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21st century retirement

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Playing by the IRA Rules

Even the rebellious at heart may choose to play by the rules governing Individual Retirement Accounts (IRAs) to avoid tax penalties. IRAs offer favorable tax-deferral benefits to individuals who are saving for retirement, but with those benefits come certain rules about when distributions may be taken. Contributions to a traditional IRA, depending on your income and participation in employer-sponsored plans, may entitle you to certain current income tax deductions. Further, because your funds are not taxed until distributions begin, your savings have the potential for tax-deferred growth. Generally, IRAs are designed to work as long-term savings vehicles, but you may be able to withdraw funds early and without penalty, provided your situation qualifies as an exception.

The Age 59½ Rule

The age 59½ rule stipulates that, if you take distributions from your traditional IRA before you reach the age of 59½, you may be subject to a 10% Federal income tax penalty in addition to regular income tax. However, you may not have to pay the 10% Federal income tax if your early distribution meets certain requirements.

Exceptions

You may be eligible for penalty-free qualified distributions, if one of the following exceptions applies:

1) You are taking qualified distributions as the beneficiary of a deceased IRA owner. If you inherit an IRA, there are stipulations outlining when you must begin taking distributions based on your relationship to the decedent. For nonspousal beneficiaries, *when* the IRA owner died, not the age of the beneficiary, determines when distributions must be taken; therefore, there is no penalty if the beneficiary has not yet reached age 59½. The age of the beneficiary will determine only the amount of the required minimum distribution (RMD). The same is true for spousal beneficiaries who do not opt to treat an inherited IRA as their own. The exception does not apply to spousal beneficiaries who opt to treat the account as their own IRA.

2) You are paying for certain first-time homebuyer expenses, generally referred to as qualified acquisition costs, such as buying, building, or renovating a first home. Distributions, which may not exceed $10,000, may be

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Entrepreneurship and the New Retiree

For an increasing number of people, retirement does not signal the end of a career, but the beginning of a new phase—entrepreneurship. Many Baby Boomers see retirement as an opportunity to start a new chapter in life, and plan to use their hard-earned knowledge and skills to create their own independent businesses.

With increased longevity, retirement often comprises 25%–30% of a person's life. According to the *2011 Retirement Confidence Survey* conducted by the Employee Benefit Research Institute (EBRI), around seven in ten workers plan to work in retirement. Certainly, financial reasons, such as paying bills and keeping health insurance or other benefits, are primary considerations in the decision, but retirees who work most often say they do so because they want to stay active and involved (92%) or enjoy working (86%).

Regardless of motivation, retired workers have many advantages when starting their own business ventures. By retirement, mortgages have often been paid and children have graduated from college. With fewer financial obligations—and perhaps a cushion from a lifetime of saving—retirees may have the opportunity and time to develop a strong business plan and concept. They also have the benefit of tapping into a seasoned network of business contacts and skills acquired throughout their working years to enhance product development, marketing, and sales.

Many Baby Boomers may find the opportunity of their dreams during their golden years. For example, prior to retirement, Bruce and Allison had thriving careers in accounting and travel services, respectively. After retiring, the couple quickly discovered that they were not content to stay at home and thought that combining their skills would serve them well in their own business endeavor. Drawing upon Bruce's bookkeeping expertise and Allison's years in customer service, the couple opened a Bed and Breakfast, which has allowed them to use their many talents in a new and challenging way.

If you want to use your years of experience and wisdom to create your own company, here are some questions to consider:

Are you personally motivated? Building a business requires intense dedication. You will need to develop your own ideas, set your own schedule, and manage a variety of responsibilities.

Are you a "people" person? Running your own business will likely involve interaction with various professionals and personalities. If you can harness the interpersonal skills you gained from four decades in the working world, you will be better prepared to handle difficult clients or professionals.

Do you have the ability to think quickly? Owning your own company may mean that you will have to provide answers and make decisions quickly, and sometimes under pressure.

Do you have passion and stamina? It is often said that you must love what you do. Realize at the start of the enterprise that a good deal of time and effort will be required.

Are you organized? Organizational and planning skills can lead to continued business success. Finances, invoices, and schedules are just a few of the tasks at which you must be or become proficient.

Is your energy level high? A business requires a lot of work, and it can be physically and emotionally stressful. Those who are energetic often do well because they are propelled by their desire to succeed and have the energy to follow through.

Will your family be supportive? A new business can consume a lot of your time, mental energy, and sometimes, capital. Make sure to tell your family what they can realistically expect from your business venture, and gain their support and trust.

There are many advantages to entrepreneurship, and many retirees are embracing the challenge. The chance to be your own boss and reap the rewards of your own hard work can make business ownership an exciting and educational adventure. Because a lack of experience can often account for many small business failures, decades of your work experience may put you ahead of the game—before it even begins.

Taxes and Your Retirement Destination

How would you like to spend your "golden" years? Do you want to live in an affordable condo on a golf course with extra room for visiting grandchildren? Would you like to remain in your community surrounded by friends and family? Or would you prefer a fresh start in a new locale that offers different cultural activities and recreational opportunities? Is easy access to certain medical providers and facilities a priority?

