We all make retirement decisions, though some make them more quickly, more efficiently, more wisely than others. A safe and secure retirement begins with the foundational knowledge you can use to choose the best financial advisor, ask the right questions and take a proactive role in your retirement planning.

It is important to work with a financial advisor who is aware of the latest IRA distribution and tax rules. These rules are complicated, and full of tax traps that could cost you your retirement dreams. If our current economic situation has taught us anything, choosing an educated financial advisor is essential to keeping more of your hard-earned money.

I do not sell investment products. I do not earn commissions. I simply believe that a comfortable retirement starts with accurate IRA advice. I am here to educate.

This is the message behind this guide, which will provide you with 86 essential ways to save and stretch your wealth so that you can spend your golden years how you have planned and envisioned them.

I hope you find my Retirement Decisions Guide educational and useful.

Ed Slott, CPA
Ed Slott and Company, LLC
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1. Plan now and retire twice as rich

Studies show that people who become educated about their finances and play a role in planning and monitoring their IRAs wind up twice as rich as those who haven’t a clue. Consider these three facts from a recent Dartmouth/Wharton study:

- **Wisdom pays**—Retirement planning is a strong predictor of retirement wealth. If you learn how money grows and how much you will need at retirement, you are much more likely to achieve your stated goals.
- **Money grows**—Those who plan are more likely to end up at retirement with twice the wealth of those who do not plan.
- **Start early**—Those who are financially literate when young are more likely to plan for retirement.

2. Avoid past years’ mistakes

The recent recession was painful for most IRA investors. But valuable lessons were learned:

- **Get IRA advice.** If you are unsure what to do, consider hiring a financial advisor who understands IRA portfolio allocation, tax issues, diversification, distribution planning, hedging and emotional handholding.
• **Keep some cash.** Setting cash aside in your IRA will buffer your portfolio against downturns and let you invest when share prices are low.

• **Know your mix.** Proper allocation among stocks and bonds—and diversification among different stock and bond classes—is essential.

• **Stocks aren’t certain.** Stocks are volatile, and stock-price growth comes after long periods of time. Even after 15 years, stock values can suddenly decline or remain flat for a period. Ease volatility by investing in a strategic mix of assets—such as stocks, bonds, annuities, cash, real estate and other investments.

• **Bonds have risks.** Many investors shooting for income invested in individual bonds. But as we know now, any company—including “safe” ones—can go belly-up. That’s why bond investments need to be highly diversified among many different types of fixed-income securities, through bond funds or individual bonds.

• **Recessions end.** While severe market downturns cause tremendous anxiety, they eventually end. That truth is hard to believe when markets are perilously low, headlines are frightening and IRA statements look foreboding. But they do.

### 3. What are the IRA rules for 2013?

**Contribution Levels**

• **Up to age 49**—$5,500 for 2013
  (Visit IRAhelp.com/2013 for all 2013 IRA and tax tables.)

• **Age 50 onward**—$6,500 for 2013
  (Visit IRAhelp.com/2013 for all 2013 IRA and tax tables.)

**Conversion Eligibility**

**Everyone qualifies** to convert a Traditional IRA or SEP IRA to a Roth IRA. After a two-year waiting period, SIMPLE IRAs can also be converted. Income restrictions on a conversion were repealed starting in 2010.
4. Do these myths sound familiar?

Many people who don’t save enough in a 401(k) and IRA typically have five reasons why not. But those feel-good excuses are flawed. Here’s why:

• **Myth: Taxes will be lower.** Many people believe that when they retire, their tax rates will be lower because they won’t be earning as much income. But those assumptions are based on today’s tax brackets—which are at historic low levels. There’s nothing stopping the government from raising them in future years. So withdrawals from a Traditional IRA years from now could actually face higher income taxes—even if you’re not working.

• **Myth: You’ll work longer.** When portfolios were down recently, many people shrugged and said they’ll just have to work longer. Sounds good, but here’s a stark fact: As you age, the odds are you physically won’t be able to work as hard as you want—or as long as you once did.

• **Myth: Pensions will kick in.** As we know now, even the healthiest of companies file for bankruptcy. Or restructure. Or face such hardships that they roll back benefits they once promised. This can include government and public pensions that were once thought to be secure.

• **Myth: Social Security starts at 62.** That’s true—now. But there’s nothing to say that the federal government won’t raise the minimum age at which benefits start—or reduce benefits for those at specific income levels.

• **Myth: Inheritances will arrive.** Don’t count on it. Many seniors are living longer today thanks to dietary changes and moderate exercise. Even when aging adults grow ill, medical care is so good that infirmities can be controlled and minimized for years. Lucky you—mom and dad will live forever!

