Make the Most of Your IRA Nest Egg

Your individual retirement account (IRA) may compose the greatest portion of your assets. Unfortunately, you can lose much of this nest egg to Uncle Sam. How do you minimize the taxes on your IRA? By understanding the rules for payouts and planning accordingly. The following guidelines can help you wind through the maze of rules.

Distributions During Life

Most distributions before age 591/2 incur a 10% early withdrawal penalty in addition to ordinary income taxes, but there are exceptions. Although there may be limitations, assuming you are the plan owner, you will incur no penalty if distributions are a result of:

- Death,
- Disability,
- Medical expenses,
- Paying higher education expenses,
- Making a first time home purchase (up to a $10,000 withdrawal), or
- Taking distributions in installments.

After you reach age 591/2, but before your required beginning date (RBD) -- April 1 of the year following the year in which you reach age 701/2 -- you can take penalty-free distributions of any amount you wish. By the RBD, however, you must begin taking the minimum required distributions (MRD) or face a 50% penalty on the difference between the MRD and your actual distributions. For example, if you should have withdrawn $10,000 and you only withdrew $8,000, you would pay a $1,000 penalty tax -- 50% of the remaining $2,000.

You can either withdraw benefits in a lump sum or have installment payments made over:

1. Your life,
2. The joint lives of you and your designated beneficiary, or
3. A defined period that does not extend beyond the life expectancies in (1) and (2).

(Your beneficiary can be a person or a qualified trust. To be qualified, the trust must be valid under state law and irrevocable as of the time of your death, and have identifiable beneficiaries. You must notify the plan administrator that you have named the trust as beneficiary.)

Your minimum installment distribution is your account balance as of the end of the previous year divided by the appropriate life or joint life expectancy factors as determined under Internal Revenue Service tables. If the beneficiary is not your spouse and is more than 10 years your junior, joint life expectancy is determined by your age and the age of a person 10 years younger, rather than actual joint life expectancy.

Distributions After Death

After your death, distribution rules change. If you had not reached your RBD before your death, the five-year rule would apply. This means that the IRA would have to be fully distributed by Dec. 31 of the fifth year after your death. If your beneficiary is your spouse, he or she could elect instead to receive payouts over his or her life expectancy or to roll over the payouts into his or her own IRA. These are not options for nonspouse beneficiaries.

If you had reached your RBD, the remaining portion of the IRA would have to be distributed at least as rapidly to your beneficiary as it would have been distributed under the method you had elected. If your spouse is the beneficiary, he or she could roll over the payouts into his or her own IRA.

Take Advantage of the Golden Years

The golden years in retirement planning are between ages 591/2 and 701/2 because you can withdraw as little or as much as you want without penalty. Take full advantage of this decade. Even if you don't need the money, consider making withdrawals to avoid mandatory withdrawals at age 701/2 that would put you in a higher tax bracket. Please let us know if you have any questions.

Plan for Your Total Retirement Picture

The first step in the planning process is to get organized:

- List all of your retirement funds. Include pensions, 401(k) plans, individual retirement accounts (IRAs), Roth IRAs and nonqualified plans. Note when you must begin to take withdrawals.

- Calculate the income you can expect from each fund. Remember: Some accounts pay out when you retire, while others can be deferred until you reach age 701/2.

- Determine how much you will need annually to support yourself. The less you will need, the more flexibility you will have in making tax-smart payout choices.