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INVESTMENTS | WEALTH MANAGEMENT

TAKING STOCK

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20 Questions On Required Minimum Distributions

Do you remember playing "20 Questions" as a kid? Here are the answers to 20 questions about required minimum distributions (RMDs). Most of this information comes from the frequently asked questions section of the IRS website.

Q1. What is an RMD?

A. This is the amount you're required to withdraw from your 401(k) plans, other employer-sponsored retirement plans, and IRAs.

Q2. Which plans do the RMD rules apply to?

A. The rules cover all employer-sponsored retirement plans, including pension and profit-sharing plans, 401(k)s, 403(b) plans for nonprofits, and 457(b) plans for government entities, plus traditional IRAs and IRA-based plans such as SEPs, SARSEPs, and SIMPLE-IRAs.

Q3. When do I have to begin taking RMDs?

A. The required beginning date (RBD) is April 1 of the year *after* the year in which you turn age 70½. For example, if your 70th birthday was January 1, 2016, you must begin taking RMDs no later than April 3, 2017. (April 1 is a Saturday.)

Q4. When do I have to take RMDs in future years?

A. The deadline is December 31 of the year for which the RMD applies. Thus, if you turn 70½ in 2016, you must take the RMD for the 2017 tax year by December 31, 2017.

Q5. How do you figure out the RMD amount?

A. Divide the balances in your plans and IRAs on December 31 of the prior year by the factor in the appropriate IRS life expectancy table.

Q6. Can I withdraw more than the required amount?

A. You can withdraw as much as you like; the RMD is the least you are allowed to take.

Q7. If I take more than the RMD this year can I withdraw less in a future year?

A. No. Each RMD is calculated based on the account balance and life expectancy factor for that particular year.

Q8. Do I have to take RMDs from all of my retirement plans?

A. Although you must calculate the RMD separately for each IRA you own, you can withdraw the total amount from just one IRA or any combination of IRAs that you choose. However, for employer-sponsored plans other than a 403(b), the RMD must be taken separately from each plan account.

Q9. What happens if I fail to take an RMD?

A. The IRS imposes a penalty equal to 50% of the amount that should have been withdrawn (reduced by any amount actually withdrawn).

Q10. How are RMDs taxed?

A. Generally, the entire amount of an RMD is taxable at ordinary income rates. The exception is for amounts attributable to non-deductible contributions to an IRA.

Q11. Are there any exceptions to the RMD penalty?

A. The penalty may be waived if you can show that the shortfall was due to reasonable error and you now have withdrawn the required amount.

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1.53% For 70 Years! Don't Miss Out!!!

In the latest example of the head-scratching interest rate world that currently exists, Austria recently issued 70-year bonds yielding only 1.53%. Investors wanted it so much they put in orders for 3.9 times the amount offered. Why would someone tie up money for seven decades at 1.53% when inflation in that country has averaged 3.29% since 1958? A lot of the buyers of this type of stuff are pension plans trying to "match" long-term liabilities with long-term investments. That makes sense in theory, but in this case the humans making the decisions seem to have lost touch with reality. Let's say that in 10 years interest rates have gone up by 3% across the board. If that happens, the bond price will have crashed by about 61% while inflation might have eroded the interest payments by 34%. Not to worry though . . . it'll mature at face value in another 60 years.

Institutions get pulled into this type of behavior because it is academically justified and safe for the managers. Individual investors, however, can choose a common sense path and not be concerned about the career risk that exists for institutional managers trying to veer away from groupthink.

Ryan

Tune Into The Tax Break For NUA

NUA isn't the latest channel available on your cable TV system. It stands for "net unrealized appreciation"—a little-known gem of a tax break for those who take payouts in the form of company stock from a 401(k) or other employer-sponsored retirement plan.

This tax law provision lets you benefit twice: once when you pay the tax on the plan distribution and once when you sell the stock.

If you receive a retirement plan distribution in company stock, you'll be taxed only on what you initially paid for it. You won't have to pay tax on any subsequent gains in value—known as net unrealized appreciation, or NUA. In contrast, cash distributions from your 401(k) normally are taxed as income, at rates up to 39.6%.

