Five Common IRA Mistakes

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Don't make a costly mistake with one of your biggest retirement assets.

IRAs can be great retirement planning tools. All too often, however, people make mistakes in handling their IRAs—mistakes that can be costly. Here are five common IRA errors to avoid:

1 Taking receipt of qualified plan distributions—Some people planning IRA rollovers are unaware of the tax problem they create when they ask for qualified plan distributions to be sent to them, rather than directly to a new IRA custodian. Tax laws mandate that 20 percent of an "eligible rollover distribution" be withheld for income tax purposes if the check is made out to the individual. An "eligible rollover distribution" is a distribution of any or all of an employee's balance in a qualified plan, such as a 401(k) plan, with a few exceptions. You can avoid this mistake by rolling funds directly to your new IRA custodian.

2 Double distribution—Federal law requires you to take minimum distributions from your traditional IRA the year you reach age $70\frac{1}{2}$. However, you technically have the option to defer the Required Minimum Distribution (RMD) until April of the following year. Be careful, making the choice to wait may not be the best decision. If you choose to wait until the next year to take your first RMD you will have a "double distribution". Two withdrawals in one year might push you into a higher income tax bracket. Work with a financial professional to determine the best timing for your first RMD.

3 Beneficiary not current—Your IRA may have been created some time ago. Have you updated your beneficiary designations as circumstances changed? For many people, the answer is no. Be sure to review your beneficiary designations at least annually.

4 Naming the estate as beneficiary—When you name your estate as beneficiary of your IRA, it creates several problems. Your IRA becomes an asset of your estate and must go through the costly and time-consuming process of probate. Even worse, the entire account balance may have to be distributed to the estate by the end of the fifth year after the year of your death. This rapid payout may make for a large tax bill and the loss of future tax-deferred growth for your loved ones. If possible, name individuals—rather than your estate—as your IRA beneficiaries.

5 Holding IRA with restrictive custodian—Some IRA custodians require a five-year payout of an IRA account balance after the death of the IRA owner. If you find out that your custodian has such a policy, you may want to transfer your IRA to a more flexible custodian during your lifetime.

Your IRA may be one of your most significant retirement assets. To ensure that it is handled wisely, review your financial situation with a qualified professional on a regular basis.

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