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Business & Personal Financial Planning

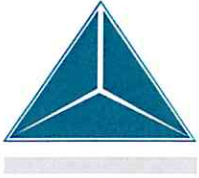
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SUMMIT FINANCIAL RESOURCES, INC.

Planning Alert: *Avoiding IRA Missteps*

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Planning Alert: *Avoiding IRA Missteps*

We are in the early stages of the great baby boomer wealth transfer that will shift an estimated \$30 trillion to the next generation. When it comes to Individual Retirement Accounts (IRAs) both the account owner and the future beneficiary need to be mindful of the distribution rules and potential traps that could impair tax efficiency.

IRA owner. Annual withdrawals (RMDs) from traditional non-Roth IRAs must begin no later than April 1 of the year *following* the year you reach age 70 ½. Missed RMDs result in a whopping 50% penalty. If you have multiple IRAs, the aggregate RMDs may be satisfied from any account; however, IRA withdrawals do not count against required distributions from other retirement plans, such as a 401(k). In addition, your continued employment past age 70 ½ does not affect required IRA distributions, but may provide relief from 401(k) account RMDs if the plan allows it and you own less than 5% of the company sponsoring the plan. In that case, 401(k) distributions may be deferred until April 1 following the year of your retirement. One way to avoid being taxed on RMDs is to make a Qualified Charitable Distribution (QCD) from an IRA to a public charity of up to \$100,000 per year. Keep in mind that QCDs do not cover transfers to Donor Advised Funds. Finally, you can rollover funds tax-free from an IRA once every twelve months (per taxpayer, not per account), provided the same amount is deposited into an IRA within sixty days of receiving the funds.

A key step in the tax efficient transfer of an IRA to the next generation is a properly completed beneficiary designation form. Payout options will depend on the age of the account owner at death and the identity of the beneficiary. For example, if an owner dies prior to age 70 ½ without naming a beneficiary and the account passes by default to the owner's estate, then the entire IRA must be distributed within five years. Naming a trust as beneficiary often makes sense when the account could pass to a minor; however, the trust must be valid under state law, become irrevocable at the account owner's death and clearly identify the individual beneficiaries. In addition, the Trustee must provide the IRA custodian with certain documentation identifying the designated beneficiaries as of September 30 following the year of the account owner's death (the beneficiary designation date applies to all IRAs). Even then, the life expectancy of the *oldest* trust beneficiary will determine the distribution period for *all* beneficiaries.

IRA beneficiary. A beneficiary is well advised to stretch distributions as long as possible and perpetuate the income tax deferral of the inherited account.¹ Spousal beneficiaries have the option of either keeping the account as an inherited IRA or rolling it over to the spouse's own IRA. While the deceased owner's unpaid RMDs cannot be rolled over, the balance can remain tax deferred until the spouse reaches age 70 ½. Non-spouse beneficiaries only have the option of an inherited IRA and must commence RMDs from both traditional and Roth accounts no later than December 31 of the year *after* the account owner's death; otherwise same 50% penalty applies. The 60-day rollover rule is not

¹ This analysis assumes that the beneficiary is younger than the account owner and inherits the account through a properly completed beneficiary designation form.

available for inherited accounts so replenishing the account or depositing the check in another IRA account will not avoid a tax bill. Instead, make a trustee-to-trustee transfer when moving an inherited IRA to a new institution. Accounts with multiple beneficiaries must be split into separate IRAs by the same December 31 deadline if the beneficiaries wish to use their respective life expectancies to calculate distributions. Otherwise the life expectancy of the oldest beneficiary controls. Also, RMDs from inherited accounts must be calculated and paid separately from RMDs for a beneficiary's own IRA. Finally, QCDs are available to a beneficiary starting at age 70 ½.

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