



Crackin' the Egg

A primer on IRA distributions

October 2006

During our entire working lives we're fed a steady diet of advice on the virtues of saving money and funding our retirement accounts. We are told this will save taxes and ensure that we live comfortably upon retirement. Then one day (too soon) you wake up sixty years young and are able to get your hands on those IRA assets without penalty. But we're then advised to avoid taking any distributions for as long as we can. Great deal, eh?

In this edition of *Fiscal Fitness*, we discuss taking retirement distributions, whether from IRAs or company retirement plans. You've committed a lifetime of hard work to funding your retirement accounts; now avoid the financial faux pas at checkout time. The taxes and penalties can be very onerous: 50% or more. Fortunately, understanding your options combined with a little diligence & prudent investing will ensure that your IRA funds last longer. And you baby boomers, who haven't saved much, listen up: you may very well be inheriting an IRA sooner than later.

So, let's define the common IRA distribution terms and then we'll discuss some proper distribution strategies:

Distribution Terms

- RMD – Required Minimum Distribution: the minimum amount that must be withdrawn annually from an IRA after the required beginning date.
- RBD – Required Beginning Date: The date you must start taking your RMD.
- Section 72t – Section of the Internal Revenue Code that permits IRA withdraws before age 59 ½ without penalty.
- Uniform Lifetime Expectancy Table – Table used to calculate RMD based on your age and life expectancy.

Key Dates

- Age 70 ½. The RBD for IRA holders is April 1st following the year they turn 70 ½. For example, if you turn 70 ½ in January of 2006, your RBD is not until April 1st 2007. Caveat: this April 1st date only applies to your first year's distribution.
- Age 59 ½. Under *most* circumstances, age 59 ½ is the earliest an IRA holder can begin taking distributions without penalty. (See Section 72 t)
- Age 55. If you turn 55 or older in the year you retire/leave your company, withdrawals are *not* subject to a 10% early withdrawal penalty – this exception only applies to company sponsored retirement plans, not IRA's.
- December 31st. After the first year distribution, all subsequent distributions must be made by December 31st. Additionally, December 31st is the date of account valuation for subsequent year's distribution calculation.

RMD Calculation

- Here's a simple example: a graying Patrick realizes he just turned 70 on April 23, 2006 and has a cumulative (all IRA accounts) IRA value on December 31, 2006 of \$1,000,000.

Patrick would turn 70 ½ in 2006 so his RBD would be April 1, 2007 (could take sooner if desired). His cumulative account balance of \$1 million is divided by 27.4 (life expectancy value from Uniform Lifetime Expectancy Table). \$36,496 would be his first year RMD. Remember, he could always take more

Strategies and Pitfalls

- A non-spouse beneficiary must leave the deceased's name on the account – if re-titled in their own name, the account becomes immediately taxable. Properly titling of beneficiaries is *critical*. Avoid naming your Estate.
- Taking RMD's from Roth IRA's. Roth IRA's do not require distributions – until you die (beneficiaries take RMD's).
- No beneficiary designate – the entire IRA becomes part of the decedent's estate and is taxed immediately. Ouch!

Planning for retirement distributions can be very complex (& costly) so it's best to get professional help. Your objective may be to spend down the account or, alternatively, to use as little as possible. As discussed, you have some discretion in how much income to distribute, which means you can control how much tax you pay. Do it strategically and your egg will remain grade A extra large. Do it poorly and the feds will gladly accept your mistake. Always remember that the retirement distribution is yours, not the property of the Internal Revenue Service. In the interim, keep saving!

Fiscal Fitness is a publication of Houlihan Asset Management, LLC for the benefit of its clients and friends.
Houlihan Asset Management. Practical Advice. Prudent Investments. www.houlihan.biz