



Your Bottom Line

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Navigating a clear course toward your financial security.

IRA Retirement Contributions



Warren Mackensen

Don't let yourself be talked out of putting away money in an IRA for 2004. Ignore the nay-sayers who argue against contributing to an IRA. You should avail yourself of every opportunity to save on a tax-deferred basis.

Deductibility: Whether your contribution is tax deductible, or not, is much less important than the tax-deferred aspect of retirement savings. For non-deductible contributions, Form 8606 is used to track your taxable basis so that your contributions will not be taxed a second time when you take distributions from your IRA.

Caution: If your year-to-year non-deductible contributions are inconsistent, there may be some years when Form 8606 will not be filed. No matter; just keep a copy of your latest-filed Form 8606 for documentation so that you may maintain the continuity of your IRA basis in future years. If you or your tax preparer uses the same tax software year after year, the Form 8606 information automatically flows forward each year. ❖

Retirement Distributions

Required Minimum Distributions (RMDs) are required starting at age 70½. What was Congress thinking when it enacted this arcane age scheme?

What is clear is that the penalty for *not* taking a required minimum distribution during the calendar year is 50%. Do we have your attention? The rules must be followed carefully.

For example, you have until April 1 of the year *following* the year that you turn 70½ to begin taking required minimum distributions. But, if you actually wait until the spring of the year following the year that you turned 70½, you will have to take two required minimum distributions that year – one for the prior year and one for the current year. *Better:* Take your first required minimum

distribution in the year that you turn 70½ to avoid the possibility that two required minimum distributions combined in one year will bump you up to a higher tax bracket.

Obviously, your date of birth governs when you turn 70½. The difference between being born on June 30th and July 1st is a whole year when it comes to taking required minimum distributions!

Early distributions: Consider taking some retirement distributions before you are required to. We have helped numerous clients capitalize on a golden opportunity to withdraw some retirement monies at very low tax cost by starting distributions earlier than their 70th birthday. ❖

Missed Deductions

If a decedent has an IRA that is part of a taxable estate (gross estate greater than \$1,500,000 in 2004 or 2005), then there is Income in Respect of a Decedent (IRD). The IRD is taxable and is reported on the federal estate tax return (Form 706). Benefit: The IRD taxed on the federal *estate* tax return is deductible on the

decedent's final *personal* income tax return as a miscellaneous itemized deduction. The sleeper here, though, is that the miscellaneous itemized deduction for IRD on the personal tax return is *not* subject to the 2% floor on miscellaneous itemized deductions, and further, it is *exempt* from the dreaded alternative minimum tax. ❖

Company Retirement Plans

If you have more than one employer, the combined contributions to your 401(k) plan, SIMPLE plan, and 403(b) plan cannot exceed the Section 402(g) elective deferral limit. For 2004, the limit is \$13,000 (\$16,000 if you are age 50 or over).

Exception: Section 457 plans, frequently sponsored by municipalities and state employers, are not considered elective deferrals under Section 402(g). As such, an employee who participates in a 401(k) plan, 403(b) plan, or SIMPLE plan may also participate in a Section 457 plan and defer up to \$26,000 for 2004, and up to \$32,000 if age 50 or over.

Unrelated employers: If you work for a business in which you have no ownership interest, i.e., your “day job,” and you also have a business on the side, you may be able to contribute the maximum amount to the plans maintained by each business. For example, you may contribute the maximum to the plan at your day job, and separately, contribute the maximum to a Simplified Employee Pension (SEP) plan maintained by your sideline business. *Key:* Employers must be unrelated and there cannot be any common ownership.

Employees in 403(b) plans with 15 or more years of service may also make additional catch-up contributions. Check with your plan sponsor to see if your plan offers this opportunity.

Overall, these contribution limits can be confusing if you have more than one employer. Contact us if you would like to discuss your particular situation. ❖



David A. Batchelder

Inherited IRAs

IRAs were first available in 1975, although they were little-publicized at the time. Some of these early adopters of IRAs are beginning to meet their Maker. Inherited IRAs, by definition, are IRAs inherited from someone other than a spouse. Spouses may do a spousal rollover and use their own (often younger) age for required minimum distribution calculations. Non-spouse beneficiaries cannot do a rollover, so the IRA received from a non-spouse is termed an “Inherited IRA.”

Beneficiary designations ensure that the original IRA Owner passes the IRA to the next in line. To stretch IRA distributions as long as possible, beneficiaries should be *people*, not the “estate.” Charities may also be named, but it is better to separate the human beneficiaries from the charitable beneficiaries using two separate IRAs before death. *Reason:* Charities have a zero life expectancy such that a single IRA passing to both a human and a charity as co-beneficiaries will cause the human’s interest to be distributed immediately. *Better:* Split the IRA into two, and name the beneficiaries separately.

Inherited IRAs have required minimum distributions. In the year of death, if the IRA Owner was 70 1/2, the IRA Owner or the personal representative of the decedent must ensure that the required minimum distribution was taken for the year of death. This distribution, computed

using the Uniform Life Table, is reported on the decedent’s final personal income tax return.

The year following the year of the IRA Owner’s death, the Inherited IRA beneficiary uses his/her own life expectancy (from a Single Life Table) to compute the required minimum distribution. The Single Life Table is used only this one time by the IRA beneficiary.

The year after that, the IRA beneficiary has to follow the “N-1” rule, which involves subtracting 1 from the Single Life Table factor used for the prior year. In ensuing years, the factor continues to be reduced by 1 (following the N-1 rule), resulting in the factor (the divisor) becoming smaller and smaller such that the Inherited IRA eventually becomes fully distributed. ❖

Code of Ethics

Mackensen & Company has adopted a firm-wide Code of Ethics in response to a recent SEC rule. Please contact us if you would like to receive a copy. ❖

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MACKENSEN & COMPANY, INC.
FEE-ONLY FINANCIAL PLANNERS

6 Merrill Drive
Hampton, NH 03842-1970
603-926-1775
800-927-7365
fax: 603-926-1249

web address: www.mackensen.com
email: info@mackensen.com