May 19 – May 25, 2006 issue

Del Mar Times

Factors to consider when retiring

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Tired of buying the same old investments for an individual retirement account, or IRA?

Any IRA, whether traditional, Roth, simple or simplified employee pension, can invest in just about anything except life insurance, S-corporation stock and collectibles such as stamps, art and antique furniture.

Complexity is one problem with non-traditional investments that are far more costly to manage in an individual retirement account. Many banks and brokerages won't hold them. If one finds an institution that will consider independent trust companies, be prepared for the paperwork and allow time for special approvals.

Moreover, Internal Revenue Service rules forbid putting family property or business's stock in an individual retirement account, or living in a house the account owns. Those qualify as self-dealing, a tax-code-defined prohibited transaction.

A person can't benefit from assets owned by the retirement account. A prohibited transaction triggers tax on the entire value of the account in which the transgression occurred.

Liquidity issues also may appear. If an investment generates expenses inside a retirement account — such as rental property repairs — the account, not the account owner, pays the bill. But most non-traditional assets are not liquid, and the annual limit on contributions to an IRA could prevent you from infusing the account with cash.

A related problem involves annual IRA distributions required after age 70. In an account with non-liquid assets, a person may not have cash for withdrawals. However, although the required minimum distribution is calculated on the balance of all one's IRAs, it can be taken from any of them if a person has more than one. The money could come from an IRA account with liquid assets.

Still, to calculate the required minimum distribution, one needs to know what the account is worth and that may prove difficult. Sponsors of private offerings often decline to furnish values for products. A person could be penalized if the IRS quibbles with a real estate or business holdings appraisal.

Attorney Natalie Choate of the firm Bingham McCutchen in Boston, recommends withdrawing hard-to-value assets from the retirement account sooner rather than later.

Another negative: In a tax-deferred IRA, depreciation write-offs for business property and other potential tax advantages of certain holdings are lost. Meanwhile, some income produced by IRA assets could trigger an immediate tax bill.

A retirement account, or other tax-exempt entity, doing business, such as through a partnership, may create unrelated business income, which is taxable. Leveraged real estate also spawns unrelated business income. An IRA receiving $1,000, or more, of such income during the year must file its own tax return, IRS Form 990-T, and pay the tax by April 15.

Those still willing to take a plunge into real estate investing within an IRA and wanting more information should consult with a tax advisor and financial advisor to discuss the implications.

The majority of financial institutions still limit the range of IRA investment options to those they offer — traditionally stocks, bonds and mutual funds. Those wanting to expand beyond these products should take time to become educated, seek professional advice and understand potential benefits and consequences of each investment before proceeding.

Some factors to consider when retiring include income. Ideally, it should remain at the same level after retirement. Unfortunately, mistakes are often made in calculating the amount needed to maintain one's life style.

Some basic questions need answering including when to retire, how much income is needed to maintain the desired lifestyle, and what lump sum is required to maintain the necessary cash flow?

Although these calculations seem straightforward, some critical factors must be considered.

Investment returns are important. However, they must be corrected to adjust for the inflation rate. This is the actual rate of return. It is computed by sub- tracting inflation rate from the return.

For example, if an investment earns 6 percent and the inflation rate is 2 percent, the real rate of return is 4 percent. Not accounting for inflation will result in underestimating the amount of money needed to retire. This should be considered when making difficult decisions about which investments to select and what level of risk to accept.

If the bulk of savings is in a 401(k) or Individual Retirement Account, taxes will have a large impact. Consider someone in the 35 percent tax bracket wanting $10,000 in spend able, after-tax income. How much would have to be withdrawn from the retirement plan?

Instinctively, one might say $13,500 to net $10,000. However, one actually needs $15,400 to net $10,000. This means an investor must accumulate 54 percent more money to net the desired $10,000. Clearly, the tax burden is an important factor.

When a couple plans to retire, financial planners estimate how long the surviving partner is expected to live. This is called joint life expectancy. However, 50 percent of individuals will live longer than predicted by life expectancy tables. These tables cannot account for new medical breakthroughs, which may prolong life for many people. Thus, when planning retirement allocations, it is important not to underestimate life expectancy.

The myth is one needs 70 percent of annual pre-retirement income when retiring. In all likelihood, more than that is needed. If a business owner, be aware some expenses will no longer be paid by the business. Those added costs for health insurance, travel and entertainment, and auto expenses can take a substantial chunk out of income.

The definition of a failed retirement is running out of money before running out of time. The definition of a prosperous retirement is maintaining a lifestyle similar to that of one's working years.

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