

Top 10 Common IRA and Retirement Plan Mistakes

Having a healthy retirement account does not guarantee a contractor will be prepared for retirement.

Retirement plan rules are complex and require income tax and estate tax planning to work in harmony. Generally, retirement plan accounts are subject to income tax at regular (not capital gains) rates as distributed. By avoiding 10 costly mistakes, a contractor can set a solid foundation for retirement.

1. Depending on a business for retirement. Company owners frequently depend on the eventual sale or family succession of the business to fund retirement. Setting up a company retirement plan that invests in outside assets is a good way to lessen the risk of depending on an event that may not occur.

2. Not taking full advantage of tax-free retirement accounts. The more money placed in a retirement account, the more money can grow tax free for a contractor and his heirs. If an employer provides a matching contribution, contribute enough to maximize the employer's match each year.

3. Withdrawing from the wrong accounts. Usually it is best to withdraw from taxable accounts first to allow for continued tax-free growth, but this may not be the best option for higher income or net-worth individuals. If taxable investments have accumulated large capital gains, leaving those investments to heirs will result in their receiving a step up in cost basis, which eliminates capital gains tax.

4. Not taking advantage of a Roth IRA, a Roth 401(k) or Roth IRA conversions. Contributions are made with after-tax money. All future qualified withdrawals from Roth IRAs are tax free

with no required minimum distributions (RMD) at age 70½. At age 70½, RMD must begin from a Roth 401(k). However, a Roth 401(k) may be rolled over to a Roth IRA, which has no RMD. If a person is able to pay the tax on a Roth conversion, future growth is never subject to income tax. Beginning in 2010, the \$100,000 adjusted growth income cap for Roth conversion eligibility no longer applies.

5. Taking RMD in 2009. The Worker, Retiree and Employer Recovery Act of 2008 suspended RMD for retirement plans including IRAs in 2009. Consider other accounts for spending needs.

6. Not carefully naming beneficiaries. Retirement plans require precise beneficiary designations. Without these, the plan may designate a beneficiary inconsistent with the account owner's wishes. A spouse may rollover tax free into his or her IRA, name new beneficiaries, consider Roth conversion and obtain a longer income tax stretch. Naming a qualified trust as a beneficiary may protect younger beneficiaries while still taking advantage of the income tax stretch. Following the death of the account owner, a beneficiary may disclaim and obtain estate tax planning and income tax stretch advantages.

7. Not coordinating retirement and estate plans. A retirement plan is controlled by the beneficiary designation, not the will or trust. Retirement plans may be subject to federal estate tax at a marginal 45 percent rate in addition to income tax. Take full advantage of the federal estate tax exemption so the retirement plan can be designated to do this.

8. Investing too heavily in company stock. Higher income executives may be vulnerable due to stock incentives.

Consider strategies for diversifying the retirement plan beyond company stocks.

9. Rolling company stock into an IRA. This is a common practice and is sometimes the right strategy. But, net unrealized appreciation may be a better strategy. Cash and other retirement plan investments are rolled into the IRA, and the company stock is distributed directly. The advantage is being taxed only on the cost basis of the company stock when it went into the retirement plan, not on its current market value at the time of distribution.

When selling company stock, a person is taxed at capital gains rates resulting in significant tax savings if the company stock has substantial appreciation. Rolling the company stock into an IRA results in being taxed at ordinary income rates on the appreciated value of the company stock at withdrawal time.

10. Not considering a charitable rollover. Rather than taking a taxable RMD, a person may rollover an RMD to a qualified charity. Gifts may not exceed \$100,000 per taxpayer per year, and the donor must be age 70½ or older. The RMD requirement is satisfied and no income tax is paid. This option is scheduled to expire Dec. 31.

Contractors work hard for their retirement—and their retirement dollars. Seemingly small decisions can have substantial financial and tax implications. By avoiding these 10 mistakes, contractors can make their retirement dollars work intelligently.

Wayne Buckwalter is a partner at Cohen Seglias Pallas Greenhall & Furman, Philadelphia. For more information, call (215) 564-1700, email wbuckwalter@cohenseglias.com or visit www.cohenseglias.com.