RETIREMENT PERSPECTIVES

Retirement Tips: Your 2017 Year-End Checklist

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Before holiday stresses set in, review your retirement plans to maximize potential savings for you and your family.

Q. Have you fully funded your IRA?

A. Virtually anyone under the age of 70½ (at the end of 2017) is eligible to fund an IRA; all you need is earned income. Even children or grandparents with reportable earned income may be eligible to make Roth IRA contributions.

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.

Q. Did you turn age 50 in 2017?

A. If you did, you can via a “catch-up” provision contribute an additional $1,000 to a traditional or Roth IRA; $6,000 to a 401(k), and $3,000 to a SIMPLE IRA.

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

While it is true that you can wait until April 15, 2018, to contribute your IRA for the 2017 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 an employer-sponsored plan, such as a 401(k), 403(b), **457(b)**, SIMPLE, or SEP IRA, does not affect **IRA eligibility or contribution limits**. However, participation may affect whether or not your contributions are tax deductible.

Q. Did you make an excess IRA contribution?

A. There are a number of scenarios that can lead an IRA owner to over fund their accounts. For example, contributing more than the maximum allows annual contribution limit ($5,500 in 2017/ $6,500 [age 50+], not satisfying Roth income-eligibility, and funding an IRA with an ineligible

rollover are just a few of the common errors that lead to excess IRA contributions.

Reviewing all of your IRA account activity for the past year with your financial and/or tax professional can 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, Roth IRA eligibility is means tested-that is, an investor must satisfy an annual income requirement. Since 2010, however, high-income earners, regardless of the amount of household income, have been eligible to contribute aftertax dollars to a traditional IRA and subsequently convert basis to a Roth IRA, a strategy commonly referred to as a "back-door" Roth IRA.

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

A. If you did, it is essential that you file IRS Form 8606, "Nondeductible IRAs." In addition, Form 8606 is used to track certain IRA distributions that included after-tax 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 don't withdraw the entire IRA value (across all IRAs owned), then taxation of the partial withdrawal 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. It is essential that IRS Form 8606 is filed.

Q. Did you turn 70½ in 2017?

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, 2018. But then you must take a second distribution before the end of 2018, and every year thereafter.

Taking two minimum distributions in 2018 may affect your marginal tax rate.

Q. If you are older than age 70½, have you taken your RMD for 2017?

A. Don't forget that a 50% excise tax is applied to the minimum distribution amount that was required but not taken.

For example, suppose your 2017 minimum distribution is $10,000. The distribution would have to be taken by Friday, December 29, this year, since the 31st falls on a Sunday). But if you mistakenly withdrew only $1,000, a 50% excise tax of $4,500 would be applied to the $9,000 shortfall, plus you would be subject to federal income tax on the $9,000 in the year it is eventually distributed. The penalty tax is reported on **IRS Form 5329**, "Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts."

You can always take more than your annual minimum distribution.

Q. If you are subject to RMDs, have you included the value of 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 or aggregate amount may be taken from any one or more IRAs.

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

A. **Remember that 401(k)s follow a different set of RMD rules.** Unlike a traditional IRA, 401(k) participants who own 5% or less of their current employer's plan can defer their RMD until the later of the year they turn 70½ or the year they retire, whereas participants who own *more than 5%* are required to start taking RMDs at 70½, regardless of work status.

If you have multiple 401(k) accounts across different employers, a minimum distribution must be

calculated and taken separately from each plan. (For additional RMD information, including 403(b) accounts, see our article, **“The ABCs of RMDs.”**)

Q. Are all beneficiary designation forms in order?

A. Individuals often have several retirement accounts (IRAs, 401(k), 403(b), 457, etc.) established at various times across multiple providers. Life events, such as marriage, divorce, newborn, adoption, and death, can change situations and outlooks. Are the correct individual(s) designated to receive the benefits?

IRAs, like most retirement accounts, generally do not pass through probate, so the beneficiary designation on file with an 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 2017, regardless of your age. If this year-end deadline is missed, IRS rules generally require the entire inherited account to be paid out in full within five years after the decedent’s death (i.e., the **“five-year rule”**). For a beneficiary inheriting an account in 2017, a complete distribution would be required by December 2022.

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 beneficial to divide the inherited account into separate inherited IRAs for each beneficiary. This approach, when finalized 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 (i.e., shortest life expectancy) to determine the annual minimum distribution payout.

Q. What can you do to optimize the tax implications of converting a traditional IRA to a Roth IRA in 2017?

A. Since each taxpayer’s situation is unique, we cannot offer specific tax advice. However, in general, each of these strategies could potentially reduce your tax liability:

▪ Consider spreading taxable income over two or more tax years. By converting a portion of your IRA in 2017 and another part in 2018 or later, taxable income would not fall in a single tax year, which could prevent you from being bumped into a higher marginal tax bracket.

▪ When there are aftertax dollars in an IRA and you elect not to convert the entire account, recognize 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, 2017, or refrain from rolling over money from another qualified plan to your IRA until after December 31, 2017.

▪ Consider establishing a separate Roth IRA for each investment. Through a technique known as **“recharacterization",** you have until tax filing plus extension (October 15, 2018) to reverse the conversion, on an IRA-by-IRA basis. This approach allows you to reverse only accounts that have lost value. Caution: if there are multiple investments in a single Roth account, recharacterization rules do not permit losses to be allocated to a specific investment. Instead, net losses are aggregated across all investments.

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

A. Yes, but again be careful. In general, there are no penalties assessed on funds converted to a

Roth IRA. However, if you are younger than 59½ upon converting, 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), although 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 your Roth IRA conversion via recharacterization, 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 up to $100,000 annually, which are sent *directly* to a qualifying charity. QCDs can be made from traditional IRAs, Roth IRAs, and inactive SEPs and SIMPLE IRAs belonging only to account owners or beneficiaries who are 70½ or older.

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% non-elective) 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 an employer maintains during a calendar year ("exclusive plan rule"). However, if no contributions are made and no benefits accrue to an existing qualified plan (e.g., 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 2017 is April 15, 2018. The total contributions for the beneficiary 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. (See **here** for more on Coverdell ESAs.)

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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.

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 nonelective 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 public schools, nonprofit, and 501(c)(3) tax-exempt organizations to invest on a pretax and or Roth aftertax basis. Contributions to a 403(b) plan are conveniently deducted directly from your paycheck. In addition, your employer may elect to make a contribution on your behalf.

A **457(b)** is a nonqualified, deferred-compensation plan established by state and local governments, tax-exempt governments, and tax-exempt employers. Eligible employees are allowed to make salary deferral contributions to the 457 plan. Earnings grow on a tax-deferred basis and contributions are not taxed until the assets are distributed from the plan.

A **Coverdell Education Savings Account** (ESA), formerly known as an Education IRA, is an attractive tax-advantaged college saving vehicle that allows an investor to save and pay for higher education for the account beneficiary (typically a child).

A **529 plan** is a tax-advantaged investment vehicle in the United States designed to encourage saving for the future higher education expenses of a designated beneficiary.

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