Besides considering these lifestyle choices, you may also want to research the effects of state tax structures on your projected retirement income as you decide where to live in retirement.

Let's take a look at the following key tax issues:

Earned and unearned income taxes. Do you plan to continue working during retirement? If so, it is important to know that some states treat senior citizens like everyone else on their income tax rolls; some give seniors special tax breaks on earned income, and others do not tax earned income for any residents. Tax rates on unearned income may also vary from state to state. Be aware that several states tax former residents on **Individual Retirement Account (IRA)** distributions. So, if you move, you may be required to file income tax returns in *two* states. Also, be sure to research any local income taxes that would apply to your circumstances.

Pension income taxes. In many cases, seniors receive important income from military, government, and private pension plans. Some states exempt all pension income from taxation, while others exempt certain types and/or amounts of pension income. Be sure you understand the applicable tax rules.

Social Security benefit taxes. Some states do not tax Social Security benefits at all, while others follow Federal tax formulas for determining the tax on such benefits. Still others have developed their own formulas to determine the income tax on Social Security benefits. Again, research the rules that will apply to your circumstances.

Property taxes. This is another area where some states and localities may offer advantages to seniors. Familiarize yourself with the relevant personal property tax laws, especially for cars and boats.

Sales taxes. Many states—and sometimes localities within each state—tax clothing, gas, household goods, and sometimes even food and prescription drugs. When you consider your retirement budget, remember to add state and local sales taxes, if applicable.

Estate taxes. While they do not *directly* affect your cost of living as a senior, do not overlook estate taxes when determining the feasibility of settling in one state over another. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Be sure to monitor changes in state estate tax codes as states seek ways to attract seniors.

While no *single* tax consideration will determine the most favorable environment for your retirement years, an analysis of your *overall* financial situation and options can help you choose a retirement destination that best suits your needs and interests, allowing you to enjoy your "golden" years. ■

Selling Your Home: Smooth Sailing into Retirement

When you think about your retirement years, do you imagine living in a new home or community? Whatever your choice of retirement haven, you may wish to sell your current home. To facilitate the sales process, consider the following points:

a) If you have already begun looking for a new home, place your existing home on the market as soon as possible to help minimize the chances of simultaneously owning two homes, along with their associated costs.

b) If you have decided to work with a real estate agent, ask friends for recommendations. Negotiate the commission *prior* to listing, and then sign for a limited period (such as three to six months). At that point, you may decide to switch agents.

c) Establish a fair asking price so your property does not sit on the market. For reference, obtain the recent selling prices of three properties in your area that are comparable to your own.

d) Hire an attorney with experience in real estate sales. Your

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selling your home: smooth sailing into retirement

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attorney can help protect your interests from the time a contract is signed until you receive the purchase check.

e) Consult with your tax professional. Selling a home can impact your Federal and state tax returns. In general, you can exclude up to $250,000 in real estate gains

($500,000 for married couples filing jointly) on property that was your principal residence for at least two years.

Many retirees choose to sell their homes. Following these tips can help make the home sales process go more smoothly. ■

playing by the IRA rules

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used to cover qualified costs for you, your spouse, your children, or your grandchildren.

3) You, your spouse, or dependents have unreimbursed medical expenses that total more than 7.5% of your adjusted gross income (AGI). If a medical expense for you, your spouse, or a dependent qualifies as an itemized deduction on your income tax return, it will generally qualify as an exception.

4) The distributions are part of a series of substantially equal payments that meet certain annuity criteria. The Internal Revenue Service (IRS) currently endorses three methods for determining an early distribution schedule: the life expectancy method, the amortization method, and the annuitization method. Once an early distribution schedule is established, it must be maintained for five years or last until you reach age 59½, whichever is later. Further, at least one distribution must be taken annually.

5) You qualify with certain physical and/or mental conditions as being disabled, determined by a physician, and if disability can be expected to result in death or continue for an indefinite duration.

6) You are paying medical insurance premiums due to unemployment. If you lost your job, and received unemployment compensation for 12 consecutive weeks, you may take distributions from your IRA account, penalty free, during the year in which you received unemployment compensation, or in the following year, but no later than 60 days after you have been re-employed.

7) You are paying for higher education expenses, such as tuition, fees, and books at an eligible educational institution (generally all accredited postsecondary institutions). The distributions may not exceed your qualified education expenses, or those of your spouse, your children, or your grandchildren.

8) The distribution is attributable to an IRS levy of the IRA.

9) Reservists qualify while serving on active duty for at least 180 days.

IRAs are strictly regulated to ensure that they are used as vehicles for retirement savings. Therefore, they generally work best as long-term savings vehicles. However, if you do need income from your IRA before you reach age 59½, it is important to know if your situation excuses you from the penalty tax levied on early distributions before making a withdrawal. Playing by the rules may save you money and help preserve your savings for retirement. Be sure to consult your tax advisor to determine whether your individual situation will qualify as an exception. ■

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