement accounts into their own IRA. Generally speaking, that is probably a good plan that most everyone will do, however, there are some exceptions. If the surviving spouse does not need the money to live on and they have a substantial estate that is subject to death taxes, they may want to consider disclaiming the account. This action will force the account to go to the next listed beneficiary (usually the children). This technique may save unnecessary estate and income taxes down the road but do not act on this advanced procedure without serious thought and advice from your tax and legal advisors.

Questions can be submitted to asksb@missionwealth.com or the authors can be reached at www.missionwealth.com.

Author's Note: Brad Stark, MS, CFP, AAMS, CMFC and Seth Streeter, MS, CFP, CEA, Co-Founders of Mission Wealth Management, LLC, a Registered Investment Advisor. The information contained in this article is general in nature and should not be construed as comprehensive financial, tax, or legal advice. As with any financial or legal matter, consult your qualified securities, tax, or legal representative before taking action. Securities offered through National Planning Corporation, Member FINRA/SIPC. NPC and MWM are separate and unrelated entities. Certain statements contained within may be forward-looking statements, including but not limited to, statements that are predictions of or indicate future events, trends, plans or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties. All statements subject to change without notice.