Retirement Distribution Planning

Life's Goals

Congratulations...

You've worked long and hard and now you're looking forward to retirement. Finally, you can focus on the things that are important to you – family, travel, or just taking it easy. And according to the 1999 AARP Profile of Older Americans, chances are very good that you'll spend many years – nearly two decades – enjoying retirement. The intent of this booklet is to help you consider the most effective method of funding those years.

Over your working life, you probably had a number of options when it came to setting aside money for retirement.

- If you worked for a corporation or other business, you very likely had access to a defined benefit pension plan, a 401(k) Plan, or a profit sharing plan.
- If you were self-employed, you might have put money aside into a Simplified Employee Pension Plan (SEP), a Savings Incentive Match Plan (SIMPLE), an Individual Retirement Account (IRA), or some kind of Executive Bonus or Deferred Compensation Plan.
- If you worked in a school system or tax-exempt organization, you might have saved money in a 403(b) Plan.
- If you worked for the government or for some other tax-exempt organization, you might have put money into a 457 Plan.
- And of course, at various times and for various reasons, you might also have purchased annuities, certificates of deposit, and/or cash value life insurance policies.

In short – you may have money tucked away in a number of financial vehicles – and you may very well be counting on this money to see you comfortably through retirement. But regardless of how or where you've accumulated your retirement assets, it is now very important that you give careful thought to how and when you will access those assets – in other words, that you develop, and implement, a retirement distribution strategy.

A carefully thought-out retirement distribution strategy will not only help ensure that you don't outlive your assets, but it will help you avoid paying unnecessary taxes and/or penalties on assets that should otherwise be earmarked for your personal enjoyment or left – intact – to heirs. At the very least, such a strategy will help you achieve your personal and financial goals and objectives on a tax-favored basis.

First Things First

Before you can develop a retirement distribution strategy, you must first understand the difference between your "qualified" and "non-qualified" accounts.

Your qualified accounts contain assets upon which you have never paid income taxes. Thus, you will owe income taxes on every dollar you withdraw from your qualified plan assets. Typically, your qualified money will be in the following types of accounts:

- Traditional IRAs
- Employer sponsored retirement plans such as 401(k), 403(b), and eligible 457 Plans
- Self-employed retirement plans such as Simplified Employee Pension (SEP IRA) and Savings Incentive Match Plan for Employees (SIMPLE IRA).

Your non-qualified accounts include assets you purchased with after-tax dollars. Thus, you will only owe income taxes on the growth of those assets. Your non-qualified accounts are most likely comprised of:

- Individual or business-owned fixed or variable annuities
- Roth IRAs
- Certificates of Deposit
- Life insurance cash values
- Individually owned stocks, bonds, or mutual funds.

There are a number of rules and regulations – some of them quite complicated – governing retirement distributions from your qualified accounts, including when you can (or must) begin taking such distributions and, in some cases, how much you are required to withdraw. Failure to abide by these rules and regulations can result in severe tax penalties.

Note: If an annuity is held within a qualified account it offers no additional tax benefits than those offered by the qualified account.

Understanding which accounts you can access without being subject to penalties and tax consequences can be complicated, and it's one of the primary reasons that many people consolidate their qualified retirement assets – generally into an IRA or tax-deferred annuity – when they retire or change jobs. Other events that can trigger a distribution from a retirement plan include death, disability and/or hardship. The advantages of adopting a consolidation strategy include:

- Increased control over investment choices.
- Increased control over when distributions must be taken.
- Fewer management fees.
- Ease of record keeping – it can get confusing trying to keep track of retirement assets accumulated with multiple employers or spread among multiple accounts.
- More beneficiary choices. You don't need spousal consent to select a different beneficiary (except in states with community property laws).
- Greater post-death distribution options.

But be careful. Not all qualified retirement assets can – or should – be consolidated. Examples of assets which cannot be consolidated or rolled over into an IRA or annuity include:

- Required minimum distributions
- Withdrawals taken under a hardship provision
- Distributions that are not included in gross income
- Elective contributions that are returned to you in order to satisfy the limits that are imposed on qualified plans
- Loans in default, which are thus deemed "distributed"
- Dividends on employee stock ownership plans.

