What Happens at 59½? Retirement Rules Explained [Ep. 25]

Transcript

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Remember at 59 1/2, it's not just the agent. When you can take money out of your qualified accounts without that 10% penalty, don't treat it just as a green light of, now I can get the money without a 10% penalty, therefore I'm going to raid the account, right? Cause then you're missing out on the potential compound interest that it could have grown. (Upbeat Music)

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(Upbeat Music)

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When people think about turning 59 1/2, they usually think about avoiding penalties on retirement withdrawals. But here's the real secret, at 59 1/2 you may be able to take what's called an insurance distribution. Even while you're still working, most people don't know this option exists and it can completely change how you invest, diversify and plan for retirement. (...) So, today I'm excited Robert to talk about this with you, how an insurance distribution really works and what it means and how to use it wisely.

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Well, thank you. And thank you for allowing me to be in your presence today. I do admire that about you. Your humbleness is overwhelming. (...) So, let's start there. You kind of gave a great introduction, but what is an in-service distribution and how does 59 1/2, how does that play into that? So, now does it happen on 100%

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of qualified retirement accounts, meaning 401(k)s, 403(b)s, but most of them or significant portion of them, if you look at your plan documents, talk to your plan administrator, what you're going to find out is that 59 1/2, sometimes even at 55, you're able to grab those assets(...) while you're still working and move them to an IRA. So, can I keep contributing to my retirement account after 59 1/2 and do an in-service distribution? That's what's the best part, Robert, is so, you can do that in-service distribution or in-service withdrawal. By the way, if I use one or the other, they're interchangeable, in-service distribution and service withdrawal. You grab those proceeds and you move it to an IRA. If you're still working at that employer, of course you still get to make your own contributions. If your employer does a matching, that continues. So, it doesn't hurt you in any way in terms of future contributions of you or your employer. So, it doesn't change a thing. Exactly. So, I guess, let's talk about this. Why is 59 1/2 the age? Why is it such a milestone age that everybody looks at? Why not 61 or 62 or 57? So, the IRS came up with a number that they think is reasonable for somebody to start taking money out of their retirement account. And they think in between 60 and 70 is reasonable. And why the half is they always, if you look at the IRS tax code, it typically is done in increments of a half a year, six months. So, they came out 59 1/2. Is it a reasonable time that they're okay with you getting access to some of your money without paying a penalty? Without paying that 10%. Exactly. Of course, you'll still pay income tax unless it's a Roth version of a forward K or an IRA. Well, I guess that answers the next question. So, what, I mean, I'm guessing taxes don't disappear after 59 1/2. You're still paying for it. At least for the traditional IRA. Is that the same for the Roth? (...) If you were to do a Roth in-service distribution because can't 401ks have Roth 401ks and you can do an in-service distribution on that? Absolutely. Yeah, if you have a Roth 401k on those distributions you make at 59 1/2, you're not going to have that penalty nor taxes because it's a Roth. Of course, an employer, if you have any matching, they're not going to throw that money into a Roth 401k. You may put your employee contribution as a Roth. They're going to match in a after-tax version of the 401k so, the business can get that tax deduction for your contribution. But that would still qualify for an in-service distribution as well. The Roth 401k. Absolutely. Perfect. Absolutely. Is there flexibility in taking money out after 59 1/2? Yeah, so, 59 1/2 is the age which you can begin to take money out of the 401k. It doesn't mean you have to. In fact, if you don't need it, I would discourage you from doing that.

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Now, there's something called required minimum distributions, right? And that comes into play, depends on your date of birth. For most people, it's going to start at age 73. At 73, this is basically the IRS's way of saying,

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"Okay, you guys, you've had your money long enough. "Now we want you to pay some taxes." Right. Right? And so, what happens is that age 73, (...) you're going to have to take out your required minimum distributions. (...) It's roughly 4% of the value of your account on December 31st of the previous year.

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Roughly 4% you're going to have to take out.

