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RETIREMENT PERSPECTIVES

Piloting Your Year-End IRA Checklist

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With holidays approaching, now is a good time to take stock of where you stand financially, especially when it comes to retirement planning.

Time flies all right, but the good news is that you're the pilot. So, with year-end approaching, remember the deadlines for doing (or undoing) financial transactions and preparing for filing taxes in the months ahead. Estate planning, while longer term, should be reviewed periodically to make sure that there have been no major changes that would require updating legacy decisions.

What follows is a fairly comprehensive check list for you to review with your financial advisor and/or tax professional, while there is still time to act.

Q. Have you fully funded your IRA?

A. **Virtually anyone** under the age of 70½ at the end of 2016 is eligible to fund an IRA; having earned income is the sole requirement. Even **children** or **grandparents** who have reportable earned income can fund Roth IRAs.

A number of variables apply in determining whether taxpayers' contributions to their **IRAs** are tax deductible. The variables include filing status, modified adjust gross income (MAGI), and whether individuals and/or their spouses are active participants in a workplace retirement plan.

Individuals generally must have earned income to contribute to both **traditional IRAs** and **Roth IRAs**; an exception is a **spousal** IRA. However, everyone is not eligible to make Roth IRA contributions. Roth IRAs carry statutory maximum income levels, and investors **must satisfy an annual income test**. There are no maximum age restrictions on Roth contributors, although individuals older than 70½ cannot make contributions to traditional IRAs.

While it is true that you can wait until April 15, 2017, to fully fund your IRA for the prior tax year, why not fund it now, if you are able to, and have the money working for you on a tax-favored basis for a longer length of time?

Q. Have you funded a Roth IRA for a child?

A: A minor who has reportable earned income is eligible to establish a Roth IRA. Once established, the **IRA can be funded by anyone**, up to the amount earned by the minor.

Q. Can you make IRA contributions if you participate in an employer-sponsored retirement plan?

A. Yes. Participation in employer-sponsored plans, such as a 401(k), 403(b), **457(b)**, SIMPLE, or SEPIRAs, does not affect **IRA eligibility or contribution limits**. However, participation may affect whether or not the contributions are tax-deductible.

While just about **anyone under 70½ who is earning an income is eligible to fund a traditional IRA**, only about 14% of eligible taxpayers made IRA contributions in tax-year 2014 , according to the Investment Company Institute (the latest data available). Confusion about eligibility may be part of the reason.

Q. Have you checked to see if you have made excess IRA contributions?

A. There are a number of situations that can lead IRA participants to over-contribute to their accounts. Misunderstanding the limits ($5,500 in 2016), not meeting the income-eligibility for Roth accounts, and funding an IRA with an ineligible rollover are just a few of the common errors.

Reviewing all of your account activity for the past year with your financial and/or tax advisor may help you avoid an inadvertent overfunding that could result in taxes and/or penalties.

Q. Have you had the “back-door” Roth IRA discussion?

A. As noted, funding a Roth IRA is means tested; an investor must satisfy an annual income requirement. Since 2010, however, high-income earners have been eligible to *convert* traditional IRA assets to Roth IRAs, a practice known as a **“back-door” Roth IRA**. This is accomplished by making nondeductible (aftertax) contributions to a traditional IRA and converting the assets to a Roth sometime thereafter.

Q. Did you make a nondeductible (aftertax) IRA contribution?

A. If you did, it is essential that you file **IRS Form 8606**, “Nondeductible IRAs.” The critical form is used to track IRA account owners’ aftertax (basis) dollars.

Q. Did you take a distribution from any traditional (aftertax) IRA that contained basis?

A. When there are **aftertax dollars in any traditional IRA** and you are not going to withdraw the entire IRA value, know that partial withdrawal taxation is based on the ratio of your aftertax dollars to your total IRA dollars (across all IRAs, including SEP and SIMPLE accounts) at the end of the year. To paraphrase this rule, it is essential that you file **IRS Form 8606**, Nondeductible IRAs.

Q. Did you turn 70½ in 2016?

A. If you did, you are required by the IRS to start taking annual required minimum distributions (RMDs) from all IRAs (excluding Roth IRAs). You are, however, permitted to postpone your first RMD until April 1, 2017; but then you must take a second distribution before the end of 2017, and every year thereafter. Be aware that taking two distributions in 2017 may affect your tax rate.

