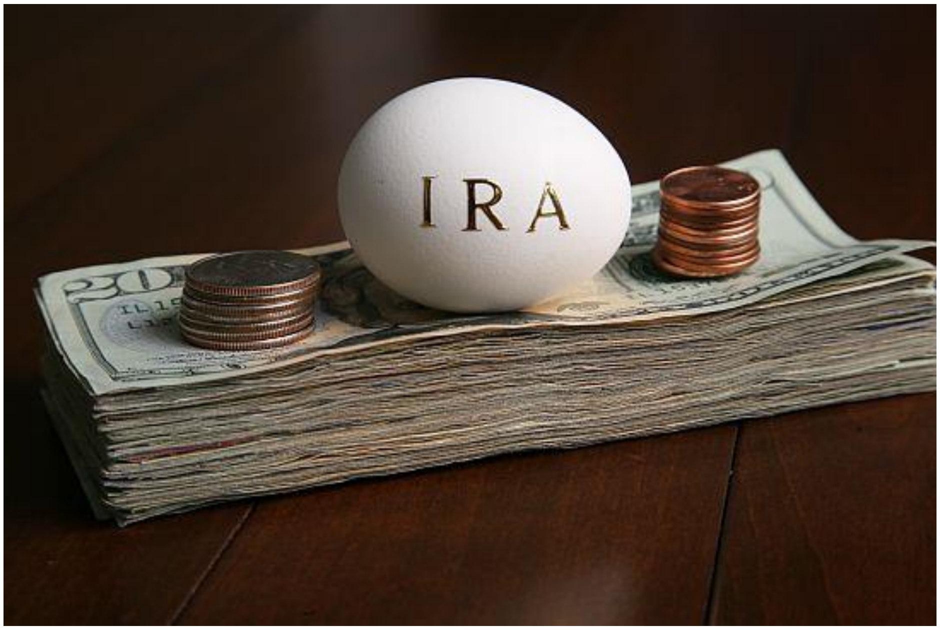
7 Strategies to Revive Your IRA



"Funding your investments on a regular basis takes advantage of the rise and fall of the investment."

-Jon Sanchez

One of the most common investments investors own is the IRA (Individual Retirement Account). When the IRA was created back in the 1970s, the investment choices within the IRA were very limited - primarily CD (certificates of deposits) and passbook savings accounts.

Fast forward the clock 40+ years and the investment choices are significantly larger. Investors can now place their IRAs into the traditional Wall Street investments, such as stocks, bonds, mutual funds, exchange traded funds, annuities and even various aspects of real estate.

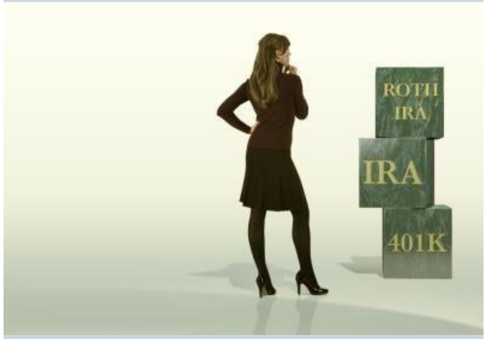
With so many investment choices, you may be confused and frustrated as to how you can invest this retirement account. More importantly, you may not know where to begin in order to administer the portfolio and revive it. If you have suffered a decline, these 7 strategies will guide you on how to revive your IRA.

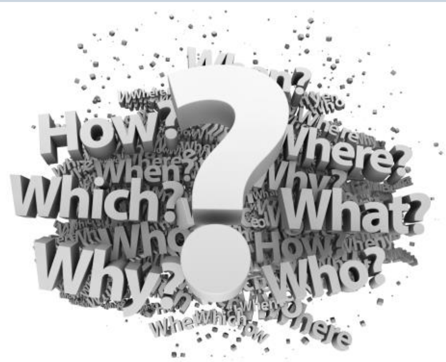
What is an IRA?

An Individual Retirement Account (IRA) is a retirement plan account that provides some tax advantages for retirement savings in the United States. Combined with potential tax savings at the time of contribution, IRAs can prove to be very valuable tax management tools for individuals. Also, depending on income, an individual may be able to fit into a lower tax bracket with tax-deductible contributions during his or her working years, while still enjoying a low tax bracket during retirement.

Investopedia US, A Division of IAC. (2014) *Individual Retirement Account IRA* Retrieved from http://www.investopedia.com/terms/i/ira.asp

What Are the Various Types of IRAs?





There are a number of different types of IRAs, which may be either employer-provided or self-provided plans. The types include:

Roth IRA - contributions are made with after-tax assets, all transactions within the IRA have no tax impact, and withdrawals are usually tax-free. It was named after Senator William Roth.

Traditional IRA - contributions are often tax-deductible ("money is deposited before tax" or "contributions are made with pre-tax assets"), all transactions and earnings within the IRA have no tax impact, and withdrawals at retirement are taxed as income (except for those portions of the withdrawal corresponding to contributions that were not deducted). Depending upon the nature of the contribution, a traditional IRA may be referred to as a "deductible IRA" or a "non-deductible IRA."

