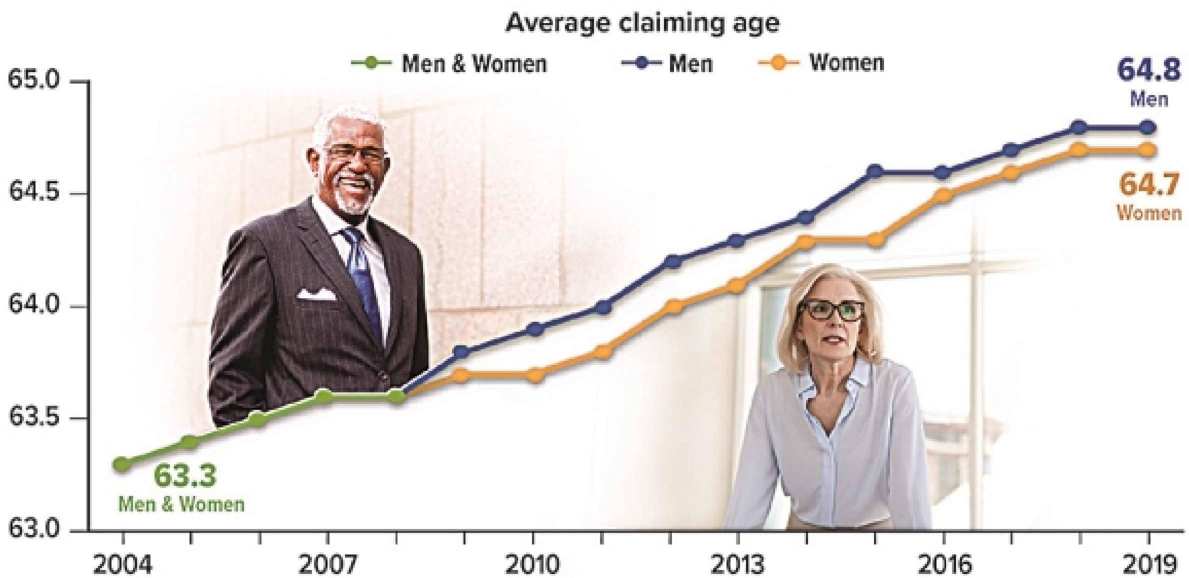
Cynthia L. Keith, CFA
Kevin T. Henry, CFP
Oppenheimer & Co. Inc.
5301 Wisconsin Ave, NW Ste 300 • Washington • DC • 20015
202-261-0769 • 877-999-9280
cynthia.keith@opco.com • www.oppenheimer.com/keithandhenry

More People Delay Claiming Social Security

The average age for claiming Social Security retirement benefits has been steadily rising. Older Americans are working longer, in part because full retirement age is increasing incrementally from 66 to 67. A worker may begin receiving Social Security retirement benefits as early as age 62, but monthly benefits will be permanently reduced by as much as 30% if claimed before full retirement age — a strong incentive to wait.



Source: Social Security Administration, 2020

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How Well Do You Understand Retirement Plan Rules?

Qualified retirement plans, such as IRAs and 401(k)s, have many rules, and some of them can be quite complicated. Take the following quiz to see how well you understand some of the finer points.

1. You can make an unlimited number of retirement plan rollovers per year.

A. True

B. False

C. It depends

2. If you roll money from a Roth 401(k) to a Roth IRA, you can take a tax-free distribution from the Roth IRA immediately as long as you have reached age 59½.

A. True

B. False

C. It depends

3. You can withdraw money penalty-free from both your 401(k) and IRA (Roth or traditional) to help pay for your children's college tuition or to pay for health insurance in the event of a layoff.

A. True

B. False

C. It depends

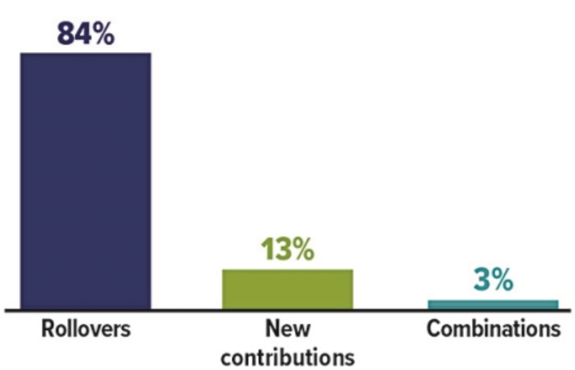
4. If you retire or otherwise leave your employer after age 55, you can take penalty-free distributions from your 401(k) plan. You can't do that if you roll 401(k) assets into an IRA.