Your financial advisor can help you determine which accounts can be rolled over into an IRA or annuity, and which should (or must) be left where they are.

Other Distribution Considerations

As you look ahead to retirement and think about putting together a retirement distribution strategy, there are, of course, many things to consider and many unknowns. What will your ongoing expenses be? How will inflation affect your spending power? Will you be able to afford ever-increasing property taxes and home maintenance costs, or will you be forced to move to a less expensive home? What about potential health-related or long-term care expenses? And finally, what about leaving something behind for your heirs or providing for a favorite charity?

Of course, you cannot know for certain what will happen with the economy, with your personal health, or how long you will live, but it is nonetheless very important that all of these factors be incorporated into your retirement distribution strategy. You will also want to consider how much income you'll receive from other sources such as Social Security, ongoing employment and/or a company pension.

A good way to start is to calculate your anticipated monthly expenses in retirement.

Rent or mortgage	______
Property taxes/maintenance fees	______
Utilities (phone, gas, electric, oil)	______
Insurance (home, auto, life, long-term care)	______
Groceries	______
Automobile	______
Clothing	______
Vacations	______
Credit cards / loans	______
Ongoing savings/investments	______
Miscellaneous	______
Total:	______

Next, calculate the income you expect to receive from other sources:

Social Security (monthly benefit)	______
Social Security (spouse's benefit)	______
Company pension	______
Disability benefits	______
Ongoing employment	______
Investment income (interest, dividends, rents, etc.)	______
Other	______
Total:	______

Finally, subtract your anticipated monthly expenses from your anticipated monthly income. If the result is negative, this is the amount you will need to make up, each month, from your retirement savings. Keep in mind that inflation and other cost-of-living increases will likely increase this monthly need as the years go by.

Finally, make a list of your total current retirement accounts.

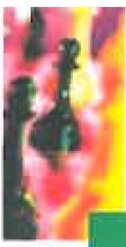
Qualified Accounts

Account	Amount
Pension	______
401(k) Plans	______
403(b) Plans	______
457 Plans	______
SEP/SIMPLE Plans	______
IRAs	______
Other	______
Total:	______

Non-qualified Accounts

Account	Amount
Annuities	______
CDs	______
Life insurance cash values	______
Stocks	______
Bonds	______
Treasury Notes	______
Mutual Funds	______
Deferred Comp. or Executive Bonus Plans	______
Personal savings	______
Other	______
Total:	______

Once you've come as close as you reasonably can to determining your annual expenses and income from sources other than your retirement savings, you'll be in a good position to begin planning your retirement distribution. And if you're like many successful people, you may find that you require very little, or even no, access to your qualified retirement accounts at all – you can leave them just as they are to continue enjoying tax-deferred growth. Unfortunately, our country's tax laws don't give you that option. Current tax law dictates the date in which you must begin receiving "required minimum distribution" from your qualified accounts.



Understanding Required Minimum Distributions

A required minimum distribution (RMD) is the minimum amount of money that you must withdraw from your qualified accounts each year. Generally, your first RMD must be taken by April 1 of the year after you reach age 70H*, regardless of whether or not you need (or want) the money. Thereafter, minimum distributions must be taken each year by December 31. Failure to take an RMD in a given year will result in a 50% excise tax on the amount not taken – a fairly severe penalty.

Calculating the size of the distribution you must take each year is based on a formula that divides your end-of-the-year qualified account balances by an age-based factor found in the IRS's "Uniform Lifetime Table." (See Tables below.)

Uniform Lifetime Table

Age of Owner	Factor
70	27.4
71	26.5
72	25.6
73	24.7
74	23.8
75	22.9
76	22.0
77	21.2
78	20.3
79	19.5
80	18.7

Joint and Last Survivor Table
(Used only when spousal beneficiary is 10+ younger)

Age of Owner	Age of Spouse	Factor
70	50	35.1
71	51	34.2
72	52	33.2
73	53	32.3
74	54	31.4
75	55	30.4
76	56	29.5
77	57	28.6
78	58	27.7
79	59	26.8
80	60	25.9

To further understand how required minimum distributions work, let's look at two examples based on the above Tables.