SEP IRA - a provision that allows an employer (typically a small business or self-employed individual) to make retirement plan contributions into a Traditional IRA, established in the employee's name, instead of to a pension fund account in the company's name.

SIMPLE IRA - a simplified employee pension plan that allows both employer and employee contributions, similar to a 401(k) plan, but with lower contribution limits and simpler (and thus less costly) administration. Although it is termed an IRA, it is treated separately. The amount the employee contributes to a SIMPLE IRA cannot exceed $12,500, in 2016, with a catch-up provision of $3,000 for participants over age 50.

Self-Directed IRA - a self-directed IRA that permits the account holder to make investments on behalf of the retirement plan.

There are two other subtypes of IRA, named ***Rollover IRA*** and ***Conduit IRA*** that are viewed as obsolete under current tax law (their functions have been subsumed by the Traditional IRA) by some; but this tax law is set to expire unless extended. However, some individuals still maintain these accounts in order to keep track of the source of these assets. One key reason is that some qualified plans will accept rollovers from IRAs only if they are conduit/rollover IRAs.

What was formerly known as an ***Educational IRA*** is now called a ***Coverdell Education Savings Account***.

Starting with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), many of the restrictions of what type of funds could be rolled into an IRA and what type of plans IRA funds could be rolled into, were significantly relaxed. Additional acts have further relaxed similar restrictions. Essentially most retirement plans can be rolled into an IRA after meeting certain criteria, and most retirement plans can accept funds from an IRA. An example of an exception is a non-governmental 457 plan, which cannot be rolled into anything but another non-governmental 457 plan.

The tax treatment of the above types of IRAs (except for Roth IRAs) is substantially similar, particularly for rules regarding distributions. SEP IRAs and SIMPLE IRAs also have additional rules similar to those for qualified plans governing how contributions can and must be made and what employees are qualified to participate.

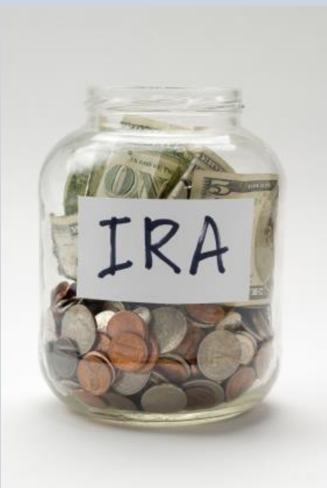
Did You Know?

- IRAs are a vital component of U.S. retirement savings, constituting 26.5% of all retirement holdings.
- Your contribution to a Roth IRA will most likely be taxed at a lower rate immediately, than when you withdraw the funds.
- Those aged 70 ½ and older can donate up to $100,000 from their IRAs to charity without paying tax.

Employee Benefit Research Institute (EBRI). (June 2013) *How Much Do People Really Have in IRAs?* Retrieved from http://www.fa-mag.com/news.

Protection from Creditors

Many states have laws that prohibit judgments from lawsuits to be satisfied by seizure of IRA assets. Please refer to your specific state statutes.



How is an IRA Funded?

- An IRA can only be funded with cash or cash equivalents. Attempting to transfer any other type of asset into the IRA is a prohibited transaction and disqualifies the fund from its beneficial tax treatment.
- Rollovers, transfers, and conversions between IRAs and other retirement accounts can include any asset.
- The maximum for an IRA contribution in 2016 is 100% of earned income or $5,500, whichever is less, for an individual under the age of 50. Individuals aged 50 and older can contribute up to 100% of earned income or $6,500 whichever is less.
- This limit is for Roth IRAs, traditional IRAs, or some combination of the two. You cannot put more than $5,500 into your Roth and traditional IRA combined ($6,500 for individuals aged 50 or more).

For example, if you are 45 and put $3,500 into your traditional IRA this year so far, you can either put $2,000 more into your traditional IRA or $2,000 in your Roth IRA. There may be an additional administrative step needed so that the trustee which holds the IRA proceeds actually retitles or transfers the $3,500.

Funding Options

Once money is inside an IRA, the IRA owner can direct the custodian to use the cash to purchase most types of securities, and some non-security financial instruments. Some assets cannot be held in an IRA such as collectibles (e.g. art, baseball cards, and rare coins) and life insurance. Some assets are allowed, subject to certain restrictions by custodians themselves. For example an IRA cannot own real estate if the IRA owner receives or provides any immediate gain from/to this real estate investment, as his personal residence or as a property manager who takes personal compensation for this service or adds capital value to the property. It should also be noted that custodians cannot provide advice.

Most IRA custodians limit available investments to traditional brokerage accounts such as stocks, bonds, and mutual funds, and do not permit real estate in an IRA unless it is held indirectly via a security such as a real estate investment trust (REIT). However, self-directed IRA custodians/administrators can allow real estate and other non-traditional assets. They typically charge fees based on asset values. There are certain special restrictions on real estate held in an IRA (the IRA owner cannot benefit from the property in any way, i.e. they cannot use it).