A. True

B. False

C. It depends

Shares of Traditional IRA Assets Opened with...



Source: Investment Company Institute, 2020 (data reflects IRAs opened in 2016)

1. C. It depends. Rollovers can be made in two ways — through a direct rollover, also known as a trustee-to-trustee transfer, in which you authorize the funds to be transferred directly from one account or institution to another, or through an indirect rollover, in which you receive a check in your name (less a required tax withholding) and then reinvest the full amount (including the amount withheld) in a tax-deferred account within 60 days. If the full amount is not reinvested, the outstanding amounts will be considered a distribution and taxed accordingly, including any applicable penalty. Generally, individuals can make an unlimited number of rollovers in a 12-month period, either direct or indirect, involving employer-sponsored plans, as well as an unlimited number of direct rollovers between IRAs; however, only one indirect (60-day) rollover between two IRAs is permitted within a 12-month period.

2. C. It depends. Beware of the five-year rule as it applies to Roth IRAs. If you establish your first Roth IRA with your Roth 401(k) rollover dollars, you will have to wait five years to make a qualified withdrawal from the Roth IRA, regardless of how long you've held the money in your Roth 401(k) account, even if you are over 59½. However, if you have already met the five-year holding requirement with *any* Roth IRA, you may take a tax-free, qualified withdrawal.

3. B. False. You can take penalty-free withdrawals from an IRA, but not from a 401(k) plan, to pay for a child's qualifying education expenses or to pay for health insurance premiums in the event of a job loss. Note that ordinary income taxes will still apply to the taxable portion of the distribution, unless it's from a Roth account that is otherwise qualified for tax-free withdrawals.

4. A. True. If you leave your employer after you reach age 55, you may want to consider carefully whether to roll your money into an IRA. Although IRAs may offer some advantages over employer-sponsored plans — such as a potentially broader offering of investment vehicles — you generally cannot take penalty-free distributions from an IRA between age 55 and 59½, as you can from a 401(k) plan if you separate from service. If you might need to access funds before age 59½, you could leave at least some of your money in your employer plan, if allowed.

When leaving an employer, you generally have several options for your 401(k) plan dollars. In addition to rolling money into an IRA and leaving the money in your current plan (if the plan balance is more than $5,000), you may be able to roll the money into a new employer's plan or take a cash distribution, which could result in a 10% tax penalty (in addition to ordinary income taxes) on the taxable portion, unless an exception applies.

Tips for Managing an Inheritance

As the beneficiary of an inheritance, you are most likely to be faced with making many important decisions during an emotional time. Short of meeting any required tax or legal deadlines, don't make any hasty decisions concerning your inheritance.

Identify a Team of Trusted Professionals

Tax laws and requirements can be complicated. Consult with professionals who are familiar with assets that transfer at death. These professionals may include an attorney, an accountant, and a financial and/or insurance professional.

Be Aware of the Tax Consequences

Generally, you probably will not owe income tax on assets you inherit. However, your income tax liability may eventually increase. Any income that is generated by inherited assets may be subject to income tax, and if those assets produce a substantial amount of income, your tax bracket may increase. This is particularly true if you receive distributions from a tax-qualified retirement plan such as a 401(k) or an IRA. You may need to re-evaluate your income tax withholding or begin paying estimated tax.

You also may need to consider the amount of potential transfer (estate) taxes that your estate may owe, due to the increase in the size of your estate after factoring in your inheritance. You may need to consider ways to help reduce these potential taxes.

How You Inherit Assets Makes a Difference

Your inheritance may be received through a trust or you may inherit assets outright. When you inherit through a trust, you'll receive distributions according to the terms of the trust. You may not have total control over your inheritance as you would if you inherited the assets outright.

Familiarize yourself with the trust document and the terms under which you are to receive trust distributions. You will have to communicate with the trustee of the trust, who is responsible for the administration of the trust and the distribution of assets according to the terms of the trust.

