AMERICAN PENSION SERVICES

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Be Advised

It's your money! Do what makes the most sense to you.

IT'S YOUR MONEY!

Curtis DeYoung, President APS

As we continue to look at the increasing value of retirement plans, it becomes more important than ever to understand the many ways we can enjoy the fruits of our retirement plan dollars today. Most of us view retirement plans as a future prize, something far in the distance, barely recognizable and rarely utilized. In truth, our retirement plan is our friendly next door neighbor which we can watch grow and mature, occasionally borrow the cup of sugar from and help build the house into a mansion which we will inherit as our own.

Borrow, you say? Yes, §72(t)[1] of the Internal Revenue Code (IRC) allows a retirement plan owner the right to use their retirement funds before retirement.

The Qualified Higher Education exception is an example of a penalty[2] free benefit which still requires the payment of regular income taxes, but more than likely, if you are going back to school, your income tax bracket will be low and the taxes on the distribution will be low. Examples of Qualified Higher Education expenses are tuition, fees, books, supplies and equipment required for enrollment of a student at an eligible educational institution. The educational distribution must be for you, your spouse or the children or grandchildren of you or your spouse.

Another unknown distribution is the $10,000 penalty[3]free distribution to purchase a "first home." I'll bet you didn't know that you can use this for a down payment or closing costs on a first time home purchase. Now a first time home is considered a first time home if you have not owned a home in the last two years.[4] This is a once in a lifetime distribution which is penalty free[5]. A taxpayer or spouse is each subject to the $10,000 limit. If the husband and wife are both first-time homebuyers, they can each withdraw up to $10,000 on a penalty-free basis for the purchase of the same home. You may also gift this money to children, grandchildren, parents or other ancestors as long as they use the money for the purchase (or renovation) of a home and the total distribution does not exceed $10,000.

Do you have a Roth IRA? All of your contributions to the Roth can be taken out without tax or penalty[6]. I am not in favor of this option because such withdrawals limit your future tax free earnings, but it's your money. Here is how it works: the money you put into your Roth is already taxed, so when you withdraw the principal, there is no additional tax to be paid. If you only take the money for 60 days and return the money before the 60 days are up, you can use the money for anything you wish[7].

Finally, you can withdraw money from your retirement plan early if you are unemployed and need to pay health insurance costs[8]; if you have certain medical expenses[9] and if you establish defined periodic payments for at least five years[10] (often called a "72 t" early retirement distribution). But those are discussions for future issues. Until then, enjoy your neighbor . . . after all, It's Your Money! ■

1 26 USC (A)(1)(B)(II)(72)(t)(2)
2 The educational exception allows distribution without the ten percent early withdrawal penalty, but you still must pay the tax on the amount distributed §72(t)(2)(E).
3 Like the educational benefit, the first time homebuyer exception is penalty free, but not tax free. §72(t)(2)(F)
4 You could own a home, sell it to go to college, use the educational benefit in college, then after two years of renting a lovely college apartment, buy another home using the $10,000 exception.
5 Well, once in a lifetime after every two years of renting.
6 The Roth must be established for 5 years or the earnings on the Roth money will be taxed upon distribution. But after the Roth is 5 years old, you can take out the principal without restriction.
7 §408(d)(3)(A) You can only take a 60 day distribution once per 12 month period and you must return the same amount as taken out. If the distribution is in any other form than money (such as stocks or bonds), that same form (stocks or bonds, etc.) must be returned to the retirement plan. The 60 day distribution is not limited to Roth IRAs.
8 §72(t)(2)(D)
9 §72(t)(2)(B)
10 §72(t)(2)(A)(4)

Is Your Child or Grandchild a TAX-FREE Millionaire?

Curtis DeYoung often speaks about creating a Family Legacy and suggest you begin while your children are young but if you already have teenage children or grandchildren it is not too late to get started. Let's say you have a teenage child or grandchild that is gainfully employed, they can contribute up to $5,000 a year to a Roth IRA. The contributions aren't tax deductible, but at the child's low tax bracket it doesn't matter.

