

10 common IRA mistakes

You've worked hard to build your retirement assets. Let them work hard for you—throughout your career and your retirement years, and then for your family and heirs after you're gone. Investing in an IRA to help fund your retirement is a smart move, but IRAs have a lot of rules, some easy to understand, some more complicated.

Making the most of your IRA requires understanding certain guidelines set by the IRS. Listed here, you'll find 10 of the most common mistakes that people make with their IRAs, some that are easy to fix, and some that may require assistance. Either way, avoiding these mistakes can help you keep your retirement plans on track.

Listed here are 10 key mistakes, but the biggest mistake you might be making is not regularly contributing to your IRA. While one-third of U.S. households own an IRA, only 35% of them made a contribution in the 2013 tax year (the latest data available).¹

¹ "The Role of IRAs in U.S. Households Saving for Retirement, 2014," *ICI Research Perspective*, January 2015.

1. Making common rollover mistakes

Many people make mistakes when rolling over their funds. You have 60 days to put rollover money into an IRA or you risk losing the tax-deferred status of the investment. There are two types of rollovers: direct and indirect.

- A direct rollover is when the financial institution that holds your old IRA directly deposits your funds into the financial institution that holds your new IRA.
- An indirect rollover is when the financial institution that holds your old IRA issues a check made payable to you. You then deposit those funds into your new IRA.

A direct rollover is the easiest way to ensure that your funds are transferred in a timely manner.

2. Not considering a Roth IRA

A Roth IRA is funded with after-tax dollars and all withdrawals are tax free, provided you hold the account for at least five years and have reached the age of 59½. Unlike a traditional IRA, Roth IRAs do not require owners to take a required minimum distribution (RMD) each year. However, there are income limits.

	Full contribution		Partial contribution	
	Single	Married filing jointly	Single	Married filing jointly
2015 income threshold for Roth IRA contribution ²	\$116,000	\$183,000	\$116,001–\$131,000	\$183,001–\$193,000
2016 income threshold for Roth IRA contribution ²	\$117,000	\$184,000	\$117,001–\$132,000	\$184,001–\$194,000

If you earn more than those amounts, you may want to investigate converting your traditional IRA assets to a Roth IRA. Conversions are available to everyone, regardless of income, but you will need to pay income taxes on the amount converted.

3. Forgetting catch-up contributions

Once you turn 50 years old, the IRS lets you kick your retirement savings into high gear. Catch-up contributions allow you to increase annual contributions. For traditional IRAs or Roth IRAs, you can add an additional \$1,000 per year to your account, which increases your total annual contribution from \$5,500 to \$6,500. Remember that catch-up contributions are also available for most employer-based retirement savings accounts, so be sure to consider all of your options.

4. Failing to name a beneficiary

It's important to know that when an IRA owner dies, the assets can pass directly to the designated beneficiary, avoiding the lengthy probate process. This makes it essential that beneficiary designations are accurate and up to date. The IRA beneficiary designation form could be one of your most important estate planning documents. It's also prudent to name a contingent beneficiary on your accounts. If the primary beneficiary is deceased and a contingent beneficiary is not named, the IRA custody agreement will generally invoke a default mechanism that will distribute the funds to your estate, where they will become subject to your creditors and lose many of the income-tax advantages of the IRA.

5. Having an outdated beneficiary

It's prudent to check your beneficiary designation forms periodically, especially if you've experienced any of the following life changes:

- Gotten married, remarried, or divorced
- Had a baby (or a grandchild)
- Gotten a new job
- Established a trust
- Had an illness or become incapacitated
- Inherited assets

While some states have laws that automatically revoke any beneficiary designation in favor of a former spouse upon divorce, many do not. If you fail to change your beneficiary after a divorce, your assets could wind up with your ex-spouse.

² Limits on modified adjusted gross income (MAGI). Note that MAGIs greater than those listed may qualify for partial Roth IRA contributions.

6. Naming a trust as a beneficiary

Estate planning attorneys frequently use trusts as beneficiaries of IRAs. However, if the trust is not structured properly and does not qualify as a look-through trust (a trust that allows distributions to be stretched based on the life expectancy of the oldest beneficiary), the IRA assets will most likely have to be paid out within five years after the owner dies. This eliminates the stretch option for beneficiaries and results in immediate taxation.

7. Not knowing your distribution options regarding inherited IRAs

Your distribution options will vary depending on your relationship to the person you inherited the IRA from. As the surviving spouse, you have the option to treat your deceased spouse's IRA as your own or you can roll the IRA assets into your own IRA. Nonspousal beneficiaries often liquidate their inherited IRA assets too quickly, resulting in immediate income taxes. Consider a stretch IRA, which allows you to prolong the tax-deferred or tax-free status over one or more generations, spreading the tax liabilities over your lifetime, and potentially your beneficiary's lifetime also.

8. Overlooking income-tax deductions with inherited IRAs

If the person you inherited the IRA from owed estate taxes, you may be able to use a deduction for income in respect of a decedent (IRD) to lower the taxes you owe. When estate taxes are paid based on IRD, the beneficiary may have the right to take an income-tax deduction equal to the amount of estate taxes attributable to the IRD.

9. Not cleaning up old retirement accounts

Having too many old retirement accounts is an easy way to make mistakes. While there are no rules regarding how many retirement accounts a person can have, trying to manage multiple accounts can lead to complicated recordkeeping, asset allocation mistakes, and inconsistent or contradictory beneficiary designations. Rolling over your old accounts into a single IRA can help you more effectively manage your assets and could lead to potentially lower fees.

10. Trying to do it by yourself

Don't be afraid to seek assistance and guidance from a financial professional. He or she has the experience to help you make the best decisions based on your individual needs, preferences, and goals. You also may wish to consult with:

- An insurance planner, who can help you with a range of insurance products, including life, disability, and long-term care insurance
- An accountant, who can not only help you with your taxes, but can also advise on investments and estate planning needs
- An attorney, who can assist with the preparation of your will and setting up a trust

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