* In certain circumstances, your required beginning date may be later if the account is held within a qualified retirement plan. See your tax advisor for guidance on your specific circumstances.

Sample RMD Calculations:

Let's assume you are a retired individual, age 77, and that you are taking required minimum distributions from your IRA. Your IRA balance on December 31 is $500,000, and you've named your spouse, age 70, as your sole beneficiary. Using the "Uniform Lifetime Table," the formula for calculating next year's minimum distribution is as follows:

IRA balance / Applicable RMD factor = Required Minimum Distribution (RMD)

Now let's use that formula to run a sample calculation:

IRA Balance / Applicable RMD Factor	=	RMD
$500,000 / 21.2	=	$23,584.90

Using the above minimum distribution formula, your required minimum distribution next year – *the amount you must withdraw from your qualified retirement accounts* – would be $23,584.90.

Not all minimum distributions, however, will be calculated in this manner. If your sole beneficiary is your spouse, and if your spouse is more than 10 years younger than you are, the "Joint and Last Survivor Table" must be used, which would result in an even lower RMD. Let's use the same example as above, but this time, let's assume your spouse is 57 years old. In this case, we'll apply the applicable RMD Factor from the "Joint and Last Survivor Table," resulting in the following smaller, required minimum distribution:

IRA Balance / Applicable RMD Factor	=	RMD
$500,000 / 28.6	=	$17,482.51

Choosing minimum distributions as a retirement distribution strategy can provide a number of benefits, chief among them the ability to continue enjoying tax-deferred growth on the balance of your qualified assets.

Another Kind of "Minimum Distribution"

Not everyone has the option – some might say the luxury – of waiting until retirement to consider how they will take retirement distributions. And at retirement, not everyone has the luxury of taking just the minimum distributions. Unexpected job transitions, downsizing, health concerns – to name only a few factors – could require that you begin withdrawing from your retirement accounts prior to retirement and perhaps even prior to age 59H.

It is also possible that, while you could wait until "normal" retirement age to begin taking retirement distributions, you simply choose not to. Perhaps you want to retire early while you're still young and have plenty of time to pursue other interests.

Regardless of your age or the reason you want (or require) early access, there is a way to begin withdrawing from your retirement accounts early without having to pay the tax penalties that are generally levied against individuals who receive funds prior to age 59H.

IRS Code 72(q) and 72(t)

If your retirement distribution strategy – or if necessity – requires you to begin accessing your qualified accounts (and non-qualified annuities) prior to age 59H, you can do so without being subject to the 10% federal tax penalty by taking advantage of IRS Codes 72(q) and 72(t).

Under these two sections of the tax code, you can take distributions from your qualified accounts prior to age 59H, provided those distributions are taken as "substantially equal periodic payments." What's more, you can choose which qualified accounts or annuities to access – you don't have to withdraw from them all. Be sure to check with your plan administrator on the availability of this option. And as long as your distributions are "substantially equal periodic payments," you will only owe ordinary income taxes on the funds you receive each year. Here's how it works:

- Payments (distributions) must be received for a period of at least five years or until age 59H, whichever occurs later.
- Payments (distributions) must be determined using one of three IRS-approved calculation methods: the Life Expectancy Method; the Amortization Method; or the Annuitization Method. Generally, the Life Expectancy Method will result in the smallest distribution. (You can also opt to consider the age of your designated beneficiary and base your calculations on the Joint Life Expectancy Table.)

Any deviation from the "substantially equal periodic payment" amount – such as changing the amount of the distribution, changing the frequency of the distribution, or taking additional distributions – may result in the 10% tax penalty being applied retroactively to amounts already distributed.

Your financial advisor can go over the details of 72(q) and 72(t) plans with you, as well as help you determine which calculation method will result in an income level that best suits your financial needs.

The King of Minimum Distributions: The Stretch IRA

Another method for taking required minimum distributions from your retirement assets is a concept called the "Stretch IRA." Stretch IRAs are designed for individuals who do not anticipate needing their retirement assets at all and who want to accomplish several objectives, including:

- Leaving a legacy to, or providing income to, children or grandchildren over the course of their lifetime(s);
- Spreading distributions from their accounts out over as many years as possible;
- Controlling who receives their assets, and when;
- Enjoying tax-deferred growth for as long as possible.

