# Retirement Assets: Frequently Asked Questions

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## Will my heirs owe income taxes when they inherit my retirement assets?

Yes, generally under the same rules that would apply to your withdrawals of the same amounts had you lived--unless it's a Roth IRA. A Roth IRA is exempt from federal income tax as long as the account was opened five years before any withdrawals were taken.

Also, your spouse can rollover your account to his or her IRA. No early withdrawal penalty applies, regardless of your beneficiary's age, but a spouse who rolled over to an IRA may owe an early withdrawal penalty on IRA withdrawals taken before age 59 ½.

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## Will my heirs owe estate taxes on inherited retirement assets?

Only a small percentage of estates (based on the value of one's assets at death, and including large lifetime gifts) are subject to the estate tax and there is no estate tax on assets passing to a surviving spouse or charity. However, if the estate is subject to federal estate tax, (except in 2010, when there was no estate tax) you can deduct the portion of the federal estate tax that is attributed to the IRA. You also won't have to pay tax on the portion of withdrawals that are attributed to any nondeductible contributions made to the IRA.

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## Is estate tax deferred if my heir will get an annuity?

No. The estate is taxed on the annuity's present value.

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## How can I minimize or eliminate tax on inherited retirement assets?

You can minimize or eliminate tax on inherited retirement assets by using the following methods:

1. Leave them to your spouse. This saves money owed to estate tax and helps postpone withdrawals subject to income tax--provided your spouse takes no withdrawals before age 59 ½.
2. Leave them to charity. Although there's no financial benefit to the family, again, this saves income and estate taxes.
3. Leave them to family for life, with the remainder to charity in the form of a charitable remainder trust. This reduces estate tax with some benefits to family.
4. Provide life insurance to pay estate tax on retirement assets. The benefit of this option is that it provides estate liquidity, avoiding taxable distributions to pay estate tax.

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## How should I take distributions from my retirement plan?

If your assets are in a tax-favored retirement fund such as a company or Keogh pension or profit-sharing plan (including thrift and savings plans), 401(k), IRA or stock bonus plan, when it comes time to take distributions you have several options:

- Take everything in a lump sum
- Keep the money in the account, with regular distributions or withdrawals on an as-needed basis
- Purchase an annuity with all or part of the funds
- Take a partial withdrawal (leaving the balance for withdrawal later)
- Take a rollover distribution
- A combination of any of the above

Your retirement assets may be distributed in kind-as employer stock, or an annuity or insurance contract. Sometimes certain withdrawal options may be associated with certain retirement plans, for instance, annuities are more common with pension plans. Other types of plan favor the other options, but for the most part most of these options are available for most plans. And more than likely, you'll want to preserve the tax shelter as long as possible by withdrawing no more than you need at any given time.

Timing your withdrawal can be a factor, too. Withdrawals before age 59 ½ risk a tax penalty. At the other end, withdrawals are generally required to start at age 70 ½ or face a tax penalty. The only exceptions are Roth IRAs and non-owner-employees still working beyond that age.

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## When is it best to take a lump-sum distribution from my retirement plan?

Your personal needs should decide. You may need a lump sum to buy a retirement home or retirement business. If your employer requires that you take a lump sum distribution, it may be wise to roll it over into an IRA.

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## What should I do about my retirement plan assets in my ex-employer's plan if I change jobs?

There are several things you might do depending upon your needs:

1. If you don't need the assets to live on, try to continue the tax shelter and leave the money where it is.
2. Transfer or roll over the assets into your new employer's plan--if that plan allows it (this can be tricky, though).
3. If you've decided to start your own business, set up a Keogh and move the funds there.
4. Roll them over into your IRA.

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## Can creditors get at my retirement assets?

In general, employer plans such as your 401(k), IRAs and pension plan funds are protected from general creditors unless you've used these assets as securities against a loan or you are entering into bankruptcy. If this is the case, there's a chance they could be seized, but if the money is in a registered IRA, pension plan, or 401(k), it's more than likely they will be protected n case of bankruptcy (subject to state and federal law of course).

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## How will my state tax affect my retirement withdrawals?

Each state is different, but in general, consider the following:

1. While withdrawals are generally taxable in states with income tax, some offer relief for retirement income, up to a specified dollar amount.
2. If your state doesn't allow deductions for Keogh or IRA investments allowed under federal law, these investments and sometimes more may come back tax-free.
3. State tax penalties for early withdrawal (before 59 ½) or inadequate withdrawal (after age 70 ½) are unlikely.

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## I understand that I'm required to take money out of my retirement plan after I reach age 70 1/2. Why is that?

Retirement plans offer the biggest tax shelter in the federal system, since funds grow tax-free while in the plan. But the shelter is primarily intended for retirement. So when you reach 70 1/2 (or shortly thereafter), you must start to withdraw from the plan.

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## How can I continue the tax shelter for retirement plan assets after age 70 1/2?

The shelter can continue for a large part of those assets, for a long time, assuming you don't need them to live on. You can spread withdrawals over a period based on, but longer than, your life expectancy, for example, over a period of at least 27.4 years if you're 70 1/2 now. You are free however, to withdraw at a faster rate--or even all of it--if you wish. The shelter continues for whatever is not withdrawn.

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## Suppose there are still retirement assets in my account at my death. Can the shelter continue for those who receive those assets?

Generally, yes. Persons you have named as your plan beneficiaries can withdraw over their life expectancies (or more rapidly if they wish). The withdrawal period is generally shorter where no individual beneficiary is named (for example, where your estate is the beneficiary), but your spouse can sometimes spread withdrawals over a longer period.

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## Can moving to another state when I retire save me state taxes on my retirement plan?

Money from retirement plans, including 401(k)s, IRAs, company pensions and other plans, is taxed according to your residence when you receive it.

If you move from a state with a high income tax, such as New York, to one with little or no income tax (Texas, Nevada and Florida have none), you will indeed save money on state income tax.

However, establishing residence in a new state may take as long as one year; if you retain property in both states, you may owe taxes to both.

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## What is a reverse mortgage?

A reverse mortgage is a type of home equity loan that allows you to convert some of the equity in your home into cash while you retain home ownership. Reverse mortgages work much like traditional mortgages, only in reverse.

Rather than making a payment to your lender each month, the lender pays you. Most reverse mortgages do not require any repayment of principal, interest, or servicing fees for as long as you live in your home.

Retired people may want to consider the reverse mortgage as a way to generate cash flow. A reverse mortgage allows homeowners age 62 and over to remain in their homes while using their built-up equity for any purpose: to make repairs, keep up with property taxes or simply pay their bills.

Reverse mortgages are rising-debt loans, which means that the interest is added to the principal loan balance each month (because it is not paid on a current basis). Therefore, the total amount of interest you owe increases significantly with time as the interest compounds. Reverse mortgages also use up some or all of the equity in your home.

All three types of loan plans, whether FHA-insured, lender-insured, or uninsured charge origination fees and closing costs. Insured plans also charge insurance premiums, and some impose mortgage servicing charges.

Finally, homeowners should realize that if they're forced to move soon after taking the mortgage (because of illness, for example), they'll almost certainly end up with a great deal less equity to live on than if they had simply sold the house outright. That is particularly true for loans that are terminated in five years or less.

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