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Doesn't mean you have to spend it. You can take it out, pay the taxes, and move it into a brokerage account, right? And continue to invest it. And in the following year, as you get a year older, it's going to increase a little bit. It starts at four, and then a little bit greater than four. You know, when you're in your late 70s, you're in north of 5%, you're taking out. Why? Because the IRS wants you to slowly deplete those assets and for you to pay taxes on them. So, how does this, let's call it 59 1/2 milestone, how does this affect my overall investment strategy?

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Well, the reason it could affect it is depending on your cash flow needs, you might want to consider, okay, if I'm 58 right now and I have this second home I want to buy, or this expense, you might want to wait 59 1/2 to be able to get access to your portfolio without that 10% penalty. But again, it's nice to know in the back of your mind, but it doesn't necessarily mean

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you have to take money out of it. Highlight a few more reasons why it would make sense for someone to start looking at an in-service distribution at 59 1/2. So, I would say there's three biggies, right? One is more investment choices. As you know, it used to be back in the day, some foreign case had three, four, five investment choices. (...) Now a lot of mutual funds are not the only option. So, that's a good thing. There's index funds and other stuff, but it still can be limited, right? And going back to the index funds, you remember how that was with an index fund. A lot of these would have three or four index funds, that's it, so, they could be over concentrated. Yeah, I remember earlier in the year of this year, back in March, end of March, early April, there was some concerns about the S&P 500 and the NASDAQ, two very big US indexes, (...) being controlled by a handful of stocks. So, like the S&P itself, it was doing well, but if you look through the underlying investments, all the 500 companies, 10 of those companies were mainly, the reason it was up, mainly the reason it was increased. (...) So, if it's controlled, if 10 stocks controlling half of that index, or a little bit over a third of that index, if they sell off and you're in an index fund in your 401k, it could ultimately, those 10 stocks could drive down the rest of the index, causing you to lose more than you should, while the other 490 of those stocks that are in it, that are representing the S&P, could be a great pick, they could be a great value, but they're getting driven down, or the index is getting driven down by it. Same thing happened in the NASDAQ with about seven stocks. So, yeah, if you're limited in your choices, (...) you could be taking unnecessary risks, you don't even know you're taking, you're just tracking the indexes. Yep, agreed. So, I would say first one, more investment choices, right? That would be a reason, in insert distribution might make sense. Second one is potentially lower fees.

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Who knows what the fees are in a 401k? Sometimes there's some 401ks that the fees are extremely low. Some of them are extremely high. So, again, potentially your fees are going to be lower, when you move the assets out of the 401k. And then lastly, to have access to an advisor. Some 401ks have access to an advisor. My experience has been even the ones that do, right? It's more of a 1-800 number, and they might be able to plan, but it's not super customizable.

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Can we go back on something? You said the fees are a mutual fund.

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Many people don't believe that there are fees in a 401k. Many people don't believe there are fees in a 401k, but that's not correct. (...) I love to tell people there's always, or typically hate using the word always or never, but typically there can be two fees. There's a fee you see, and there's a fee you don't see. So, if your 401k just charges you an annual fee of 200 bucks, that's what you see. (...) If you have a $2 million in there, and they're charging you 2% a year, which I've seen, that's 40k that you're paying. And that's in the fund. That's in the fund. You don't see it, but it's a fee. A fee's a fee. It's coming out of your performance.

Exactly. Yeah. So, to summarize that, I would say it might make sense because potentially you have lower fees, potentially you have more investment choices, because in an IRA, right, the world's your oyster. You can invest in whatever you want. And lastly, you can cherry pick the financial advisor that you want to help you and your family. I would highlight those three reasons. What about things like Irma? When we look at Roth conversions, when we look at in-service distributions that can allow certain tax strategies. Yeah. Yeah. So, that's a good point because Roth conversions, sometimes they're allowed in foreign Ks, depending on, as you know, if a Roth foreign K is available. A lot of clients need to move their foreign K to an IRA