Unfortunately, as we've already learned, it's not quite that easy.

- First, federal tax law requires that you begin taking at least minimum distributions from your assets once you reach age 70H, regardless of whether you need them or not.
- Second, as long as you are alive, your minimum distribution will be based on the Uniform Lifetime Table (or, if your spouse is your sole beneficiary and is 10 or more years younger than you, on the Joint and Last Survivor Table).

So how can a Stretch IRA help?

Under a Stretch IRA, when the time comes for you to begin taking required minimum distributions from your IRA, you would name a young, non-spouse individual as your primary beneficiary. In this case, let's assume it's your grandchild. Once you turn 70H, you would begin taking required minimum distributions based on the Uniform Lifetime Table. At your death, the required minimum distribution would be recalculated based on the age of your grandchild using the same Single Life Table. The result is a much smaller RMD.

Another Stretch IRA option would be to name your spouse as your primary beneficiary and a younger, non-spouse individual (again, your grandchild) as your contingent beneficiary. At your death, if he or she needed the income, your spouse could opt to inherit your IRA and begin taking required minimum distributions based on his or her life expectancy. If he or she did not need the income, however, under current tax law he or she could disclaim the inheritance, in which case the IRA would pass to your contingent beneficiary. Your spouse would have until September 30 of the year following your death to make that decision.

How Powerful Can a Stretch IRA Be?

To give you an example of just how powerful the Stretch IRA concept can be, let's revisit our earlier example. We'll assume you are a retired individual, age 77, and that you are taking required minimum distributions from your IRA. Your IRA balance on December 31 is $500,000, but this time, you've named your wife, age 70, as your beneficiary, and your grandchild, age 25, as your contingent beneficiary. Using the Uniform Lifetime Table, the formula for calculating your next year's minimum distribution is as follows:

IRA Balance / Applicable RMD Factor	=	RMD
$500,000 / 21.2	=	$23,584.90

Now let's assume that at your death on January 1, your spouse disclaims the IRA and that it passes to your contingent beneficiary – your grandchild. For the purposes of simplicity, let's further assume that your IRA balance is still $500,000. Using the Uniform Lifetime Table, the required minimum distribution is recalculated based on your grandchild's age (25), resulting in the following, much smaller RMD.

IRA Balance / Applicable RMD Factor	=	RMD
$500,000 / 58.2	=	$8,591.06

As you can see, the required minimum distributions are now considerably smaller. To understand just how powerful this concept can be for different beneficiary ages, consider the following chart.

Impact of Beneficiary's Age on Required Minimum Distribution Amounts after the Original IRA Owner's Death.

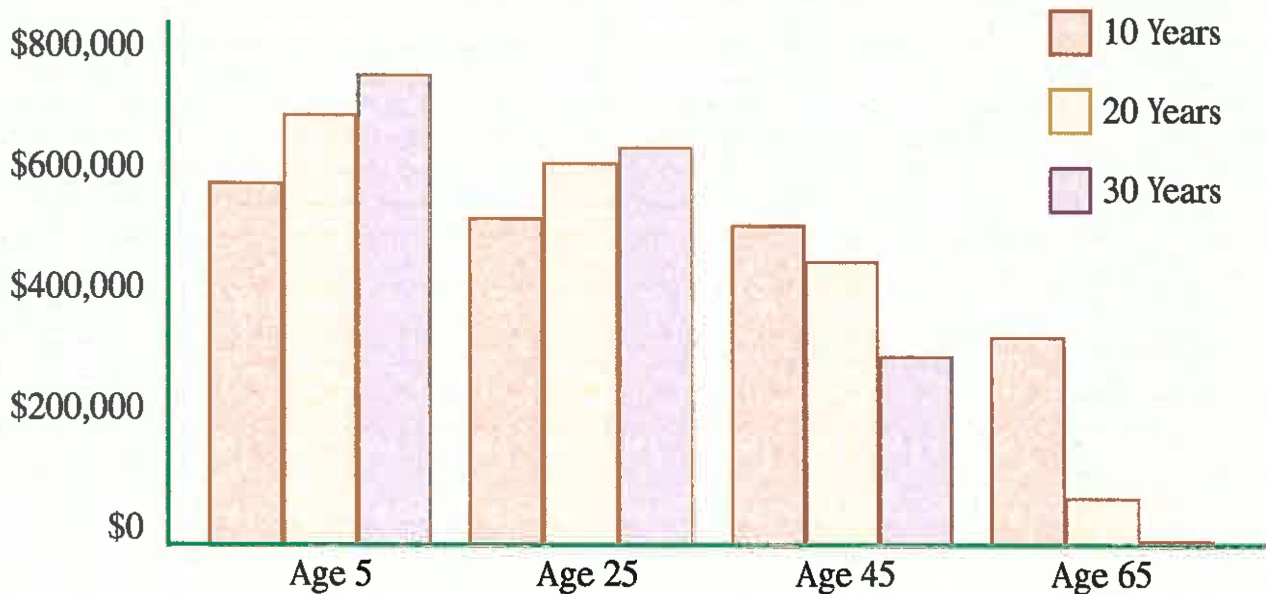
(Assumptions: $500,000 in IRA at Owner's Death, level earnings of 3% per year)