5. Why bother saving in an IRA?

If you’re contributing to a 401(k) at work, you may be wondering why you need an Individual Retirement Account (IRA). Or you may feel you can’t afford to save the max in both. But opening and saving even a little in an
IRA is important. Here’s why:

- **Tax-free growth.** Assets in an IRA grow tax-free—meaning there are no taxes on capital gains when you sell assets within the account. Taxes are paid upon distribution.

- **Tax deduction.** You can always deduct your full Traditional IRA contribution if your modified adjusted gross income in 2013 is less than $95,000 (married filing jointly) or $59,000 (single) (visit IRAhelp.com/2013 for all 2013 IRA and tax tables).

- **Investment freedom.** Unlike a 401(k), which typically offers a small menu of mutual funds, an IRA lets you invest in any securities you wish. In addition, you can use an IRA to diversify your total retirement portfolio by investing in assets not offered by your 401(k).

- **Long-range planning.** When you eventually leave your job, you will almost certainly wind up transferring the balance of your 401(k) into an IRA for greater investment choices, control and efficiency. You may as well open one now, even if you don’t contribute the max each year. Many online brokerages waive annual fees for some IRA accounts.

6. **What is a Traditional IRA?**

The Individual Retirement Account (IRA) was created in 1974 with the enactment of the Employee Retirement Income Security Act (ERISA). The original version is commonly called a “Traditional IRA,” which distinguishes it from other types of IRAs that have been introduced over the years. What you need to know about a Traditional IRA:

- **Contributions.** Each year you may contribute up to an amount set by the tax law—provided you earned at least that sum in salary or self-employment income. The max you can contribute is based on whether you are age 49 or younger—or age 50 or older (visit IRAhelp.com/2013 for current levels).

- **Deadline.** Annual contributions can be made until April 15 of the following year.

- **Deduction.** If you are covered by a company plan, you can deduct your annual contribution if you meet the latest income levels (visit IRAhelp.com/2013 for the current levels).

- **Gains.** Gains on assets in an IRA are not taxed until they are
withdrawn, giving assets an enormous opportunity to compound and grow over time.

- **Withdrawals.** The Traditional IRA was created to encourage retirement savings. So withdrawals before age 59 ½ face both income tax and a stiff 10% penalty. You can withdraw penalty-free starting at age 59 ½—but withdrawals aren’t mandatory. Starting at age 70 ½ you are required to take annual distributions based on the IRS’ life-expectancy table.

- **Taxes.** Withdrawals face income taxes at your tax rate at the time.

- **Heirs.** The person or persons you want to receive your assets upon death should be named in your IRA beneficiary document. IRA assets shouldn’t be passed through your will.

### 7. What is a Roth IRA?

The Roth IRA was named for William Roth, a U.S. senator from Delaware who sponsored the Taxpayer Relief Act of 1997. Here’s what you need to know:

- **Qualifications.** Only taxpayers with specific income levels can open and contribute annually to a Roth IRA (visit IRAhelp.com/2013 for the latest qualifying levels).

- **Contributions.** Each year you may contribute up to an amount set by the tax law, provided you earned at least that sum in salary or self-employment income. The max you can contribute is based on whether you are age 49 or younger—or age 50 or older (visit IRAhelp.com/2013 for the latest levels). Annual contributions can be made at any age.

- **Deadline.** Annual contributions can be made up until April 15 of the following year.

- **Deduction.** There is no tax deduction for contributions to a Roth IRA.

- **Gains.** Gains on assets in a Roth IRA are generally not taxed, giving them an enormous opportunity to grow and compound over time.

- **Withdrawals.** Assets in a Roth IRA may be withdrawn after age 59 ½ tax-free if any Roth was opened five years earlier. That means every dollar growing in a Roth IRA can be yours to keep. In addition, there is no mandatory withdrawal age, meaning assets can continue to grow tax-free.
Chapter 1 | IRA Basics

- **Penalty.** Gains withdrawn before age 59 ½ will face a 10% penalty plus taxation.

- **Heirs.** The person or persons you want to receive your assets upon death should be named in your Roth IRA’s beneficiary document. Roth IRA assets shouldn’t be passed through your will.

- **Inheritance.** Upon death, a Roth IRA can pass estate-tax free to a spouse. Or it can pass to one or more non-spousal beneficiaries, though part of the assets may be needed to pay estate taxes. Non-spouse heirs must take distributions based on their life expectancies set by the IRS. But the required annual distributions are generally income-tax free. The only catch is that the Roth IRA had to have been set up at least five years before the distribution.

8. **What is a SEP IRA?**

A Simplified Employee Pension Individual Retirement Account (SEP IRA) is an IRA for the self-employed or small-business owner. The rules for a SEP IRA are the same as for a Traditional IRA (see tip #6)—with the following exceptions:

- **To qualify.** You must be a self-employed individual or small-business owner (with or without employees) whose venture generates income. You can open a SEP IRA even if you work for an employer and participate in another retirement plan—provided your side business generates income and complies with certain ownership guidelines.

