MFS ADVISOR EDGE®

RETIREMENT BASICS

Top IRA Planning Mistakes

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Talk with your investment professional, accountant or attorney today about these potential IRA planning issues and how best to address them.

1. Not naming or updating IRA beneficiaries

Not listing primary and contingent beneficiaries may result in the distribution of the IRA assets to the IRA owner's estate, resulting in accelerated distribution and taxation. Not keeping beneficiary designations current and coordinating them with other estate planning documents can also lead to conflicts and unintended results.

2. Not planning for taxes on an inherited IRA

Generally, a non-eligible-designated beneficiary has 10 years to liquidate an inherited IRA.[1] Timing the distributions to match low tax years or keeping distributions low enough to avoid higher tax brackets can potentially lower the total tax liability. Some beneficiaries, including your spouse, your minor children, disabled persons, chronically ill beneficiaries and beneficiaries who are not more than 10 years younger than you can take life expectancy payouts (the minor can only do that until they reach the age of majority and then switch to the 10-year rule).

3. Making inappropriate spousal rollovers

Most IRAs list the owner's spouse as the primary beneficiary. One of the most popular strategies for a spousal beneficiary is to simply roll the inherited IRA into his or her own IRA. But in some cases it can be more tax efficient for a surviving spouse to keep the IRA as an inherited beneficiary IRA or disclaim the assets, thereby allowing them to pass to the contingent beneficiary.

4. Not using a direct transfer

There are two ways to move funds between IRAs: indirect rollover and direct transfer. In an indirect rollover, you withdraw funds from one IRA and deposit the same amount into another IRA. This must be completed within 60 days and can be done only once a year. Also, a nonspouse beneficiary cannot do an indirect rollover. The failure to follow these rules could result in a taxable distribution. In a direct transfer, a financial institution issues payment directly to another financial institution; this is not subject to the 60-day/once-a-year rules regarding indirect rollovers.

5. Rolling low-cost-basis company stock into an IRA

Distributions from a qualified plan such as a 401(k) are generally taxed as ordinary income. If company stock is rolled into an IRA, future distributions are taxed as ordinary income. If, instead, the company stock is taken as a lump-sum distribution from the qualified plan, only the cost basis of the stock is taxed as ordinary income. (Note: The distribution must be taken as stock, not cash.) Unrealized capital appreciation (the difference between the cost basis and current fair market value) is not taxed until the stock is sold, at which time it is taxed as long-term capital gains, which for many is a lower rate than ordinary income. Be sure to talk with your tax advisor. Keep in mind that there are advantages and disadvantages to an IRA rollover, depending on the investment options, services, fees and expenses, withdrawal options, required minimum distributions, tax treatment and your unique financial needs and retirement goals. Your investment professional can assist in determining if a rollover is appropriate for you. If any of these issues apply to your situation, be sure to discuss them with your investment professional, accountant or attorney so you can avoid what might be a costly mistake.

[1] If the IRA Owner died before 1/1/2020, different rules apply. Consult your tax advisor. Some beneficiaries will need to take distributions during the ten-year window.

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See next page for more top IRA planning mistakes.

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6. Not taking advantage of a Roth IRA

A Roth IRA is a potentially valuable retirement resource. Not only are qualified withdrawals tax free, but Roth IRA distributions do not impact the taxability of Social Security and Roth accounts pass to beneficiaries tax free as long as the decedent opened a Roth IRA more than 5 years ago. There are income limits that affect eligibility for a Roth IRA, so be sure to discuss this option with your investment professional.

7. Not taking advantage of maximum contribution limits

The contribution limit for 2023 was $6,500. For 2024 it will increase to $7,000. IRA owners age 50 or older can make an additional $1,000 catch-up contribution.[2]

8. Assuming that a nonworking spouse cannot contribute

The truth is that separate "spousal" IRAs may be established for spouses with little or no income up to the same limits as the working spouse.

9. Taking the wrong required minimum distribution (RMD)

Once IRA owners turn 73,[3] they are required to take the RMD out of their account each year, based on the value of all their non-Roth IRAs. Those who do not take enough out each year may be subject to a federal income tax penalty of the amount that should have been taken as an RMD but was not.[4] Consolidating retirement assets may make it easier to manage these distributions.

10. Not considering Qualified Charitable Distributions

Once you reach age 70½, you can make donations of up to $105,000[5] to a qualified charity directly from your IRA. If this is done correctly, the distribution is not taxable income. For many taxpayers, this results in a lower tax liability than withdrawing from the IRA and then donating the proceeds to a charity. Please consult with your tax advisor for alternative gifting options.

11. Paying unnecessary penalties on early (before age 59½) IRA distributions

Early (before age 59½) IRA distributions may be subject to a 10% penalty tax under IRS Code Section 72(t), but there are several exceptions. One method to avoid the penalty is to take distributions in substantially equal periodic payments, at least annually, over the life or life expectancy of the employee or over the joint lives or joint life expectancies of the employee and the employee's designated beneficiary. There are three permitted calculation methods to determine the amount of the distributions. Payments must continue for five years or until age 59½, whichever is the longer period of time.

[2] Source: www.irs.gov

[3] Under the "Setting Every Community Up for Retirement Enhancement Act" of 2019, as revised in 2022 ("the SECURE Act 2.0"), the required beginning date of RMDs is raised from age 72 to 73 for any person who attains age 72 after December 31, 2022. There is no change to RMDs for people who turned age 72 prior to January 1, 2023.

[4] In 2023, the SECURE Act 2.0 reduces the IRS penalty for taking out less than your full RMD from 50% of the underpayment to 25% (10% if corrected in a timely manner). You should consult your investment professional or tax advisor about your specific situation.

[5] The $105,000 limit may be reduced by deductible IRA contributions made after age 70½.

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