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and then convert it to a Roth might make sense. Why? To avoid Irma. You want to dive into that a little bit? I know we were using some acronyms on that. So, Irma is, it's a surplus on your Medicare premiums. So, when you get to age 65, you know you're going to pay Medicare. What many people don't know is depending on how much income they recognize, ordinary income they recognize in any given year, there's levels. And if you go over that level, like if you're at 207,000, 209,000, that'd be the first level in 240, and they're different levels. If you go over those levels in income, (...) then your social security premium, your Irma could double, triple, and even some cases quadruple. (...) So, there's also, a two year look back. So, this start, Medicare starts at 65, but Irma does a look back two years earlier when you're 63. (...) So, what they're doing is saying, okay, at 63, did you make too much money? Many people don't know that. And when people find out about Irma, it's usually too late. So, it's important that if you're going to do an in-service distribution, or that you're considering a Roth conversion, do it between that sweet spot of 59 1/2 and 63. You could be saving yourself tens of thousands, even hundreds of thousands of dollars in taxes. Also, you mentioned this earlier when you were talking about RMDs, the required minimum distributions that you're going to face at 73. (...) You could be avoiding massive taxes later on in life by doing the Roth conversion now, because there are no RMDs on that money. (...) 100% agree to recap that, I would say. And I know we've done episodes in the past on Roths, but to any viewers out there or listeners, you really, really want to look at considering doing a Roth conversion. Even if you're allowed to do it in a foreign case, that might be the right answer, depending on the other things we talked about, fees involved, et cetera. If not, might make sense to do an in-service distribution and then do the Roth conversion, (...) but the savings to kind of repeat what you just said, Robert, would be not only the income taxes that you might be saving, but the Irma taxes that you might be saving.

Okay, so, Glen, as we wrap up today's episode, what is the biggest nugget, the biggest takeaway that you want our listeners to remember?

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Remember, at 59 1/2, it's not just the agent when you can take money out of your qualified accounts without that 10% penalty. Don't treat it just as a green light of, now I can get the money without a 10% penalty, therefore, I'm going to raid the account, right? Because then you're missing out on the potential compound interest that it could have grown.

(...)

And analyze it and see, does it make sense to grab a portion or all of it?

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We're using 59 1/2 as a placeholder. The reality is some plans allow you to do this at 55. (...) So, look at, does it allow you and does it make sense? Compare the fees, compare the resources you're getting,

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investment choices, and does it make sense to do that? And lastly, just do your homework. Measure twice, cut once, see what makes the most sense.

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Just because you do an interest withdrawal, make sure you get into something that makes sense. We've seen people do a interest withdrawal, grab the bulk of their retirement because they think that's the right thing to do, and maybe it is in their situation, but then it gets slammed into a index annuity or a product that isn't ideal. That's not great either. So, make sure you do your homework on what makes the most sense. All right, Glen, well, thanks for that insight. Are you ready for the mailbag questions? All right; I believe I read it earlier. I think this is, yeah, it's from Jesse.

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What's one question clients should ask you, but rarely do?

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Man, that's a tough one. I would say--(…) It's a thinker. What's that? It's a thinker. It's a thinker. (…) There's a million questions I think somebody should ask an advisor, and I'm going to say an answer that hopefully, hopefully the advisor already addressed these issues, but I would say if I'm a client, I would ask that advisor, what am I missing, right? Where are my blind spots?

(…)

I think if an advisor has some experience, they're going to bring those to the forefront without being asked, but if you're working with an advisor who's maybe new into business and inexperienced, maybe they're not telling you the obvious potholes there are. So, I'm going to actually give you 10 answers, but I would go with what am I missing? (…) Well, what you're missing is we're not saving enough, right? But I think that would open the door to give the advisor another opportunity to show you what you're missing out and possibly have that more uncomfortable conversation, right, that a younger advisor might not be willing to do. Yeah, awesome. What do they say? There's wisdom and experience. (…) I agree with that. All right, well, perfect. Guys, thank you for watching, and of course, we appreciate Jesse. Appreciate the question. If you have any questions, feel free to drop them in the comments on YouTube or email us at GDS at gdswealth.com. Glen, thanks for another great episode. My pleasure, thank you. Absolutely. (Upbeat Music)

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