- **Contributions.** You can contribute up to 20% of net earnings from self-employment—(25% if incorporated)—but not to exceed annual amounts set by the tax law (visit [IRAhelp.com/2013](http://IRAhelp.com/2013) for the latest levels). If your business has employees, all employees must receive the same benefits under a SEP IRA plan. Unlike a Traditional IRA, you can continue to make contributions to your SEP IRA after age 70 ½, if you are still working for the company.

- **Taxes.** Contributions are deductible dollar for dollar. This means if you contribute $25,000 to your SEP IRA, you can deduct this amount from your income on tax returns. This feature makes SEP IRA contributions highly desirable from a retirement-planning and tax-savings standpoint.
9. Which IRA is right for you?

- **What’s your income?** If your income level is under the eligibility threshold, open a Roth IRA.
- **Are you self-employed?** Open a SEP IRA and contribute up to 20% of your net income (25% if you’re incorporated)—but not more than the annual amounts set by the tax law (visit IRAhelp.com/2013 for the latest levels).
- **Do you have kids?** Open a Roth IRA for teens with salaried summer jobs. You can make the contributions on their behalf. So, if your child earned $2,000 over the summer, you can contribute up to that amount in his or her Roth IRA. They will thank you when they retire and can withdraw the accumulated assets tax-free.

10. Easy way to save $36,000

You can easily contribute at least $1,326 a year to an IRA. Here’s how: The average American winds up with $5.50 in spare change each week. Pool the coins along with $20 a week in stray singles, and you’ll have $1,326 by year’s end. Why bother? If you continue to contribute this sum annually for 15 years, and your IRA account earns a modest 6% annually on a compounded basis, you will wind up with nearly $36,000. That’s hardly chump change.

11. What is a Roth IRA conversion?

The tax code lets you convert all or part of your Traditional IRA or SEP IRA to a Roth IRA. Prior to 2010, the IRS allowed such a conversion—but only if your annual income did not exceed $100,000. But starting in 2010, this income threshold was waived. That means anyone can convert a Traditional IRA into a Roth IRA—regardless of annual income. What you need to know:

- **Benefit:** A Roth conversion grants you all the benefits of a Roth IRA—including tax-free withdrawals of earnings after five years of ownership and after reaching age 59 ½.
12. **Does a Roth IRA conversion pay?**

In many cases, the answer is a resounding yes. If you can pay the income tax due on the portfolio’s market value at the time of conversion, the move is a powerful one.

- **Here’s why:** Historically, today’s income-tax rates are relatively low. A conversion allows you to pay income tax at the current rate and get rid of Uncle Sam for life. So, for example, if a $500,000 portfolio in a Roth IRA grows to $1 million in 15 years, all of those dollars are yours. And you get to enjoy all of the benefits of a Roth IRA, including no mandatory withdrawals.

13. **Roth IRA conversion questions**

Converting your Traditional IRA to a Roth IRA is a terrific deal. Anyone can do this—regardless of annual income, but you will owe income tax on the conversion. Five big questions:

- **When doesn’t it pay?** If you expect your income to decline in retirement and tax rates to be where they are now, a Roth conversion might not be ideal. That’s because the tax hit on your withdrawals from a Traditional IRA in the future will likely be lower than what you would have to pay now to convert.

- **How is a conversion taxed?** If you convert part or all of a Traditional IRA to a Roth IRA, you will owe income tax on the assets’ market value on the date of conversion. But if you have made nondeductible IRA contributions, you have to follow the IRS’ pro-rata tax rule, which can be tricky. Consult a financial advisor or an accountant with specialized knowledge in this area.

- **How to cover the tax?** Ideally you want to use funds in taxable accounts to pay the tax. It doesn’t make sense to tap an IRA or 401(k) to pay taxes and a 10% early-withdrawal penalty if you’re under age 59 ½.

- **Can the tax be minimized?** Sure. Convert only part of the Traditional IRA.
• What about a SEP IRA? Yes, you can convert part or all of a SEP IRA. If you convert the entire SEP IRA, however, you can’t continue making deductible contributions to your newly created Roth IRA. Instead, you’ll have to set up a new SEP IRA account for future deductible contributions.

14. Yes, current tax rates are low

Federal income tax rates are at historic lows. Even if you’re paying a top federal rate of 39.6%, your rate is relatively low and may rise to pay for the new wave of government spending and deficits. (For a look at the 2013 tax rules, see pages 49-52.) Over time the top tax rate has been as high as 94%. Remember, the government can change the tax rates at any time for all taxpayers or just for those who earn more than a specific level:

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<tr>
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<tr>
<td>1988-1990</td>
<td>28%</td>
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<td>92%</td>
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<td>1946-1951</td>
<td>91%</td>
</tr>
<tr>
<td>1944-1945</td>
<td>94%</td>
</tr>
</tbody>
</table>
15. What’s a Roth recharacterization?
A Roth IRA “recharacterization” is a Roth IRA conversion do-over.

