Investments

- ***Your investment choices; how do you decide?***
- ***Annuities vs securities, what are the advantages and disadvantages of each?***
- ***I need extra income in retirement, how should I do this?***
- ***What is an RMD and how does it affect my retirement plan?***

You are months away from retirement and you have come to a "Y" in the road. Your monthly income is about to be permanently reduced. You're looking to roll-over your retirement plan into something to help fund your future needs. You do some calculations to determine how long your retirement nest egg will last while drawing down on your investments, for your monthly living expenses. A modest return on your investments should offset the withdrawals, but how would a market downturn effect your strategy?

The strategy you choose in retirement, should be different than the plan you chose in your working years, when, you were accumulating wealth. You could wait out a market downturn and let your investments recover. Most people remember 2008 when the market lost 40%. Eight years later most people who held-on were whole again. But, some couldn't wait, the result was lower income and reduced assets.

So, what is your investment strategy now? Equally important, who do you seek for advice? Who can you trust to handle your investments? Don't think there isn't a bias in the industry among advisors, because there is.

There are several investment options to choose from to roll-over your retirement funds, annuities and mutual funds are right at the top. Securities such as stocks, bonds and mutual funds, are sold by financial advisors. Talk to a financial advisor and they will want to put you into one of these products. ? Annuities are sold by Insurance Companies. Talk to an insurance agent and he will likely want you to liquidate your stocks, bonds or mutual funds to purchase a fixed/indexed annuity. Why? Because annuities share in market gains and guarantee against market losses. Annuities can also provide income streams that you can't outlive. Mutual funds, unlike annuities have risks. Both investment advisors believe they are right; and they are. But, each are correct as they have expertise and preference in products they represent. Financial advisors usually don't sell insurance products and insurance agents don't sell securities. Hence the bias. The truth is; you should probably include both in a diversified portfolio.

At Anderson Bear and Associates, we are licensed financial advisors and insurance agents, where we offer both investments and insurance planning options.

Qualified vs Non-Qualified Investments:

There are two classes of investments that you should be familiar with; q**ualified** and **non-qualified.** Monies from these accounts must be separate and cannot be mixed.

Qualified

The term "qualified" relates to investments that are purchased with pretax income. These investments are exempt from income taxes until it is withdrawn in retirement. Withdrawals taken prior to age 59 ½ could result in an additional 10% tax penalty. A 401(k), IRA, or 403(b) are examples of qualified investments. Because qualified investments grow tax deferred these investments are susceptible to full taxation when you withdraw funds. Because the IRS will tax any withdrawals as regular income, it is usually wise to take withdrawals gradually over an extended period (several years).

Qualified accounts grow tax deferred, but at some point, the IRS will want their cut. In the year in which you turn 70 ½, you must begin taking the **required minimum distribution** (**RMD**). These withdrawals are mandatory. Failure to make these withdrawals will result in a 50% IRS penalty.

The one exception is a **Roth IRA** account. A Roth IRA is a qualified account that is funded with after tax income and grows tax free. The RMD rule does not apply to a Roth IRA. However, withdrawals taken prior to age 59 ½ will be taxed as income and an additional 10% penalty will be applied.

Non-Qualified

"Non-Qualified" investments are those that were made with after tax money. They do not have any preferential tax treatment. Inheritances, cash in your bank account or cash values in life insurance policies are examples of non-qualified monies. When you take a withdrawal from a non-qualified account you are only taxed on the earned interest.

Qualified vs. Non-Qualified Accounts

Since the tax consequences from removing money from a qualified account are generally more severe, thus making them less liquid, you may want to treat qualified investments differently than non-qualified. It is usually wise to think of qualified money as a long-term investment where you can take withdrawals gradually thereby reducing or even eliminating your tax bite over time. Therefore, you may see annuities as an attractive option due to their guarantees against loss and growth potential.

Non-qualified accounts on the other hand do not suffer the tax bite of qualified accounts and are more liquid. Monies can be quickly moved from one investment to another if market conditions dictate. Securities could be a better option for non-qualified accounts to take advantage of market growth.

Rollovers, Transfers and 1035 exchanges:

The term "rollover" is often used to describe any tax-free transfer of qualified funds from one retirement account to another. This is inaccurate and can lead to problems. Using the wrong terms and not understanding the rules as it applies to the movement of funds from one account to another can cause delays and have unwanted tax consequences.

