Protecting Your IRA From Bloopers and Blunders

If you're like many Americans, your largest single asset may be your traditional individual retirement account (IRA). That's why you need to know that an administrative error or distribution mistake by your bank or broker could take a huge bite out of your life savings.

What are these mistakes and is your IRA vulnerable? Let's take a look at how you can protect your IRA against them.

Your Beneficiary Form

What happens if you filled out your beneficiary form wrong? Or your bank or broker misplaces or loses it? Or you're given an erroneous distribution check? Any of these mishaps could end your IRA's tax-deferred compounding and force immediate distribution of the funds over a period as short as five years. You would not only lose decades of future tax-deferred growth, but you'd also have to pay tax on the distributions when received. Thinking about what the lost funds could have grown to can be devastating.
So how can you prevent these catastrophic scenarios? First, be sure that your IRA provider has your beneficiary form. Second, verify the accuracy of even the most basic information on the form, because even a simple error in a birth date can affect distribution. Third, make a copy of the form and keep it in a safe place where you and your family members can find it. Finally, find out what your IRA provider will do if your form is lost or contains incorrect information.

Your Distribution Method

By April 1 of the year after you reach age 701/2,you must decide how much money you will withdraw from your IRA every year. Take care when choosing your distribution method. Don't let your provider talk you into a method that may be easiest for it but not the best choice for you.

For example, suppose you choose the recalculation method and name your estate as beneficiary. Then the provider recalculates your life expectancy every year to determine the annual required minimum distribution. This method ensures that you won't outlive your IRA money. But when you die, your life expectancy drops to zero, and your remaining funds will have to be completely distributed, typically within a year. Think how much less your estate's beneficiaries will end up with.

A better way, if you're married, is to name your spouse as a beneficiary. Then your provider combines the recalculation method with a fixed term method based on your actual life expectancy at age 701/2. This strategy ensures that you won't outlive your retirement funds, and if your spouse dies before you, the IRA funds won't be forced into premature distribution. A surviving spouse can roll over the IRA, name new beneficiaries and establish a new distribution schedule.

Suppose you decide to make your children or grandchildren beneficiaries. In that case, you'd want to use the fixed term method. The younger the beneficiary, the more advantageous this strategy is, because the beneficiaries' ages stretch out the IRA's term. Even if you live to be 109, you won't outlive your IRA.

If you inherit an IRA, how can you avoid mishaps? You can name your own beneficiaries. This can allow you to extend the life of the IRA and avoid a sudden, tax-liable payout.

Your Choice of Provider

Protect your money by preparing for these important decisions. For example, if you choose a brokerage firm as your provider, its forms may not address critical issues such as naming multiple beneficiaries or even choosing a distribution method. Before you open an IRA, discuss these matters and look at sample forms.

After all, your IRA may be your largest single asset. It’s well worth protecting.