



Five Ways To Lose Your Nest Egg

by Denise Appleby, CISP, CRC, CRPS, CRSP, APA ([Contact Author](#) | [Biography](#))

There are two surefire ways for you to help your retirement accounts grow: maximizing your contributions as often as you can and properly managing the investments in your accounts. But there are also some sure ways to *decrease* the size of your retirement [nest egg](#). Here we look at five actions that could lead to the loss of your retirement savings - once you know what they are, it will be much easier to avoid such mistakes.

1. Making Ineligible Rollovers to Your IRAs

[Rolling over](#) funds you receive as [distributions](#) from your retirement account helps you to defer including these distributions in your income, and to ensure that any earnings on such amounts accrue on a [tax-deferred](#) (or tax free, for Roth IRAs) basis.

However, this is the case only if the amount is rollover eligible. Ineligible rollovers can result in severe penalties being owed to the IRS, and any taxable portion of the amount rolled over to your [IRA](#) must be included in your income for the year the distribution occurred. To ensure that this doesn't happen to you, you need to know which assets are not rollover eligible. They include the following:

- [Required minimum distributions](#) (RMD) - A common mistake people make when they roll over RMD amounts is to assume that the RMD amount can be taken after the rollover is made. This is not the case because the first amount withdrawn during a year for which an RMD is due includes the RMD amount. Let's look at an example:

Example - RMD Rollovers and Withdrawals

John reached age 70.5 in 2008. As such, John's RMD from his [401\(k\) plan](#) for the 2008 plan year, which is \$10,000, must be distributed from the account by April 1, 2009. In June 2008, John rolls over \$30,000 from his 401(k) account to his [Traditional IRA](#). John feels that the transaction is acceptable, as his first RMD did not have to be withdrawn until April 1, 2009.

However, while John could have deferred withdrawing his RMD until April 1, 2009, any withdrawal made from his 401(k) during 2008, his first RMD year, is considered to include his RMD for the year. As such, \$10,000 of the \$30,000 is not rollover eligible and creates an excess

contribution of \$10,000 in his Traditional IRA for the 2008 tax year. If John fails to remove the amount from his IRA on a timely basis, he will owe a 6% penalty (\$600) on the amount for every year it remains in the IRA. Furthermore, John must include the \$10,000 in his income for the 2008 tax year.

- Hardship withdrawals from [qualified plans](#) and [403\(b\)](#) accounts
- Excess contributions that are withdrawn or returned from your retirement account
- Loans that are distributed because they are in default or do not satisfy other regulatory requirements
- Distributions that are part of a series of substantially equal periodic pension or [annuity](#) payments made at least once per year for at least 10 years and amounts that are calculated using your [life expectancy](#) or the joint life expectancy of you and your beneficiary
- Distributions for the cost of life insurance coverage
- Distributions made to you from a qualified plan, 403(b) account or IRA that represents distributions to you as a beneficiary after the death of the retirement account owner, unless you are the spouse beneficiary of the deceased (For further reading, see [Moving Plan Assets: How To Avoid Mistakes](#) and [Exceptions To The 60-Day Rollover Rule](#).)

2. Making Excess Contributions to Your IRA

IRA contributions are limited to the lesser of 100% of eligible compensation or the contribution limit for the year. Should you contribute more than the allowable limit to your IRA, you must remove this excess amount from your IRA by the applicable deadline. Similar to ineligible rollovers, failure to remove the excess amount by the deadline will result in you owing the IRS a penalty of 6% of the amount for each year it remains in your IRA. (To learn more, see [Correcting Ineligible \(Excess\) IRA Contributions - Part 1](#), [Part 2](#) and [Part 3](#).)

3. Ineligible Roth Conversions

A [Roth IRA conversion](#) is viewed by many as a good financial planning move because earnings accrue on a tax-deferred basis, while distributions are tax-free if qualified. However, not everyone is eligible for a Roth conversion - certain income limitations apply. (For more information, see [Roth IRA: Back To Basics](#).) If you make an ineligible Roth conversion, it can be corrected as a [recharacterization](#). Should you fail to recharacterize an ineligible conversion on a timely basis, the amount will be treated as ordinary income from your Traditional IRA and an excess contribution to your Roth IRA. Therefore, not only would you lose the tax-deferred status of your IRA assets, but you would also owe a 6% penalty for each year the excess contribution remains in the Roth IRA. (For further reading, see [Did Your Roth IRA Conversion Pass or Fail?](#) and [Recharacterizing Your IRA Contribution Or Roth Conversion](#).)

4. Failing to Distribute Your RMD

You must begin taking RMDs from your Traditional, [SEP](#) and [SIMPLE IRAs](#), qualified plan, and 403(b) accounts the year you reach age 70.5, and must continue for each subsequent year. Exceptions

apply to qualified plan accounts and 403(b) accounts if you are still employed and your employer allows you to defer beginning RMDs from such accounts until after you retire.

Failure to take your RMD by the applicable deadline will result in you owing the IRS an [excess accumulation penalty](#) of 50% of the RMD shortfall. While it is not required that this penalty be withdrawn from your retirement assets, you may have no choice but to use your retirement assets to pay it if you have no other financial resources. You may apply for a waiver of the penalty, but you are generally required to pay the penalty first and request the waiver thereafter. (For more information, see [Missed Your RMD Deadline? What To Do.](#))

5. Engaging in Prohibited Transactions

You are prohibited from using your IRAs in certain transactions. For example, your IRA cannot be used as security for a debt or to invest in collectibles. Engaging in these transactions could result in loss of tax-deferred status for the assets involved in the transaction and, in some cases, loss of tax-deferred status for the entire IRA. The following are a few examples:

- If your IRA is pledged as security for a loan, the extent of the consequences is determined by whether the account is an individual retirement account or an [individual retirement annuity](#). For an IRA, the amount pledged as security for the loan is treated as a distribution to the IRA owner. For an individual retirement annuity, the entire balance, as of January 1 of the year the pledge occurs, will be treated as a distribution to the IRA owner, regardless of the amount that is pledged as security for a loan. The distribution will be treated as ordinary income and be subject to a 10% [early-distribution penalty](#), unless an exception applies.
- If your IRA assets are invested in collectibles, such as artworks, rugs, antiques, precious metals, gems, stamps, coins and alcoholic beverages, the value of the investment is treated as a distribution to the IRA owner. The distribution will be treated as ordinary income and subject to a 10% early-distribution penalty, unless an exception applies.

Conclusion

Most taxpayers now find it natural to consult with investment advisors, tax professionals and attorneys; however, the same cannot be said for those who need assistance managing their retirement accounts. Few people seek assistance from a retirement planning professional for issues such as moving IRA assets and making IRA contributions, but they should. The number of individuals losing the tax-deferred status of their IRA assets and paying large penalties because they've misunderstood the portability rules and eligibility requirements for certain transactions is increasing at an alarming pace. Unless you are absolutely sure of the effect that a certain transaction will have on your IRA assets, you should consult with a financial professional who is well-versed in the rules and regulations of retirement plans. This is key to protecting and building your retirement nest egg.

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Denise Appleby is a retirement plans consultant, freelance writer and editor. Before starting her own business, [Appleby Retirement Consulting](#), Denise worked for Pershing LLC for almost 10 years. While at Pershing, Denise rose to the rank of vice president, and held many positions including retirement plans product manager, manager of the retirement plans technical assistance group and retirement plans training manager. Appleby Retirement Consulting provides technical assistance to financial institutions and financial professionals; content for newsletters, websites and magazines; and technical editing services for books and other retirement plans material. Denise holds several retirement professional designations.

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