Financial Planning – Distribution Planning

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One of the more important decisions someone makes is that of retirement plan distributions. Although important, this decision usually gets far less attention than wealth accumulation and investment management. Depending upon whether you are retiring or changing jobs, your options will vary. If you are retiring the options are:

- Lump Sum Distribution – you elect to take all of your retirement money in a lump sum and pay ordinary income tax, and possibly a 10% penalty tax, on the entire distribution. Not all plans provide for lump sum distributions. Depending upon circumstances, certain specific options may be available to persons with substantial service born before 1936
- Direct Rollover IRA – you establish an IRA to receive your lump sum distribution and the money is transferred directly from your current plan to your IRA. The entire balance distributed may not be eligible for rollover. See your tax advisor for details.
- Indirect Rollover to an IRA – you have the distribution paid directly to you and then, within 60 days, you roll it over to an IRA. Your employer is required to withhold 20% of the taxable portion for income taxes. In order to defer the income taxes, and possibly the 10% penalty, on the 20% that was withheld, you must add that 20% back to the plan with your own funds.
- Leave Money in Former Employer's Plan – if your account has more than $5,000, you have this option.

If you are changing jobs, all of the previous options are available plus you could roll over your account to your new employer's plan. However, not all plans will accept rollovers so you will need to check with your new employer.

Cash distributions prior to age 59½ from qualified plans are "premature" and generally carry a 10% penalty tax in addition to ordinary income tax. This election can rarely be justified. However there are several important exceptions to this rule.

The following exceptions apply to distributions from qualified plans, 403(a) & (b) plans, government plans and IRAs:

(1) Death – any payments to the estate or beneficiaries of the account owner are not subject to the 10% penalty tax regardless of age;
(2) Disability – if the account owner becomes disabled, the penalty tax does not apply; and
(3) Substantial Equal Periodic Payments (IRC Section 72t) – distributions that represent a series of "substantially equal periodic payments" that can be based on one of three different methods are not subject to the penalty tax. However, if the payment schedule is modified before 59½ (other than for death or disability) or before the 60th payment, the penalty tax can be imposed in all previous payments plus interest.

The following exceptions apply to distributions from qualified plans, 403(a) & (b) plans and government plans, but not to distributions from IRAs:

(1) Separation of Service After Age 55 – no penalty; and
(2) Qualified Domestic Relations Order (QDRO) – distribution made as part of a divorce settlement are exempt from the penalty tax.

The following apply to distributions from IRAs only:

(1) Distributions for medical expenses;
(2) Higher Education Expenses – distributions used to pay for qualifying education expenses for you or your immediate family are not subject to the penalty tax;
(3) Health Insurance Premiums – certain distributions used to pay the health insurance premiums with respect to an unemployed individual and his or her immediate family will not result in a penalty if the unemployed has been receiving unemployment benefits for 12 consecutive weeks; and
(4) First Time Home Buyers – can withdraw up to $10,000 to help pay for the purchase of a first home.

Another distribution planning area that can be confusing is that of required minimum distributions at age 70½. You are <u>not</u> required to take any distributions from your qualified retirement accounts before reaching 70½ (Your plan, however, may be cashed out if it is less than $5,000 in value.). The Small Business and Job Protection Act of 1996 created one significant exception to the 70½ required minimum distribution rule. Participants who did not own at least 5% of the sponsoring company could delay distribution until their actual retirement even if it was past 70½. However, this exception does not apply to IRAs or IRA type plans such as SEP IRA or SIMPLE IRA.

Generally you must begin distribution no later than April 1 of the year following attainment of age 70½. However, waiting until April 1 for the first distribution can create tax issues if you have the problem of very large required minimum distributions. If you wait until April 1 of the year following 70½, you will be required to take a second distribution by December 31 of that same year, resulting in 2 distributions and more tax. For most people the prudent course of action is to take your first required minimum distribution by December 31 of the year in which you turn 70½.

This is just a sampling of the type of decisions you need to make about your retirement plan distributions and is by no means a complete discussion of all issues relating to retirement plan distributions.

We are equipped to help you with this myriad of retirement plan distribution issues and encourage you to call us.

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