Let's say the child puts in $4,000 a year between the ages of 16 & 21, and then doesn't contribute another dime. If the Roth IRA earns 10% per year, the child will have $2,045,042.00 at age 65 and the money will be 100% tax free. Just imagine the possibilities if they start earlier and or continue contributing until they retire. Now that is the beginnings of a beautiful "Family Legacy." ■

June Focus: Funding Roth IRAs

Ed Slott, CPA

There is no doubt that Benjamin Franklin was right when he said "In this world nothing is certain but death and taxes." However, what is uncertain about taxes today is not if, but by how much, they will increase in the future. Economists and financial experts project that the tax rates will go up in the future, and as such, taxpayers should look for ways to shelter their money from those projected increased tax rates. One way of doing so is to fund the increasingly popular Roth IRA.

Roth IRAs are funded with after-tax (already taxed) money, which means you do not get a deduction for any contributions you make. However, the tradeoff is that future distributions are tax and penalty-free if they meet certain requirements.

Funding Roth IRAs

Roth IRAs can be funded from the following sources:

Rollovers from Designated Roth Accounts (DRA): Balances in Roth 401(k) and Roth 403(b) accounts, referred to as DRAs, can be rolled over to Roth IRAs, providing the individual meets requirements to make withdrawals from the DRA.

Regular Roth IRA contributions of up to $5,000 or $6,000 for individuals who are at least age 50 by the end of the year. For a married couple, aggregate contributions for the year can be $10,000 or $12,000 if they are both age 50 or older by the end of the year.

Roth IRA Conversions: An individual can move his balances from his Traditional IRA, SEP IRA and SIMPLE IRAs to his Roth IRA, providing his modified adjusted gross income (MAGI) does not exceed $100,000 and his tax-filing status is not married-filing-separately. This is referred to as a Roth IRA conversion. The $100,000 MAGI and married-filing-separately limitations are repealed beginning in 2010, which means everyone can convert to Roth.

While any taxable portion of Roth conversion amounts are taxable for the year in which the conversion occurs, the potential for tax-free growth can outweigh the impact of paying income taxes on the amount at the time of conversion. However, the following should be noted:

A partial conversion is an option. Therefore, an individual can choose to convert only a fraction of his non-Roth retirement account balance to his Roth IRA instead of converting the entire balance in one year.

Spread the conversion over several years. Individuals who cannot afford to pay the taxes on a conversion of a large amount can choose to convert the balance in smaller amounts each year. For instance, someone who wants to convert $200,000 in total can choose to convert $50,000 each year instead of the entire $200,000 in one year.

The income tax break. For conversions done in 2010, the income from the conversion can be spread ratably over 2011 and 2012.

Assess the impact on the tax return. Individuals must understand the impact of including the conversion on their tax return. The additional income can impact deductions, phase-outs, exemptions, credits, taxability of Social Security payments and AMT.

Roth Conversion Don'ts

Don't Convert RMD Amounts: Only amounts that are rollover eligible can be converted to a Roth IRA. Therefore, required minimum distribution (RMD) amounts must be taken from the retirement account before the conversion occurs. Otherwise, the conversion will include the RMD amount and create an excess contribution (of the RMD amount) in the Roth IRA.

Don't Convert SIMPLE IRA assets in the first 2 years: SIMPLE IRA assets can be converted to a Roth IRA only if it has been at least two years since the first contribution was deposited to the SIMPLE IRA. If the conversion occurs before the 2-year period, it will be considered an ineligible conversion by the IRS and subject to a 25% penalty if the conversion occurs when the owner is under age 59 Â½ .

Don't pay your withholding taxes from your IRA: If you request to have taxes withheld from your Roth conversion, the amount withheld for taxes is not considered part of the conversion. Instead, it is treated as a regular distribution and is subject to the 10% early distribution penalty unless an exception applies. If you cannot afford to pay the taxes out of pocket, consult with your tax or financial professional to determine whether it makes sense for you to do a conversion that year.

Individuals who are considering converting their non-Roth retirement accounts to Roth IRAs should consult with a tax professional about the possible tax impact of the conversion and determine steps that can be taken to reduce or eliminate any negative impact. For instance, consideration should be given to how the conversion could affect an individual's Medicare Part B premium. ■