

Retirement Account Review

We feel that an important part of investing is reviewing the setup of your accounts from time to time. For instance, is the retirement account you opened ten years ago with an employer you no longer work for, still the most advantageous investment vehicle? Have circumstances in your family changed since you last reviewed your accounts? This newsletter relates specifically to retirements accounts, however the concepts can be carried over to your entire estate.

One of the easiest things to check is who has been designated as beneficiary of your account or accounts. This information can be found on your account application or a beneficiary designation form that was subsequently submitted. Distribution of your IRA account is determined by the person or people designated. You may need to change your beneficiary information due to a recent addition to your family. Likewise, if someone who was supposed to receive a portion of your assets has passed away, a review of your beneficiaries may be advisable.

Another question to ask: does the type of retirement account you have make the most sense given your current circumstances? Perhaps you are self employed and have a higher income than in previous years. As a self employed person you may want to consider an individual 401K or a pension plan to increase the amount of your yearly contributions. On the flip side, perhaps your income has dropped substantially and you should consider rolling over a portion of your assets into a Roth IRA.

Convert to a Roth IRA?

An option to consider for some investors is conversion of an existing IRA to a Roth IRA. The amount of the conversion is taxable. Therefore, whether to convert and the amount to convert, must be carefully considered.

First a little background on the Roth IRA is necessary. For single taxpayers, full contributions are allowed so long as their income is below \$95,000. Partial contributions are allowed for people with incomes between \$95,000-110,000. Similarly, joint tax payers are allowed to make full contributions if their income is under \$150,000. The phase-out for married people occurs between \$150,000-160,000.

A Roth IRA differs from a Traditional IRA because there is no current tax benefit associated with a Roth IRA. The tax benefit for a Roth IRA is realized when the money is withdrawn because no taxes are paid on the withdrawal, assuming it is qualified (after age 59 ½ and the funds have been in the account for 5 years). Therefore withdrawals from a Roth IRA are tax-exempt, rather than tax-deferred as with a Traditional IRA.

Beyond the favorable tax treatment over the Traditional IRA, there is additional flexibility with the Roth. With a Traditional IRA withdrawals must begin when you turn 70 ½. This is referred to as a required minimum distribution (RMD). Therefore, whether you would like to or not, you must take money from your



Traditional IRA and pay taxes on the withdrawal as though it is income. However, there is no RMD for a Roth IRA. This provides added flexibility in managing your estate.

The first consideration is whether you qualify to convert your IRA. In order to do so, you must have an AGI (adjusted gross income) of \$100,000 or lower. This applies no matter how you file your tax return (single, married filing jointly, or married filing separately).

This can make sense for people in very specific situations. For those who are relatively young, and in a fairly low income tax bracket, conversion is particularly attractive. Also people who have variable incomes (the self-employed, consultants, those in sales or startups) may benefit by converting their IRA. It is attractive for these people because they have a long time to recover the taxes incurred after the change is made.

Another instance in which we have seen conversions make sense is when people retire at a fairly young age. With no earned income the retiree is often below the \$100,000 AGI income limit. By converting a portion of the account each year the tax bill can be kept low while providing for future tax-free growth.

To Rollover or Not to Rollover?

One item that continues to come up in client meetings is what options are available to retirement accounts held with previous employers (e.g. 401K plans, PSP, etc). Typically these accounts can be transferred into what is known as an IRA Rollover account. The advantages of doing so are numerous as outlined below.

First, there is typically a much broader array of investments to choose from if the assets are moved to an IRA Rollover account. While some argue that the mutual funds within an employers retirement offering are diversified, by purchasing individual securities, greater

diversification can be achieved. Many mutual funds hold the same stocks and it is therefore difficult to create a truly diversified portfolio.

Additionally, many people are under the impression that they pay no fees for mutual funds held in retirement accounts. Most of the time this simply is not the case. The fees are not paid by the employer, but instead are paid by the owner of the account. Though you never explicitly see the fee, it is deducted from the gross return of the fund.

Finally and most important is the tax treatment of a 401K plan upon the participant's death. If the participant is married and the spouse is named as the beneficiary of the account, it can be rolled over into an IRA account. However, if the beneficiary is anyone other than the spouse, some companies require that the account be cashed out and distributed. If you have a sizeable 401K this can create a large tax liability for your beneficiaries. By converting to an IRA Rollover account the beneficiaries have the option of spreading the withdrawals over their lifetime. This lowers their immediate tax bill and still allows for tax-deferred growth.

Please keep in mind that there are many rules which apply to the rollover of assets from retirement accounts. It is best to have professional help in determining the best way to transfer these assets.

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