And what happens when you sell the shares you received from your retirement plan? Then you will be taxed on the difference between what you paid for the stock and its sale price. But that profit will be taxed at capital gains rates, and if it qualifies as a long-term gain—because you've owned the stock longer than one year—the maximum tax rate is only 15% (or 20% if you're in the top 39.6% ordinary income tax bracket).

But the tax breaks for NUA aren't automatic. The distribution must be:

- Made from a "qualified" retirement plan sponsored by your employer. (IRAs don't count.)
- Because of a triggering event—you died or became disabled, you reached age 59½, or you stopped working for the company sponsoring the plan.
- Taken in a single tax year.

Assuming you qualify, though, the tax savings for NUA can be substantial. Suppose that during the past 20 years, hypothetical investor Jane Doe has acquired 20,000 shares of company stock in her 401(k). The stock originally was bought for $5 a share, but now it's worth $50 a share, or a total of $1 million.

If Jane sells the stock within the 401(k) and then takes a cash distribution of the proceeds, the entire $1 million will be taxed as ordinary income. If Jane is in the 39.6% tax bracket, she'll be hit with a federal income tax bill of $396,000 (39.6% of $1 million). But if she instead takes the distribution as stock, not cash, she'll be taxed only on her original cost of $100,000, and she will pay only $39,600.

Now suppose that Jane sells the stock immediately for $1 million. Her $900,000 gain ($1 million - $100,000) is taxed as long-term capital gain at the maximum 20% rate, giving her a tax bill of $180,000. Add that to the $39,600 she paid on the distribution, and her total taxes are $219,600—or $176,400 less than she would have paid if she'd sold the stock inside her retirement plan. ●

5 Key Documents In An Estate Plan

To do a job right, you need the proper tools. And while each and every estate plan is unique, these five documents are often integral elements:

1. Financial power of attorney. This document authorizes an "attorney-in-fact" to act on your behalf in financial matters. The most common power of attorney, a "durable" one, remains in effect if you're incapacitated. Another variation, which is known as a "springing" power of attorney, transfers control to the designated person only if you're incapacitated.

The attorney-in-fact may have broad powers, able to buy or sell personal property, for example, or the role may be limited to specified tasks. This power of attorney expires when you die.

2. Health-care power of attorney. This also authorizes another person to make decisions on your behalf if you're unable to do so—in this case, involving medical care, carrying out your end-of-life wishes, and related matters. Here, the attorney-in-fact is typically your spouse, a child, or a sibling. Like a financial power of attorney, it may be broad or limited and expires at your death.

3. Living will. While a health-care power of attorney may authorize someone to help with end-of-life decisions, establishing what will happen when you're dying is the sole purpose of a living will. Depending on the laws of your state, you may be able to use a living will to say whether or not you want life-sustaining treatment if you are terminally ill or grievously injured.

Also depending on state law, a health-care power of attorney and a living will may be able to be combined into one document. In other states, a living will may supplement a health-care power of attorney, and both documents can be coordinated with other medical directives or proxies.

4. Trusts. There are many reasons

Dynasty Trusts: A Gift That Keeps On Giving

Would you like your assets to last forever? Of course, there are no guarantees, but a "dynasty trust" could help you preserve wealth for your heirs indefinitely. As the name implies, this type of trust is designed to span several generations, barring drastic changes in applicable laws or your family's financial circumstances.

Under a common law principle known as the "rule against perpetuities," trusts normally are required to have a beginning, middle, and an end. This rule was adopted in many states, establishing an expiration date for trusts of 21 years after the death of a potential beneficiary who was alive at the time of the trust's creation. California and other states have adopted a variation of that rule with a limit of about 90 years. Delaware is among a few states that have repealed the rule completely and actively encourage people to set up dynasty trusts in those states.

With a dynasty trust, you transfer selected assets—perhaps stocks, bonds, real estate, or a combination of those—to a trust managed by an independent trustee. The trust can be created as an "inter vivos" transfer during your lifetime or a testamentary transfer through your will. Once established, the trust is irrevocable—you give up control over the assets and the right to change beneficiaries.

The trustee invests the trust assets. Depending on the terms of the trust, income may continue to accumulate within the trust or it could be paid out to beneficiaries, usually your descendants. You might name your adult children as the initial beneficiaries, to be followed by your grandchildren and great-grandchildren. The trustee also may have discretion to invade the trust principal for the health, education, support, and maintenance of beneficiaries or for other reasons.

