



Notorious Top Ten

Common Mistakes made with Retirement Accounts

August 2004

Maybe “bottom ten” would be more appropriate. Most workers today participate in some form of qualified retirement accounts, whether it be traditional or ROTH IRA, a SIMPLE plan, 401K, 403b plans, etc. In many cases, the retirement accounts represent a worker’s largest asset, if not the most neglected. Qualified retirement accounts are the protected darlings of the tax code because of the political benefit to Congress. Because of the special protection provided, however, proper attention must be paid to the basic rules to avoid often costly mistakes. In this month’s edition of *Fiscal Fitness*, we review 10 of the most common.

1. **Not getting professional advice.** Tax laws are constantly being modified, affecting annual contributions limits (including age “catch-ups”) and income restrictions. If you don’t call us, by all means, call someone if you aren’t familiar with the current provisions of your plan.
2. **Failing to name a beneficiary.** By default, plan participants may have their spouse as the primary beneficiary. But what about the contingent beneficiary? If no one is named, the IRA proceeds will usually be paid to the owner’s estate. This could be the worst possibly result from an income tax viewpoint. Don’t neglect naming a contingent beneficiary.
3. **Naming the wrong beneficiaries.** Do not name your minor kids as primary beneficiaries. For starters, your company sponsored retirement plan (i.e. 401k plan) will not pay proceeds to a minor. If this is your intention, a custodian or trustee must be established. And while a spouse beneficiary generally provides the greatest amount of tax benefits, sometimes it makes sense to name an adult child. This is another area you don’t want to be passive.
4. **Not taking timely minimum required distributions (MRD).** You are required to begin taking MRD by April 1 of the year following the year in which you turn age 70½. Note: there is *no* MRD on ROTH IRA’s. Proper attention should be given to the IRS actuarial distribution schedule so as to avoid nasty penalties for insufficient distributions.
5. **Not knowing what forms of distribution the plan permits.** Does the company plan provide “stretch” IRA payments or just a lump sum? Not all company sponsored retirement plans include the options permitted under the law. Review this when the time is right.
6. **Failure to maintain copies of the plan documents.** It’s difficult to know what your plan provisions are without a copy of the plan document. Usually, employer documents are posted or available from HR upon request. Also keep a copy of your beneficiary designations and other elections.
7. **Putting the wrong investments in an IRA.** Do not put municipal bond investments within your IRA. Further, there is no need to put *any* form of tax-advantaged investments within the tax-deferred protection of an IRA. Also high on the abuse list are tax-deferred annuities within the plan. Fire anyone who suggests this to you.
8. **Taking possession of funds during rollover from 401k.** Potentially expensive mistake. Tax-free rollovers can be accomplished if done within 60 days after the initial withdrawal. If not done correctly, the participant’s funds will be taxed as ordinary income and may be subject to a 10% penalty tax if under age 59 ½. Instead, avoid any possession of funds and conduct a trustee-to-trustee transfer to an IRA rollover.
9. **Failing to incorporate the Net Unrealized Appreciation (NUA) strategy.** This provides special tax treatment to retirement plan participants who receive a lump-sum distribution that includes company stock. The NUA strategy particularly benefits individuals who own substantial amounts of highly appreciated employer stock within their 401k or other employer-sponsored plan. Call us for more in-depth NUA details and if this strategy makes sense for you.
10. **Not maximizing contribution limits (when possible).** Unfortunately, many 401k participants only contribute up to the company match percentage (usually 5-6%). 2004 participant elective deferrals are \$13,000 for 401K’s and \$9000 for SIMPLE IRAs. Catch up provisions are permissible for participants over age 50. The problem here is that most people don’t pay themselves first.

This is a top ten list to avoid. Spending just a few minutes periodically reviewing your current plan and participation electives can ensure you’re on track with your objectives. While market returns can be variable, vigilance to your retirement nest egg should be a constant. Unless you expect a large inheritance some day, it’s tough to retire fiscally fit without a healthy retirement account.