RMD Amounts Withdrawn

Age (Beneficiary)	After 10 yrs	20 yrs	30 yrs
65	$275,186	$657,576	$706,772
45	$148,316	$349,727	$624,921
25	$98,738	$232,247	$413,070
5	$73,908	$173,666	$308,417

The bottom line? Over the course of 30 years (assuming a mere 3% rate of return), a 25-year old beneficiary would have drawn $413,070 from that $500,000 IRA, and there would be $600,746 remaining. That's pretty powerful.

Amount Remaining in IRA Assuming Only RMD Withdrawals



The above hypothetical illustration is based upon Penn Mutual's understanding of current tax laws, which are subject to change. These are not indicative of any specific product nor a guarantee of future results. Actual results may be more or less than those indicated.

Using Life Insurance to Protect and Achieve Results

While the Stretch IRA concept can extend both the growth and distribution of your assets over many years, those same assets, if they're left at death to individuals other than your spouse, may be subject to both income and estate taxation.

If you're taking required minimum distributions because you have to – because you've reached age 70H and the government is requiring it – and if you don't have a current need for the income those distributions are providing, you might want to consider using those dollars to purchase a life insurance policy. At your death, the proceeds from your policy could be paid to:

- Your spouse, replacing the value of the IRA assets you are passing to your children or grandchildren. This can be an effective strategy if you want to leave assets to both your spouse and your children or grandchildren.
- Your children or grandchildren for the purpose of satisfying any estate taxes which come due following your death. This strategy essentially allows you to pass your IRA assets on, intact, to your heirs.

There are a variety of ownership arrangements relative to your life insurance policy that could help keep the proceeds out of both your, and your beneficiary's, estate. Your financial advisor will be happy to review those ownership arrangements with you.

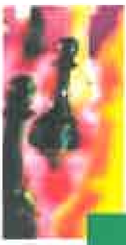
A Secure Financial Future Doesn't Just Happen by Accident...

Regardless of whether you elect – or you are required – to take minimum distributions from your assets, and regardless of whether a Stretch IRA or distributions under IRS Code 72(q) and 72(t) are right for you, it is essential that you give some thought to how, when, and in what amounts you will access the assets you've built over your lifetime. In short, if you've accumulated any assets at all, it is important that you develop and implement some sort of retirement distribution strategy.

A secure financial future doesn't happen by accident. It requires examining your current circumstances; identifying your goals and objectives; developing a plan to achieve those goals and objectives; taking action to implement your plan; and periodically reviewing your plan.

The tool that helps us gather the appropriate information to begin this planning process is referred to as a fact-finder, which is simply a series of questions specific to your unique situation. You can rest assured that all the information you provide will remain strictly confidential. Once we have a good understanding of your current situation, we will be better prepared to serve your needs – now and in the future.

Together, we'll develop the steps you can begin taking immediately to help secure your financial future.



Notes...