OAKLAND BUSINESS & Finance

Plan retirement distribution to save taxes

MORE THAN MONEY

SID MITTRA Ph.D

Congress has constructed an obstacle course in the form of distribution and excess accumulation rules that discourage retirement plan distributions that are not only *too early* or *too much*, but also *too late* or *too little*.

Inertia Can Be Dangerous — Plan participants sometimes develop a "sacred cow" mentality toward qualified plans, tax-sheltered annuities and IRAs (for simplicity, hereinafter referred to as "qualified plans") during their *saving years*. *Recognizing* the advantage of tax-deferred growth, they contemplate liquidating their tax-deferred plans only after exhausting all their other assets. But plan participants who defer retirement plan distributions until the minimum distribution rules apply at age 70½ face the following risk:

■ Being forced by the minimum distribution rules to take an excess distribution that is subject to a 15-percent excise tax.

■ Dying with a plan balance that subjects their estates to a 15-percent surtax for an "excess retirement accumulation."

Your Retirement Account May Be Larger Than You Think — Many people who do not consider themselves to be "wealthy" will find that, as time progresses, tax-deferred appreciation of assets and compounding of income are creating substantial qualified plan balances — possibly subjecting them to the above risks.

Planning Can Reduce Or Eliminate These Extra Taxes — Many plan participants can reduce or avoid the excess distribution/excess retirement accumulation taxes altogether through prudent planning.

■ Any distributions before age 70½, however, should be taken only after carefully weighing all of the participant's other financial and tax circumstances. For example, a thorough analysis may indicate that the advantages of tax-deferred growth outweigh any additional taxes.

Four Distribution Rules to Remember

Penalty For Early Withdrawal — Any distribution from a qualified plan prior to a participant reaching age 59½ will be taxed at the participant's ordinary income-tax bracket, plus a 10-percent excise tax. The excise tax does not apply to distributions (1) on account of certain medical expenses, (2) upon the death or disability of the participant, (3) after the participant separates from service after reaching age 55, and (4) that are made in the form of "substantially equal periodic payments" over the participant's life or the joint lives of the participant and his or her beneficiary.

Minimum Distribution Requirement — Minimum distributions must begin when the participant reaches age 70½. The required distribution generally consists of the amount accumulated in the plan divided by the participant's life expectancy. Joint and survivor beneficiary designations, such as the participant and spouse (or a child or grandchild), can be used to extend the distribution period. *Failure to take minimum required distributions on time results in an excise tax that is 50 percent of the distribution amount.*

Excess Distribution — Amount distributed in any one year from qualified plans in excess of $150,000 (as adjusted for inflation) — or a higher grandfathered amount elected on 1987 or 1988 federal income-tax returns — will be subject to an additional 15-percent excise tax.

Excess Retirement Accumulation — A 15-percent estate surtax on excess retirement accumulations at death complements the 15-percent excise tax on excess distributions during life. Such accumulations are defined as the amount by which the value of all qualified plans *exceeds* the greater of the unused grandfathered amount or the present value of a single life annuity of $150,000 (as adjusted for inflation) annually over the life expectancy of an individual at the decedent's age (using Treasury interest rates and mortality tables). For example, an individual 80 years old who dies owning retirement accounts with a combined balance of $2 million as of the estate-tax valuation date will have an excess retirement accumulation of $1,209,770, and the estate will have to pay an additional tax of $181,466, computed as follows:

Value of all qualified plans	$2,000,000
Less present value of single life annuity of $150,000 per year	(790,230)
Excess retirement accumulation	1,209,770
Special estate tax rate	15 percent
Estate surtax	$181,466

It is important to note that this estate surtax cannot be reduced by federal estate tax deductions (i.e., marital or charitable bequests) or credits (i.e., unified credit exempting up to $600,000 from estate tax).

Planning Tips

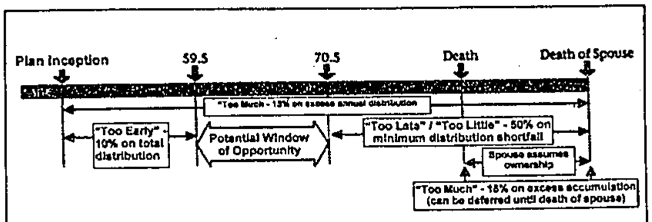
Consider Paying Income Taxes Early — By beginning distributions soon after turning age 59½, a participant can avoid the 10-percent early withdrawal tax, and may avoid the 15-percent excess distribution or excess accumulation taxes. Any distributions before age 70½, however, should be taken only after carefully weighing all of the participant's other financial and tax circumstances. For example, a thorough analysis may indicate that the advantages of tax-deferred growth outweigh any additional taxes.

Take Advantage of the Spousal "Takeover" Election — If a decedent's estate is liable for a surtax due to an excess retirement accumulation and the decedent's spouse is the sole beneficiary of the retirement plan, the spouse may defer or eliminate the surtax by electing to assume the ownership of the plan. The spouse can then name his or her own beneficiary and establish a new minimum distribution period, based on their joint life expectancy (subject to Treasury regulation limitations).

The accompanying chart illustrates the distribution excise taxes and the excess accumulation surtax, and highlights the period from age 59½ to 70½ when distributions can be taken to possibly avoid or minimize such taxes.

These are just some thoughts to consider. Your legal and tax advisor can provide more detailed information and should be consulted before any action is taken.

Sid Mittra, Ph.D., CFP, is professor of finance, Oakland University, Rochester Hills, and owner, Mittra & Associates, a Troy financial consulting firm. Deloitte & Touche supplied the material for this article.



BUSINESS MILESTONES

This column highlights promotions, transfers, hirings, openings and other key business news with Farmington-area connections. Send a brief biographical summary — including the towns of residency and employment and a photo, if possible, to: Business Editor, Farmington Observer, 33411 Grand River, Farmington 48335. The Observer's fax number is (810) 477-9722.

June Crafton Fiske of Farmington Hills has joined ERA Banker's Realty as a sales associate, according to John C. Ross, Member Broker of the Farmington real estate company.

Madison National Bank opened a new branch office in Farmington Hills located at 38386 12 Mile Road, east of Halsted Road.

Kara Kurtz, a 1991 Farmington High School alumna, is a new acquisition to Multi-Media Services of Alexandria, Va. She joined the Washington, D.C.-based firm as a media buyer to assist with the Bob Dole for President account during the national primary election.

Previously, Kurtz interned in the Washington offices of U.S. Rep. David McIntosh. She is a 1995 cum laude graduate of Ball State University, where she earned a bachelor of science degree in telecommunications.

Kurtz also volunteers at the Veteran's Hospital.

Charles Cobb has been named director of manufacturing at Inalfa Hollandia, Inc., a leading supplier of OEM electric-sliding sunroofs to the worldwide automotive industry.

Based in Farmington Hills, Inalfa Hollandia Inc. is one of North America's leading suppliers of roof systems to the automotive industry.

See MILESTONES, 8A