- **How it works:** Let’s say you converted your Traditional IRA to a Roth IRA. You owe income tax on the value of the assets on the date of conversion. But let’s say that in the same tax year, the value of the portfolio you converted tumbles significantly. You’d still owe the original income tax—even though the portfolio’s value was much higher then. Not fair!

- **Solution:** If you recharacterize the Roth IRA back to a Traditional IRA, you will no longer owe the tax from the conversion. Plus you can re-convert at a later time and pay only the tax on the lower amount.

16. Who’s your IRA beneficiary?
No matter what kind of IRA you own, request a copy of your signed beneficiary form for review. When you receive it, be sure that the people you want to inherit your IRA’s assets are listed properly. Also provide your advisor and estate attorney with copies of the signed document.

- **Reason:** When you die, your IRA does not pass according to wishes in your will. Whatever IRA assets are left will pass to the person or persons named in your signed beneficiary document.

17. Inheriting an IRA: Spouse
Under the tax law, if you inherit a spouse’s IRA, there are no estate or income taxes due—no matter how large your inheritance. But you have three choices regarding how to treat the IRA inheritance:

- **Option #1: You can roll** the inherited IRA assets into your existing IRA or one you set up.

- **Option #2: You can transfer** the inherited IRA assets into an Inherited IRA account. If your spouse was age 70 ½ or older, you must begin taking mandatory distributions by December 31st of the year following your spouse’s death. If your spouse was younger than age 70 ½, you can delay distributions until your spouse would have turned age 70 ½.
• **Option #3: You can disclaim** all or part of the IRA inheritance within nine months of the IRA owner’s death. You do not get to choose who is next in line to receive the disclaimed property. Instead, the assets will pass to the IRA’s contingent beneficiary, as if you had died before the IRA’s owner. Since the assets will be passing to a non-spouse, estate taxes may be owed based on the value of the IRA.

18. **Inheriting an IRA: Non-spouse**

If you inherit an IRA from a parent or someone who isn’t your spouse, you have three choices:

• **Option #1: Take distributions.** Whether you inherit a Traditional IRA or a Roth IRA, you cannot roll the assets into your existing IRA as a non-spouse. Instead, you must set up an “Inherited IRA” and have the assets transferred directly in there. Rules…

  1. Begin taking minimum distributions from the Inherited IRA by December 31 of the year following the IRA owner’s death.
  2. Minimum annual withdrawals are based on your life expectancy set by the IRS (visit IRAhelp.com/2013 to view the IRS table).

• **Option #2: Take the total.** You can choose to take the full value of the inherited IRA as a lump-sum check. You will owe income tax on the sum if you inherited a non-spousal Traditional IRA. If you inherit a Roth IRA, you may owe income tax on earnings if the account is less than five years old.

• **Option #3: Disclaim it.** Your third option is to disclaim the inheritance within nine months of the IRA owner’s death. Why would you do this? In most cases it’s done to pass the inheritance to the next-in-line beneficiary who may need it more than you do.

• **Ed Slott’s advice:** Consult an IRA advisor on the appropriate choice. If you decide to take annual distributions or a lump sum from an inherited Traditional IRA, see if you can claim the IRD deduction (“income in respect of a decedent”). It’s a deduction
for non-spousal inheritors of a Traditional IRA on which federal estate taxes were paid (see tip #85).

19. Did you inherit a Roth IRA?

- **If you’re the spouse**—you can roll the inherited Roth IRA into your existing Roth IRA or a newly set-up Roth IRA. Then you can avoid taking distributions for life if you choose. You also can retitle the Roth IRA as your own. Either way, upon inheriting, you should immediately name heirs on the beneficiary form. When non-spouse heirs inherit from you, they will have to take required minimum distributions each year, although they can stretch them out over their lifetime—income-tax free.

- **If you’re a non-spouse**—you have to take required distributions based on the IRS’ single life-expectancy table (visit IRAhelp.com/2013 to view the table). But the mandatory annual required distributions will be tax-free.

20. Beware of this costly IRA penalty

If you’re a non-spouse who’s inheriting a Roth IRA, you have to set up an “Inherited Roth IRA” to receive the assets.

- **Big trap:** Be sure to take the required minimum distribution (RMD) each year based on the IRS’ life-expectancy table (visit IRAhelp.com/2013 to view the table). If you don’t take the distributions, you will owe a 50% penalty on each RMD you missed—even though the distribution remains tax-free.