Q. If you are older than age 70½, have you taken your RMD for 2016?

A. A 50% excise tax is applied to the amount that was not taken, but which should have been. For example, if you are required to take $10,000 by December 31, 2016, but you withdraw only $2,000, a 50% excise tax of $4,000 will be applied to the $8,000 shortfall, plus you will be subject to federal income taxes on the $8,000 when distributed. The shortage is reported on **IRS Form 5329**, “Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.”

You can always take more than the mini□mum. To know how much, RMD figures become available each January 1 for that year.

Q. If you are taking RMDs, have you included all your IRAs in the calculation?

A. Government rules require account owners to calculate **RMD amounts** for each individual (separate) IRA, including SEP IRAs and SIMPLE IRAs, but *not* Roth IRAs. Once calculated, however, the total may be taken from **any one or more IRAs.**

Q. If you are taking RMDs, have you included your 401(k) account?

A. IRAs and 401(k)s have different rules regarding minimum distributions. Unlike a traditional IRA, 401(k) participants who own 5% of their current employer's plan can defer their RMD until the year they turn 70½ or the year they retire, whichever is later. Participants who own more than 5% are required to start taking RMDs at 70½, regardless of work status. If you own multiple 401(k) accounts, a RMD must be calculated and taken separately from each plan. (For additional RMD information, please see our Retirement Perspectives article, **"The ABCs of RMDs."**)

Q. Are all beneficiary designation forms in order?

A. Individuals often have several IRAs established at different times. Life events, such as marriages, divorces, children, and death, can change situations and outlooks. Are the correct people still positioned to receive the benefits? IRAs do not pass through probate, so the **beneficiary designation** on file with the IRA provider, rather than a **will**, is what prevails.

Q. Did you inherit an IRA or qualified plan from someone other than your spouse in 2016?

A. If you did, you must begin taking minimum distributions—**even if it's a Roth IRA**—before the end of 2016, regardless of your age. If you miss this year-end deadline, IRS rules generally require the account to be paid out in full within five years after the death of the plan owner (the "five-year rule"), which would mean by December 2020.

Q. If you want to create separate IRAs for each designated beneficiary, have you done so? A. When multiple beneficiaries stand to inherit an IRA, it's often advantageous to divide or "split" the account among separate inherited IRAs established for each beneficiary. This strategy, when completed by December 31 of the year *following* the death of the IRA owner, allows **each beneficiary to use his or her own life expectancy for future minimum distributions.** If separate inherited accounts are not established in a timely manner, all beneficiaries must use the life expectancy of the oldest beneficiary for purposes of determining minimum distribution payout.

Q. What can you do to optimize the tax implications of converting a traditional IRA to a Roth IRA in 2016?

A. Each taxpayer's situation is somewhat unique, so we cannot, nor should we, offer specific tax advice. However, in general, each of these strategies potentially could help lower taxes:

▪ Consider spreading the taxable income over two or more tax years. By converting part of an IRA to a Roth IRA in 2016 and another part in 2017, the taxable income generated does not fall in one tax year, and that may prevent the income becoming placed into a higher marginal tax bracket.

▪ When there are **aftertax dollars in a traditional IRA** and you are not going to convert the entire IRA value, know that partial conversion taxation is based on the ratio of your aftertax dollars to your total IRA dollars (across all IRAs, including SEP and SIMPLE accounts) at the end of the year. This is referred to as the **"pro-rata rule."** However, you either can either transfer the taxable (pretax) dollars from your IRA to a qualified plan (e.g., 401(k)) before December 31, 2016, or refrain from rolling over money from another qualified plan to your IRA until after December 31, 2016. (For more information, click here for our article on reporting **aftertax IRA contributions**.)

▪ Consider opening a separate Roth IRA for each separate investment. You have until October 15, 2017, to reverse your conversion—through a process known as **"recharacterization"**—on an IRA-by-IRA basis. This approach allows you to reverse only accounts that have lost value. Whereas if multiple investments are under a single Roth IRA, a recharacterization does not allow you to allocate the loss to a specific investment. Instead, the net losses are aggregated across all investments.