By letting you designate the ultimate beneficiaries of the trust at the outset, this arrangement gives you some control over where the assets end up. In addition, a dynasty trust could help you protect some kinds of assets from creditors.

But a dynasty trust also may help reduce potential estate taxes. Under current rules, everyone is entitled to a generous estate and gift tax exemption of $5.45 million in 2016, which is indexed for inflation, and likely will rise in future years. This exemption is "portable" between spouses, which enables you to use any leftover amount not used when your spouse died. Similarly, while there is a generation-skipping transfer tax (GSTT) that applies to most transfers that skip a generation, including those made to a trust, that same exemption amount applies to the GSTT.

When you transfer assets to a dynasty trust, the transfer is potentially subject to federal gift tax—if its value exceeds $5.45 million. But future appreciation of those assets won't be taxed, and that growth could benefit multiple generations of your heirs.

For example, suppose you and your spouse transfer $10 million to a dynasty trust. That gift isn't taxed because it is less than the total $10.9 million combined exemption that you and your spouse are allowed. But by the time both of you have died, suppose the assets have grown to be worth $5 million more than your combined exemption would have covered. Without a dynasty trust, your family would have to pay a 40% estate tax, or $2 million. The estate tax bill for the dynasty trust is zero.

Of course, there are other considerations, including income taxes, which the trust must pay each year on investment earnings. For this reason, dynasty trusts often are funded mainly with assets that don't produce current income—growth stock that doesn't pay dividends, for example, or tax-free municipal bonds. Life insurance policies also could be transferred to a dynasty trust.

Just keep in mind that these trusts are complex arrangements, and you'll need the help of an experienced estate planning specialist to create one that can benefit your family for generations to come. ●

for creating and funding trusts. A trust could be used to prevent family squabbles or impose restraints on spendthrift family members. One variation, a living trust, often supplements a will because assets in the trust don't have to go through probate court proceedings.

Though there are myriad variations, all trusts are either revocable or irrevocable. With a revocable trust, you retain control over the assets. Yet while that's not the case with an irrevocable trust, this type of trust can protect assets from creditors and remove them from your taxable estate.

5. Will. Last but not least is your will, which establishes how your assets will be distributed after you die and who will have custody of any minor children. You also could use it for other purposes such as making charitable donations and creating trusts.

If you die without a will—"intestate," in legal parlance—the laws of your state will determine who gets your assets and assumes guardianship of young children. As the centerpiece of your estate plan, this is definitely one tool you can't be without. ●

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20 Questions On RMDs

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Q12. Is an RMD subject to the net investment income (NII) surtax?

A. Distributions from retirement plans don't count as NII. However, RMDs *will* increase your modified adjusted gross income (MAGI), and a higher MAGI could result in NII tax liability.

Q13. Can I still contribute to my plans if I'm taking RMDs?

A. Yes. If you're still working and participating in a plan, you may qualify to continue your contributions.

Q14. Do I have to take an RMD if I'm still working?

A. Generally, you have to take RMDs from all employer-sponsored plans and IRAs. However, you don't have to withdraw an RMD from non-IRAs if you still work full-time and don't own 5% or more of the business.

Q15. Can an RMD be rolled into an IRA or other plan?

A. Absolutely not. Rollovers are prohibited.

Q16. Can an RMD be donated to charity?

A. Yes. Under a recent tax law extension, if you're 70½ or older you can transfer an RMD of up to $100,000 directly from an IRA to a charity without paying tax on the distribution.

Q17. What happens if I die before my required beginning date?

A. No distribution is required for the year of death. For subsequent years, RMDs must be taken from inherited accounts. A spousal beneficiary has greater flexibility than non-spouses, including being able to treat the account as his or her own.

Q18. What happens if I die after my RMD?

A. The beneficiaries of the accounts must continue to take RMDs under complex rules. Again, spousal beneficiaries have greater flexibility than other heirs.

Q19. Do the RMD rules apply to Roth IRAs?

A. No. You don't have to take RMDs from a Roth IRA during your lifetime. After your death, however, your heirs must take lifetime RMDs from the Roth.

Q20. When should I arrange my RMD?

A. The sooner, the better. Don't wait to get caught in a year-end crush. We can help with the particulars. ●

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