Self-Directed IRA's allowing non security investments are more complicated and to properly set up may require additional expertise and experience that not all CPAs, attorneys, or other advisors would have.

While certain types of investments are prohibited in an IRA, real estate is not one of them. As a result, real estate owned by an IRA can generate rental income and gain on a sale which escapes immediate taxation. However, the IRA does not get (or, need) the related deductions (e.g., depreciation, mortgage interest, property taxes, etc.).

The rules regarding IRA rollovers and transfers allow the IRA owner to perform an "indirect rollover" to another IRA. This can be used to temporarily "borrow" money from the IRA, once in a twelve month period. The money must be placed in another IRA account within 60 days, or the transaction will be deemed an early withdrawal (subject to the appropriate withdrawal taxes and penalties) and may not be replaced.

Rules of Borrowing

- It is a prohibited transaction for the IRA owner to borrow money from the IRA.
- A "borrowing" transaction disqualifies the IRA from special tax treatment.

An IRA may incur debt or borrow money secured by its assets, but the IRA owner may not guarantee or secure the loan personally. Income from debt-financed property in an IRA may generate unrelated business taxable income in the IRA.

Distribution of Funds

Although funds can be distributed from an IRA at any time, there are limited circumstances when money can be distributed or withdrawn from the account without penalties. Unless an exception applies, money can typically be withdrawn penalty free as taxable income from an IRA once the account owner reaches age 59 ½. Also, non-Roth account owners must begin taking distributions, of at least the calculated minimum amounts, by April 1st of the year after reaching age 70 ½.

If the minimum distribution is not taken by the deadline, a late penalty, equivalent to 50% of the amount that should have been taken, is assessed. The amount that must be taken is calculated based on a factor taken from the appropriate IRS table and is based on the life expectancy of the account owner (and possibly their spouse as beneficiary if applicable).

At the death of the account owner distributions must continue and if there is a designated beneficiary, distributions can be based on the life expectancy of the beneficiary.

There are several exceptions to the rule that penalties apply to distributions before age 59½. Each exception has detailed rules that must be followed to be exempt from penalties. The exceptions include:

- The portion of unreimbursed medical expenses that are more than 7.5% of adjusted gross income.
- Distributions that are not more than the cost of medical insurance while unemployed
- Disability (defined as not being able to engage in any substantial gainful activity).
- Amounts distributed to beneficiaries of a deceased IRA owner.
- Distributions in the form of an annuity, see Substantially equal periodic payments.
- Distributions that are not more than the qualified higher education expenses of the owner or their children or grandchildren.
- Distributions to buy, build, or rebuild a first home. ($10,000 lifetime maximum)
- Distribution due to an IRS levy of the plan.

There are a number of other important details that govern different situations. For Roth IRA's, with only contributed funds, the basis can be withdrawn before age 59½ without penalty (or tax) on a first in first out basis. A penalty would apply only on any growth (the taxable amount) that was taken out before 59½ where an exception didn't apply. Amounts converted from a Traditional IRA to a Roth IRA must stay in the account for a minimum of 5 years to avoid having a penalty on withdrawal of basis, unless one of the above exceptions applies.

If the contribution to the IRA was nondeductible, or the IRA owner chose not to claim a deduction for the contribution, distributions of those nondeductible amounts are tax and penalty free.

The LITTLE things add up – looking up a phone number instead of using 411 saves approximately **$2,160** in 30 years!

How to Revive Your IRA

Now that you have a thorough understanding of the internal workings of an IRA, let's explore 7 strategies to revive your IRA.

1. **Create:** Create a growth plan and determine how many years you have to invest and what value the IRA needs to be at by a specific date, i.e. retirement.
2. **Analyze:** Analyze the current holdings and ask if they are commensurate with the current market and economic conditions. If they are not, consider making changes.
3. **Assess:** Assess your risk level. Is your portfolio's volatility causing you sleepless nights or are you comfortable with the fluctuation? If the volatility is too much, it may be time for a change.
4. **Research:** If you suffered losses, investigate why. Were they due to weak overall economic conditions or poor investment selection?
5. **Diversify:** Allocate, allocate and allocate. In real estate, they say location is everything. When it comes to investing, allocation should be at the top of your list. Make sure you own investments that are not correlated to your other investments.
6. **Monitor:** Monitor your performance on a regular basis. The larger the IRA, the more frequent your monitoring should be. A good rule of thumb is to review your account at least once per week.
7. **Contribute:** Fully fund your IRA each year, to the maximum contribution limits, if you are eligible.

Do You Have Additional Questions Regarding Your IRA?

Make sure you are taking advantage of the benefits of owning an IRA.

We understand that financial planning for your future is scary and uncertain.

Contact Sanchez Wealth Management, LLC at 775.800.1801 to review your retirement savings goals.

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