

# 21<sup>st</sup> century retirement



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## *Trimming Your Taxes While Saving for Retirement*

**C**ontributing to tax-advantaged retirement plans is one of the most effective financial planning strategies available to U.S. taxpayers: Saving money in a 401(k), IRA, or a Roth IRA account can trim your tax bill, while helping you prepare for the future. Even if you are already contributing to a retirement plan, you should review your retirement savings strategy regularly to ensure that you are making the most of the tax breaks you qualify for.

When you contribute money to a traditional individual retirement account (IRA) or an employer-sponsored defined contribution plan, such as a 401(k) or a 403(b), the adjusted gross income (AGI) figure that is used to calculate your income tax liability is lowered by the amount saved. Depending upon your income and the amount contributed, depositing funds in an IRA or 401(k) can substantially reduce your tax bill. While taxes must be paid on distributions from these accounts, most savers come out ahead because they are in a lower marginal tax bracket in retirement than they are while working. Investment growth within these retirement plans is also tax deferred. Even savers whose marginal tax bracket is not lower in retirement usually benefit by allowing money they would otherwise have paid in taxes to grow over time.

While the advantages of saving in tax-advantaged retirement plans are clear, selecting the types of accounts that are best for your circumstances may be less straightforward. If your company offers a 401(k) plan with matching contributions, start by having your employer deduct from your paycheck at least the amount necessary to take advantage of the full match. If the plan allows, consider contributing beyond the matching limit, up to the maximum of \$18,000 or \$24,000 (\$18,000 + \$6,000 “catch-up” contribution), for people age 50 and older in 2015. Depending upon your income, you may also have the option of contributing to an IRA in addition to your workplace retirement plan.

Employees without access to a retirement plan at work, either because they are self-employed or because their company does not offer one, have a number of options when choosing a tax-advantaged savings account. If you have earned income, you and your spouse may be eligible to each make pre-tax contributions of up to \$5,500 (\$6,500 for those over age 50) to an IRA

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## Retirement Plan Rollover Options for Non-Spouse Beneficiaries

If you participate in an employer-sponsored qualified retirement plan, such as a defined benefit plan, 401(k) plan, employee stock ownership plan (ESOP), 403(b) plan, or 457(b) plan, you may have chosen a beneficiary to receive your account balance in the event of your death. If you are married, the law requires that your spouse be named the primary beneficiary of your account, unless he or she waives that right in writing. However, if you are unmarried, or your spouse has waived his or her right, you may wish to name a parent, sibling, child, domestic partner, other relative, friend, or trust as the beneficiary. As of 2010, non-spouse

beneficiaries of inherited retirement plan accounts are permitted to roll over these assets into Individual Retirement Accounts (IRAs) on a tax-free basis.

The provision allowing rollovers by non-spouse beneficiaries was included in the Pension Protection Act of 2006 (PPA '06) and initially went into effect on January 1, 2007. Prior to this time, only the spouse of the deceased account owner was permitted to defer taxation on the account by rolling over the funds to an inherited IRA, while any non-spouse beneficiary was required to take a lump sum distribution from the account. Non-spouse beneficiaries

were thereby obligated to pay taxes on the full amount received and to declare the income on their personal tax return, potentially creating a challenging tax situation. Starting in 2007, non-spouse beneficiaries were allowed to make the same tax-free rollovers as spouses.

However, under the PPA, tax-qualified employer-sponsored retirement plans were not required to offer direct rollovers to non-spouse beneficiaries. Consequently, many non-spouse beneficiaries did not have access to these tax-free rollovers, unless the plan sponsors had voluntarily chosen to provide the option.

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## trimming your taxes while saving for retirement

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in 2015. There are also a number of tax-advantaged defined contribution plans designed specifically for the self-employed or small business owners, including simplified employee pension (SEP) plans, SIMPLE IRAs, and owner-only 401(k) plans. These plans are relatively easy to set up and administer, and they can help both owners and employees lower their taxes and build their retirement savings.

While Roth IRAs and Roth 401(k)s do not immediately reduce your taxable income, they can be useful tax planning tools over the long term. The contribution limits for Roth IRAs and Roth 401(k)s are the same as for traditional IRAs and 401(k)s, but the contributions to Roth accounts must be funded with after-tax dollars. Investment growth

within Roth accounts is tax free, and no taxes are owed on qualifying withdrawals. However, it is important to note that Roth 401(k)s are subject to required minimum distributions (RMDs) starting at age 70½, whereas Roth IRAs are exempt from RMDs.

A Roth IRA can be an attractive option for people who earn too much to contribute to a traditional IRA, but whose AGIs are still below the Roth IRA eligibility phase-out ranges of \$116,000–\$131,000 for single filers and \$183,000–\$193,000 for married joint filers in 2015. For married couples who file separately in 2015, the Roth IRA eligibility phase-out remains \$0 to \$10,000. Roth IRAs also offer greater flexibility than traditional IRAs and 401(k)s. Unlike retirement plans funded with

pre-tax dollars, Roth IRAs do not require savers to begin withdrawing funds after the age of 70½, making it easier to pass on a retirement nest egg to the next generation. A Roth IRA may also be a wise choice for people who do not expect to be in a lower marginal tax bracket in retirement, and wish to maximize their retirement income.