Rollovers

Rollovers, also called **indirect rollovers**, refer to the moving of money from one retirement account to another by having the check paid directly to you and you then re-deposit the funds to the same or another IRA account within 60 days. With a retirement plan rollover, 20% of the distributed funds (10% for IRA's) are withheld to go toward the taxes and penalties you will owe if you do not complete the rollover. During the 60-day period, the IRS does not care what you do with the money. However, you are responsible for redepositing the entire amount including the 20% withholding before the end of the 60 days. So, if you requested a distribution of $50,000, you would receive $40,000 ($10,000 was withheld). But, you must then have sufficient cash available to make up for the withheld amount so you can re-deposit the original $50,000 before the end of 60 days.

You can avoid the 20% withholding rule by opting for the more popular **direct rollover.** A direct rollover is where money is transferred directly from one retirement account to another. In most cases the retirement account administrator will send the money directly to the new retirement account. In some cases, they may make a check payable to the new IRA account "for the benefit of" you. For instance, the check could read "ABC Co. for the benefit of John Doe". Since you cannot cash the check the IRS will not consider it as income and no money will be withheld. You would however, be responsible for getting the check to the new IRA account within 60 days.

Trustee-to-trustee Transfers

A **transfer** functions much like a direct rollover as it involves the transfer of monies from one retirement account to another. Transfers, however, must be of the same type. For instance, you can transfer a 401(k) to a 401(k). A rollover on the other hand can involve different types of investments. For instance, a 401(k) that you wish to move to an IRA after retirement would require a rollover, not a transfer, to complete the transaction.

Transfers are not taxed and unlike rollovers where you can only make one transaction each year, with transfers, you can make as many transactions as you want.

1035 exchange

1035 exchanges generally involve life insurance policies and annuity contracts. A 1035 exchange allows a policy holder or contract owner to exchange a life insurance policy or annuity for a new contract without paying taxes on the earned interest. The exchange must involve the same contract owner. You can make a tax-free exchange from a life insurance policy to another life insurance policy or a life insurance policy to an annuity. But, you cannot exchange an annuity contract for a life insurance policy.

In the confusing world of life insurance, a properly researched 1035 exchange can provide a substantial benefit for someone with a poor performing life insurance policy. Care should be taken before making such a decision. Review All illustrations for your existing policy and the proposed policy to determine the degree of benefit. The agent making the recommendation can provide this information to you.

In the case of annuities, a 1035 exchange allows you to exchange one non-qualified annuity contract for another with the accumulated earned interest remaining tax deferred. Over the years annuities have evolved with many companies offering income and long-term care riders and more attractive terms. A 1035 exchange may offer you an opportunity to switch companies while avoiding taxes and take advantage of these new products.

Finding Extra Income in Retirement:

Sometimes you need a little extra income during your retirement years. Reducing your taxes on your S***ocial Security*** puts extra dollars in your pocket. For some, who own life insurance policies or a Roth IRA, this strategy may help.

Depending on your income, up to 85% of your Social Security can be taxed. The amount they choose to tax is based on your combined or **provisional income,** which is the sum of wages, interest, dividends, pensions, taxable income, non-taxable municipal bonds and half your Social Security benefits. Just about everything is included <u>except</u> distributions from cash values in life insurance policies and Roth IRA's. If your provisional income is between $25,000 and $34,000 on a single return or $32,000 and $44,000 on a joint return, up to 50% of your Social Security benefits can be taxed. Anything higher than this, your Social Security is taxed at 85%. So, supplementing your social security with withdrawals from your life insurance or a Roth IRA, could help you stay under the above Taxable guidelines and save you money.

Many annuities offer income riders that offer a front-end bonus that allows you to take withdrawals without having to annuitize your annuity contract. Income riders offer the freedom to access your pool of cash for emergencies while allowing it to continually grow.

For some couples who own their own home a **reverse mortgage loan** may offer some welcomed financial relief. If you are age 62 or older and you (and your spouse if married) intend to live out your life(s) in your current residence, a reverse mortgage can supply tax free dollars. A reverse mortgage can pay-off an existing mortgage, provide additional monthly cash flow or be available to supply cash for an emergency. Any loan proceeds that you use do not have to be paid back during your lifetime. Upon your death, or the deaths of both you and your spouse, the home would then be sold and the bank loan would be paid off. Any equity remaining in the home would be paid to your estate. If the value of the loan and the accumulated deferred interest should ever exceed the value of the home, neither you or your estate is responsible.