Retirement Traps

#3: The Distribution Trap

I'm retired, now what?

Taxes and accessing your retirement were the first two traps; the third is the Distribution Trap.

You have done a great job, hopefully, of accumulating your wealth and now you want to sit back, drink your lemonade, and finally relax. Maybe you've amassed enough money to retire in your early or mid-fifties – great job. But, where are your retirement funds sitting? Most likely, it is locked up in your qualified accounts such as your 401k and maybe an IRA or two. Since these are the most common retirement accounts out there, and all we hear on the money shows is to max out your 401k and IRA each year if you can, you probably didn't set up any other type of retirement account. We do this because our company offered a retirement plan and we took it and that's what everybody else is doing. We didn't look thirty years down the road, since it's such a long time from now and we have time to figure things out then.

The problem, as you will soon find out, is that if you access these funds prior to 59 ½ then the IRS will assess you a 10% penalty for an early withdrawal in addition to ordinary income tax. Maybe your dreams of early retirement are out of the question now.

So realization has set in that you will have to work into your sixties, not a big deal right? Soon, the other age limitation for qualified accounts creeps in – 70 ½. That's right. The IRS stipulates that you MUST withdrawal what is called your Required Minimum Distribution (RMD) or they will assess you a penalty. It's not 10% this time either. This time it is 50% PLUS ordinary income tax. If you are in a 25% tax bracket, then it's a whopping 75% straight to Uncle Sam – whose retirement are you planning for?

Maybe you want to leave the money to your grandchildren or a foundation. That doesn't get away from either age limitation or the taxes. Once you take that tax deduction during your accumulation phase, the IRS has you. And remember, when you do begin withdrawals on your qualified accounts, it's considered earned income so you have to pay income tax on it, no matter the amount.

So again, whose retirement are you planning for?