IRA Rescue Story...

8 Signs IRAs/401ks are Broken and How to FIX them

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In 2002, the IRS finalized new regulations for required distributions of IRAs. Under the old rules, children and grandchildren who inherited an IRA were forced to pay the income taxes within one to five years, depending on the age of the IRA owner at death. Under the new distribution rules, the same beneficiaries can spread the distributions and taxes over their individual life expectancies. According to pages 38 and 86 of the 2006 IRS Publication 590, a beneficiary age zero, who inherits a traditional IRA, can spread the distributions for as long as 82.4 years. Spreading out or "Stretching" the distributions allows the beneficiaries to continue earning interest on money that, under the old rules, would have been paid prematurely to the IRS.

A $300,000 IRA at 5% can pay out in distributions as much or more than $1.5 million over three generations, if the IRA is properly structured. These new distribution rules gave birth to the "Stretch/Multigenerational IRA." Unfortunately, many IRA owners aren't taking advantage of the new tax laws and many advisors are not up to speed on the new distribution rules. The bottom line is that most IRAs are broken.

Examine these 8 important signs of a broken IRA:

1 Your prospect has no formal distribution plan. According to LIMRA Research Briefing #8, Sept. 2005, the first of the 78 million Baby Boomers began turning 59 ½ in 2005 and became eligible to take distributions from their IRAs and 401(k)s without the 10% penalty. 85% of Boomers nearing retirement have no formal distribution plan to transform their retirement savings into a steady stream of retirement income. They are currently not taking advantage of the new distribution rules and run the risk that their beneficiaries may be forced into rapid distribution causing rapid taxation. The beneficiaries may lose the advantage of stretching the distributions over their individual life expectancies.

2 Your prospect is not taking advantage of the "Separate Account Rule" The 2006 IRS Publication 590 states, "If Separate Accounts with separate beneficiaries are not established, all beneficiaries' distributions will be based on the life expectancy of the oldest beneficiary. This will greatly diminish the income to the younger beneficiaries."

Let's use the example of an IRA owner who dies with $200,000 left in his account. He has two beneficiaries, a daughter age 45 and a grandson age 12 and they each inherit $100,000.

According to Table 1 (Single Life Expectancy for use by beneficiaries) the daughter age 45 has a life expectancy of 38.8 and the grandson age 12 has a life expectancy of 70.8 years. Without separate accounts, both beneficiaries will be treated as if they were age 45. At a 5% rate of return, each will receive a total payout of approximately $313,000 or a combined payout of $626,000. If separate accounts are established, the 12 year old grandson will be able to use his own life expectancy of 70.8 years. His total payout will increase form $313,000 to $945,000 for a total pay out of $1,258,000 for both beneficiaries. Establishing separate accounts more than doubled the total distributions. Separate accounts with separate beneficiaries can be established at no cost.

3 **Your prospect has improper or no designated beneficiaries.**
Only a properly set up "Designated Beneficiary" has the right to spread the distributions and taxes over his/her individual life expectancy. Only the IRA owner or inheriting spouse can establish a designated beneficiary. If designated beneficiaries are not established, the beneficiaries may have to pay all the IRA taxes in five years if the owner dies prior to age 70 ½ or they may use the remainder of the owner's life expectancy if death occurs after age 70 ½.* Either way, the stretch is lost
*IRS Pub. 590 Page 37

4 **Your prospect's current advisor is not an IRA distribution specialist.** Many advisors who are not trained in the new distribution rules may unknowingly be giving the IRA owner bad advice. Poor advice can result in IRA owners and their beneficiaries losing the many advantages of the new distribution rules. Two examples: 1) If the beneficiary fails to take their 1st distribution before December 31st of the year following the year of the owner's death, the entire account may be subject to immediate taxation. 2) If the IRA owner fails to take a required minimum distribution, he/she will pay tax on the distribution and may be subject to a 50% excise tax in addition to the income tax on the failed distribution.

Beneficiaries who get inaccurate advice may wind up with rapid distribution causing rapid taxation and the loss of enjoying a lifetime of income from an inherited IRA.

5 **Your prospects money is still in a 401(k), 403b, Simple IRA or a 457 Plan.** The new distribution rules apply to IRAs only. Prospects who fail to roll their other qualified plans to a properly structured IRA, currently will not be able to take full advantage of the "Stretch." Most 401(k) plans do not allow non-spousal beneficiaries to spread the distributions over their life expectancies. Many 401(k) plans and other company sponsored plans force the beneficiaries to take the distributions in as little as five years, forcing premature taxation and loss of a lifetime of income.

6 **Your prospects using a Trust or Will to determine beneficiaries** ***Using a Trust*** – According to the 2007 IRS Publication 590, "The separate account rules cannot be used by the beneficiaries of a trust." Again, all beneficiaries may be forced to use the life expectancy of the oldest beneficiary. This will greatly diminish the value of the "Stretch" to the younger beneficiaries. See # 2 - Not taking advantage of the Separate Account Rules.

Using a Will **–** Using a will to set up IRA beneficiaries does not establish "Designated Beneficiaries." Only a Designated Beneficiary has the right to spread the distributions over his/her individual life expectancy. See #3 – Improper or no Designated Beneficiary.

7 **Your prospect has too much of their IRA at risk in the market**
During the accumulation years of an IRA, market losses can be compensated for by making additional contributions and taking advantage of dollar cost averaging.

When your prospect turns 70 ½, two things change:

1 - Owners can no longer make contributions to compensate for market fluctuations.
2 - Owners must begin taking Required Minimum Distributions from their traditional IRAs.

Market losses can dramatically reduce the income streams to the IRA owner, spouse, children and grandchildren. Risking the income from your prospects' retirement plans, for those who will depend on that income, is the number one culprit that can decimate the well made plans to have a comfortable retirement. The simple truth is "You can't have a guaranteed income from a non-guaranteed account." According to the ICI's 2007 Investment Company Fact Book, 83% of qualified accounts are at risk in mutual funds and securities. Fixed annuity producers can offer the advantages of guaranteeing the principle and guaranteeing a minimum rate of return. Fixed annuities can also guarantee the income streams to the owner, spouse, children and grandchildren.

8 **Your prospect is still paying fees and loads on their IRAs** The high cost of small fees can cost IRA owners and their beneficiaries as much as ½ of the total income paid over three generations.

Example: Let's assume at the IRA owner's death there is $300,000 left in the account to pass on to his spouse, children and grandchildren. The current fee or load is 2% and the youngest beneficiary, age zero, has a life expectancy of 82.4 years (Pub. 590 page 86). Assuming a rate of return of 5%, let's see what happens.

$300,000 IRA
X 2% Fee or Load
=$6,000 Fee or Load

The fee or load will be out of the compounding formula for 82.4 years.

$6,000 Load
X5% ***(Compounded Annually)***
X82 years
= $327,848 less income over 3 generations

The following year there will be a second fee or load and the process repeats itself. When a fee or load is taken from the IRA, it will be out of the compounding formula for ever…..

Learning all the new distribution rules and the 8 signs that your prospects' IRAs/401(k)s are broken will help your prospects achieve their retirement income goals. It will also help you capture the largest qualified accounts and take your practice to the next level…….