Q. Can I pay taxes from my IRA upon converting to a Roth IRA?

A. Yes, but proceed with caution. In general, there are no penalties assessed on pretax IRA dollars converted to a Roth IRA. However, if you are younger than 59½ upon converting to a Roth IRA, the amount withdrawn to pay the taxes will be viewed as a distribution, subject to the 10% early-withdrawal penalty (in addition to income taxes). However, the penalty does not apply to those investors who are 59½ or older at the time of distribution; income taxes continue to apply.

In addition, if you decide to reverse (recharacterize) your Roth IRA conversion, you cannot recover the taxes paid as part of the conversion.

Q. What do you need to know about qualified charitable distributions from IRAs this year?

A. In late December 2015, through the enactment of the Protecting Americans from Tax Hikes (PATH) Act, Congress made qualified charitable distributions (QCDs) permanent.

First permitted in 2006, QCDs are tax-free IRA distributions of up to $100,000 annually, which are sent *directly* to a qualifying charity. QCDs can be made from traditional IRAs, Roth IRAs, and inactive SEP and SIMPLE IRAs belonging only to account owners or beneficiaries who are age 70½ or older. (For more on qualifying for QCD treatment, click **here.**)

Q. Have you distributed SIMPLE IRA plan notifications to eligible employees?

A. Employers that sponsor SIMPLE plans are required to distribute notices to eligible participants providing plan information such as the opportunity to make or change salary deferrals, summary plan description, and employer contribution formula (3% match or 2% nonelective) for the following year. The election period is generally the 60-day period immediately preceding January 1 of a calendar year (November 2 to December 31).

Q. Are you complying with the SIMPLE IRA Exclusive Plan rule?

A. A SIMPLE IRA must be the only qualified retirement plan that an employer maintains during a calendar year. However, if no contributions are made and no benefits accrue to an existing qualified plan (401(k) of the employer during this time period, the employer will satisfy the requirement. (For more information on SIMPLE IRAs and the Exclusive Plan rule, click **here**.)

Q. Have you funded a Coverdell Education Savings Account?

A. The deadline to establish and or fund a **Coverdell ESA** for 2016 is April 15, 2017. The total contributions for the beneficiary of this account cannot exceed $2,000 in any year, no matter how many accounts have been established. Any individual can contribute to a Coverdell ESA if the individual's household income (MAGI) for the year is less than $110,000. For married couples filing joint returns, that amount increases to $220,000.

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Traditional IRA contributions plus earnings, interest, dividends, and capital gains may compound tax-deferred until you withdraw them as retirement income. Amounts withdrawn from traditional IRA plans are generally included as taxable income in the year received and may be subject to 10% federal tax penalties if withdrawn prior to age 59½, unless an exception applies.

A **Roth IRA** is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax deductible, but withdrawals during retirement are generally tax-free.

SEP IRA—A Simplified Employee Pension Plan is a retirement plan specifically designed for self-employed people and small-business owners. When establishing a SEP IRA plan for your business, you and any eligible employees establish your own separate SEP IRA; employer contributions are then made into each eligible employee's SEP IRA.

SIMPLE IRA—A Savings Incentive Match Plan for Employees' IRA is an IRA-based plan that gives small-business employers a simplified method to make contributions toward their employees' retirement and their own retirement. Under a SIMPLE IRA plan, employees may choose to make salary reduction contributions and the employer makes matching or non-elective contributions. All contributions are made directly to an individual retirement account (IRA) set up for each employee (a SIMPLE IRA). SIMPLE IRA plans are maintained on a calendar-year basis.

A **401(k)** is a qualified plan established by employers to which eligible employees may make salary deferral (salary reduction) contributions on an aftertax and/or pretax basis. Employers offering a 401(k) plan may make matching or non-elective contributions to the plan on behalf of eligible employees and may also add a profit sharing feature to the plan. Earnings accrue on a tax-deferred basis.

A **403(b)** plan is a retirement savings plan that allows employees of certain non-profit and 501(c)(3) tax-exempt, public and private schools and religious organizations to save for retirement on a tax-advantaged basis.

A governmental **457(b) deferred-compensation plan** allows employees of states, political subdivisions of a state, or any agency or instrumentality of a state to invest money on a pretax or Roth aftertax basis through salary reductions. The employer deposits amounts withheld into an annuity, custodial, or a trust account, where the funds accumulate tax-deferred or potentially tax free in the case of Roth aftertax contributions until withdrawals commence, usually at retirement.