Even if you're used to handling your own finances, receiving a significant inheritance may promote spending without planning. Although you may want to quit your job, or buy a car, a house, or luxury items, this may not be in your best interest. Consider your future needs, as well, if you want your wealth to last. It's a good idea to wait at least a few months after inheriting money to formulate a financial plan. You'll want to consider your current lifestyle and your future goals, formulate a financial strategy to meet those goals, and determine how taxes may reduce your estate.

Receiving a significant inheritance may promote spending without planning, but don't make any hasty decisions.

Develop a Financial Plan

Once you have determined the value and type of assets you will inherit, consider how those assets will fit into your financial plan. For example, in the short term, you may want to pay off consumer debt such as high-interest loans or credit cards. Your long-term planning needs and goals may be more complex. You may want to fund your child's college education, put more money into a retirement account, invest, plan to help reduce taxes, or travel.

Evaluate Your Insurance Needs

Depending on the type of assets you inherit, your insurance needs may need to be adjusted. For instance, if you inherit valuable personal property, you may need to adjust your property and casualty insurance coverage. Your additional wealth from your inheritance means you probably have more to lose in the event of a lawsuit. You may want to purchase an umbrella liability policy that can help protect you against actual loss, large judgments, and the cost of legal representation. You may also need to recalculate the amount of life insurance you need because of your inheritance. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased.

Evaluate Your Estate Plan

Depending on the value of your inheritance, it may be appropriate to re-evaluate your estate plan. Estate planning involves conserving your money and putting it to work so that it best fulfills your goals. It also means helping reduce your exposure to potential taxes and creating a comfortable financial future for your family and other intended beneficiaries.

Some things you should consider are to whom your estate will be distributed, whether the beneficiary(ies) of your estate are capable of managing the inheritance on their own, and how you can best shield your estate from estate taxes. If you have minor children, you may want to protect them from asset mismanagement by nominating an appropriate guardian or setting up a trust for them. If you have a will, your inheritance may make it necessary to make significant changes to that document, or you may want to make an entirely new will or trust. There are costs and ongoing expenses associated with the creation and maintenance of trusts and wills. Consult with an estate planning attorney for proper guidance.

Can Creditors Take Your Retirement Savings? It Depends

Given the immense financial hardship inflicted by the COVID-19 pandemic, a rise in personal bankruptcies could be waiting in the wings. For those whose livelihoods have been hit the hardest, it might be important to review the creditor protections that apply to their retirement accounts.

The extent to which assets are protected can vary significantly, depending on the type of account and applicable federal or state law. Being aware of the details can help individuals in financial or legal jeopardy determine whether and/or when they should file for bankruptcy to preserve their retirement funds. It may also help them avoid costly rollover mistakes.

Employer Plans

Most employer-sponsored retirement plans, such as 401(k)s, provide virtually unlimited protection against both bankruptcy and non-bankruptcy general creditor claims under the Employee Retirement Income Security Act of 1974 (ERISA). An example of a general creditor claim is when a person files a lawsuit and wins a judgment in court against the account owner. Thanks to ERISA, creditors cannot attach retirement account funds to satisfy any debts or obligations, regardless of whether bankruptcy has been declared.

Solo 401(k) plans, which are often utilized by self-employed individuals and independent contractors, are not covered by ERISA. This means that solo 401(k) plans — along with other non-ERISA employer plans such as 403(b)s, 457(b) governmental plans, and SEP and SIMPLE IRAs — do not receive non-bankruptcy creditor protection under federal law, though they are fully protected from bankruptcy under the Bankruptcy Code. (Outside of bankruptcy, general creditor protection is based on state law.)

IRAs and Rollovers

Traditional and Roth IRA contributions and earnings are protected from bankruptcy up to $1,362,800 per person until April 1, 2022. This limit is for all accounts combined and is adjusted for inflation every three years. Rollovers from employer plans, including SEP and SIMPLE plans, do not count against this cap. However, the U.S. Supreme Court ruled unanimously that IRA assets inherited by nonspouses are not protected under the Bankruptcy Code.

General creditor protection for traditional and Roth IRAs is based on state law, as it is with SEP and SIMPLE IRAs. So, account owners should carefully consider their own state's general creditor protections before rolling fully protected ERISA plan dollars into an IRA. Those who change jobs should remember they may have two other options: leave savings in the former employer's plan or transfer them to a new employer's plan, if allowed. Unfortunately, retirement account withdrawals and pension benefits paid as income are no longer protected from bankruptcy, so creditors may wait patiently and stake a claim to retirement funds after they are withdrawn.