The ideal financial plan may involve contributing to a variety of tax-advantaged retirement accounts. Changes in your income or in tax law can affect your eligibility for some plans. Therefore, be sure to periodically review your situation with qualified financial and tax professionals to modify your tax and retirement planning strategies, as needed. ■

## Tax and Retirement Planning for Families with a Stay-At-Home Spouse

In many families, one of the spouses stays home, often to care for children and the household. This may be hard work, but for tax purposes the contributions of the stay-at-home spouse are not recognized in the same way as they are for individuals with earned income. If your wife or husband does not have paid employment, your family may have to do some additional planning to minimize your tax bill, while ensuring that you are saving enough for retirement to cover the needs of both partners.

Even if your husband or wife has not earned a significant amount of income through paid employment, he or she may be entitled to a Social Security spousal benefit. Based on the working spouse's earnings record, the spousal benefit can be claimed after the working partner has filed for benefits and the nonworking partner has reached retirement age. The spousal benefit generally amounts to 50% of the monthly Social Security payment received by the spouse who worked regularly, or less if claimed early.

But Social Security benefits alone are unlikely to cover the needs of most couples in retirement. Thus, your family's retirement strategy should include a plan for both partners, even if you are the sole earner. If you have not done so already, consider making the maximum contribution to your employer-sponsored 401(k) plan. While your nonworking partner is not permitted to contribute to your workplace retirement plan, the annual contribution limit in 2015 is \$18,000, or \$24,000 for individuals age 50 and over. The funds in the account will be held in your name, but can be inherited

by your spouse, and are typically divided between the spouses in the event of a divorce.

Another option for tax-advantaged retirement savings is a spousal IRA, which is simply a regular IRA designed specifically for spouses who are not employed or are working too little to contribute to a qualified retirement account. While it is a fundamental rule that individuals need to have earned income, or wages, in order to contribute to an IRA, a nonworking spouse is permitted to open an account to which the working spouse may contribute. Provided you file a joint return, you are permitted to contribute up to \$5,500 (or \$6,500 for those age 50 and older) in 2015 to an account in your partner's name, while also contributing the same amount to your own IRA. Thus, your household may be eligible to contribute up to a total of \$11,000 or \$13,000 to two separate IRA accounts.

A spousal IRA can be a traditional IRA or a Roth IRA. The traditional IRA is tax-deferred, which means that you won't pay income taxes on current contributions, but you will owe taxes on distributions in retirement. By contrast, Roth IRA contributions are made with after-tax dollars, but the funds in the account grow on a tax-deferred basis and can be withdrawn tax free in retirement. Thus, a Roth IRA may be an attractive option if you expect to be paying higher tax rates in retirement or wish to leave an IRA to beneficiaries. However, in 2015 the eligibility for contributing to a Roth account starts to phase out for married couples with a modified adjusted gross income (AGI) of \$183,000, and is capped at \$193,000.



It is also important to keep in mind that the deduction for taxpayers making contributions to a traditional IRA is phased out for married couples filing jointly when the spouse who makes the IRA contributions is covered by a workplace retirement plan. While the modified AGI phase-out range is \$98,000 to \$118,000 in 2015 for the spouse who is employed, it is raised to \$183,000 to \$193,000 for an IRA contributor who is not covered by a workplace retirement plan and is married to an individual who is covered.

Married couples in which one partner owns a business or is self-employed have additional options for saving for a stay-at-home spouse's retirement. For example, if you own a business, your partner may be able to provide services to your company, such as bookkeeping or answering calls, while still remaining primarily at home. If you pay your partner as an employee, he or she can qualify to participate in the company's retirement plan. This approach can lower your family's current income tax bill, while helping to secure your financial future as a couple. ■

## retirement plan rollover options for non-spouse beneficiaries

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Congress closed this gap in the Worker, Retiree and Employer Recovery Act of 2008 (WRERA), through a provision mandating employer-sponsored retirement plans to offer the rollover option to non-spouse beneficiaries in plan years beginning after December 31, 2009. The WRERA provision also stipulates that beneficiaries who do not opt for a direct rollover, and instead choose to take distributions in the form of a cash lump sum, will be subject to mandatory 20% income tax withholding rules. As a result of IRS Notice 2008-30, non-spouse beneficiaries may also choose to roll over retirement account funds into an inherited Roth IRA subject to taxation.

Under the rules, non-spouse beneficiaries are permitted to directly roll over funds inherited from employer-sponsored retirement plans into inherited IRAs. According to the IRS, retirement plan distributions to a non-spouse beneficiary are subject to many of the same rules that apply to other eligible rollover distributions. Retirement plan sponsors must offer a non-spouse beneficiary the option of making a direct rollover, or a trustee-to-trustee transfer, of eligible rollover distributions to an inherited IRA. This

means the transfer is made from the retirement plan to the IRA, and not to the beneficiary.

Other restrictions apply. The rollover must be made to a new IRA, not one already owned by the non-spouse beneficiary, and the new IRA must bear the name of the deceased, not the beneficiary. The rollover must be completed by December 31 of the year following the account holder's death. In addition, beneficiaries are not permitted to make additional contributions to the inherited IRA. The beneficiary must have the same basis in the inherited IRA as the deceased account owner, and the beneficiary may not combine

the basis in the inherited IRA with the basis in his or her own IRAs.

After the rollover has occurred, the beneficiary must begin receiving distributions under the beneficiary distribution rules. The beneficiary will not owe taxes on the inherited IRA assets until he or she starts to receive distributions.

These rule changes, which provide important options to non-spouse beneficiaries of employer-sponsored qualified retirement plan accounts, apply to all retirement plans as of 2010. For more information about your employer-sponsored retirement plan, consult the benefit plan administrator at your company. ■



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