

Sy Accountancy Corporation

Member, American Institute of CPAs

704 Mira Monte Place, Pasadena, California 91101

Tel (626) 744-0200 • Fax (626) 744-0300 • vsy@victorsycpa.com • www.victorsycpa.com

10 TIPS ON DISTRIBUTIONS FROM YOUR RETIREMENT PLAN

By Victor Sy, CPA, MBA

The subject of distributions is usually a mixture of emotions: the joy of finally reaping financial benefits from accumulated funds for many years, the confusion with what to do, and the shock from taxes to be paid. This last emotion is the result of withdrawing without proper planning. Let's learn a few planning techniques.

1. You have some **choices** upon the receipt of a distribution from your retirement plan:
 - a. Report the income as ordinary income and pay taxes at current rates,
 - b. Report the income but use special averaging methods that will be discussed later, and
 - c. Rollover the proceeds to an IRA account or another qualified plan.
2. If you withdraw funds before the age of **59 ½**, you can **avoid the dreaded early withdrawal penalties** by taking substantially equal payments of at least once a year over your life, your joint lives, or those of your beneficiaries.
3. You may withdraw IRA funds for **qualified education expenses** without paying the 10% penalty for early withdrawal.
4. You may also withdraw up to \$10,000 or IRA funds for **first-time homebuyers** without paying the 10% penalty. In both cases, you still have to pay the regular income tax. TIP: The term "first-time homebuyer" does not mean that you never owned a home before; it merely means that you did not own a home during the **past two years**. This is a very liberal interpretation, a good one. 😊
5. You may elect to defer taxes by making **rollovers** if you follow the following rules:
 - a. The amount must be rolled over to a new plan within **60 days** (120 for first-time homebuyers).
 - b. Rollovers between IRAs are allowed only once during any 12-month period. This one-year period begins on the date that you receive the distribution, not on the date that you roll it over to another IRA. If you receive property other than money, you must transfer the same property to the new plan. For example, if you receive IBM stocks from an old plan, you may roll over the same IBM shares into a new plan. If you do not wish to keep just any stocks anymore, then you may sell the stocks and roll over the proceeds into the new plan. You cannot sell the IBM stocks, buy new stocks, and roll over the new stocks into the new plan.
 - c. TIP: Instruct your trustee to **directly transfer** the funds to another trustee. You don't have to worry about missing the rollover window requirement. It is safer. There is no 1099R to deal with. Eligible rollover distributions from qualified plans are subject to 20% withholding unless there is a direct trustee-to-trustee transfer (discussed below).
 - d. Accumulated non-deductible employee contributions may not be rolled over as they are not taxable when received.
6. **Mandatory distributions:**
 - a. Minimum distributions **must be made by December 31** of each year **once you reach age 70½**.
 - b. A special rule allows taxpayers reaching age **70½** to take their first distribution no later than April 1 of the following year. If this happens, you will be taking two distributions in that following year.

c. The most welcome provision of the Small Business Act is the elimination of the requirement that forces you to receive benefits when you reach the age of 70 1/2. You may stay on the job and not receive distributions until you actually retire.

7. **Mandatory 20% withholding on distributions:**

- a. It applies to qualified plans, not to IRAs.
- b. It does not apply to periodic payments,
- c. You can avoid this 20% withholding by having a trustee-to-trustee transfer (instead of a rollover),
- d. It does not apply to distributions of securities.

You really need to plan your retirement distributions with your tax advisor. Let me illustrate this case in point. If you are under the age of 59½ and you take a distribution of \$10,000, you could end up receiving much less because of withholdings, penalties, and taxes. This gives you various disadvantages:

- a. You have to pay a federal penalty of 10% and state penalty of 2½%.
- c. You also have to pay federal and state income tax.

You may have much left after deducting federal and state income tax and penalties.

8. The Taxpayer Relief Act repealed both the 15% excise tax on excess distributions from qualified retirement plans, tax-sheltered annuities, and IRAs and the 15% excise tax on excess retirement accumulations.

9. **TIP:** Protect your retirement from lawsuits and seizure. Ask if your prior employer can keep your distributable funds inside their corporate plan.

10. The Bankruptcy Abuse Prevention Act protects IRAs from creditors.

The subject of distribution is also a complex one. In this article, we can only summarize the basics to make you aware of the possibilities. You can then mention these possibilities to your tax advisor for an in-depth analysis of your tax situation: