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Road map to retirement: 12 IRA planning mistakes to avoid

Presenter name
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Hello. Thank you for coming today to “Road map to retirement: 12 IRA planning mistakes to avoid. “



But first, have you ever found yourself at an intersection like this? Most of us have. You're out driving with a special destination in mind, you come to a spot like this, and before you know it, you're off in the wrong direction. Even with the best intentions — a road map in hand, plenty of gas in the tank — we all make wrong turns sometimes. And when you find yourself lost, what's the best step to take? Look for someone who knows the area well and can tell you the rules of the road. You need an expert, right?

Planning for retirement is much the same. As a financial advisor, my goal is to make sure that your road map to retirement is clear and accurate so that you'll stay on track toward retirement goals.

Today, I'm going to outline IRA mistakes to help you make the most of IRA savings.

Make the most of IRA savings

1 The stretch distribution option

- Beneficiary choices
- Taxes
- Flexibility



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1. One IRA mistake is not taking advantage of the “Stretch IRA” distribution option or not establishing it properly.

A Stretch IRA is really a beneficiary designation technique that potentially extends the tax deferral of an IRA across multiple generations. It can be a useful planning technique for investors who do not need to live off their IRA assets and wish to pass them on to children or grandchildren.

A few things to consider:

- Your beneficiaries have a choice on how to take distributions. They can take all the money out right away, or, if they follow some IRS rules, they may be able to spread the distributions over their life expectancy. Taking all the money right away can cause a problem because of...
- Taxes – Taking all the money at once causes any taxable income to be recognized in that tax year. This can be a significant problem. Spreading the distributions out also spreads out the tax liability and may be a better choice.
- Flexibility – We can't always know what our beneficiaries should do because circumstances change. Naming beneficiaries in the right way gives them the flexibility to make the right choice at the time. Talk to your financial and tax advisor about your goals and make sure your beneficiary designations match.

Speaking of beneficiaries, our next mistake is...

Make the most of IRA savings

2 Beneficiary mistakes

- Missing or blank
- Outdated
- Inconsistent



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2. Not naming or updating IRA beneficiaries

Even when an owner intends to name a beneficiary, mistakes are sometimes made. Here are some common ones:

- missing forms
- blank designations
- no contingent beneficiary named (if all primary beneficiaries disclaim or predecease the owner, assets would go as IRA document or as state law provides)
- outdated (examples)
 - Mom or dad is still listed when the owner has subsequently married and/or had children and intends for the assets to go to his or her new family.
 - An ex-spouse is still listed when the owner intends the assets to pass elsewhere.
 - A beneficiary is deceased.
- does not match with current estate plan

One of the best ways to keep beneficiary designations current is to review them regularly. Here are several good times:

- annually
- marriage
- births
- divorce
- death
- retirement

Make the most of IRA savings

3 Spousal rollovers

- Consider not rolling IRA assets if a surviving spouse
 - is older than 70½ and the deceased spouse was not
 - is under age 59½ and needs income
 - plans to disclaim IRA assets (the stretch distribution option)



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3. The number-three IRA mistake is inappropriate spousal rollovers.

A unique characteristic of a spousal beneficiary on an IRA is that the spouse has the ability upon the IRA owner's death to "roll over" the IRA into his or her own name (and in many cases this is a good solution). It's not always a good reason though. Some reasons to consider not rolling over (or not rolling over right away) include:

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The surviving spouse is older than 70½ and the deceased spouse was not. In this case, rolling over would immediately subject the surviving spouse to required minimum distributions instead of being able to wait until the owner would have reached age 70½.

The surviving spouse is under age 59½ and needs to take income from the IRA. If the IRA is rolled over, distributions will be subject to the 10% early distribution penalty. The penalty would not apply if the surviving spouse took distributions as a beneficiary from the owner's IRA.

The surviving spouse wishes to disclaim all or part of the IRA. If the IRA has been rolled over, it can't be disclaimed. If the beneficiary disclaims part or all of the IRA, the disclaimed IRA assets pass as if disclaiming beneficiary had never been named. Beneficiaries who disclaim have NO say where IRA assets go. Assets will pass as provided in the owner's beneficiary designation or in the IRA document or per state law.

All of these scenarios involve choices that may seem complicated to investors. You should speak with a qualified professional when making investment decisions.

Make the most of IRA savings

4 The “IRD” deduction

- Double taxation
- Relief



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4. The number-four IRA mistake is beneficiaries not taking advantage of “income in respect of a decedent” (IRD) rules.

First, let’s address IRD. Otherwise known as income in respect of a decedent, it’s income payable after the death of a person who was entitled to that income that would have been taxable had he or she lived to receive it. IRD may include IRA assets, annuity earnings, retirement plan benefits, and unpaid compensation and is often subject to both income and estate taxes.

What’s important for owners and beneficiaries of IRAs to know is that relief from double taxation for recipients of IRD is available in the form of a federal income tax deduction equal to the estate taxes paid on the IRD.

If you think you may be inheriting IRD, you should consider consulting your tax advisor.

Make the most of IRA savings

5 Net unrealized appreciation

- Company stock
- Ordinary income vs. capital gains
- Mistakes



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5. The number-five IRA mistake is rolling low-cost-basis company stock into an IRA, which can eliminate your ability to use a tax treatment called net unrealized appreciation.

Distributions from a qualified plan, such as a 401(k), are generally taxed as ordinary income. If company stock is rolled into an IRA, future distributions would be taxed as ordinary income. However, the IRS allows distributions of company stock to be taxed at the capital gains tax rate instead if the following steps are taken.

If the company stock is taken as a lump-sum distribution and rolled to a regular (non-IRA) brokerage account only, the cost basis of the stock is taxed as income at income tax rates. (Note: The lump-sum distribution must be taken as stock, not cash and also note that long term capital gains are typically taxed at a lower rate than ordinary income.) The unrealized capital appreciation (the difference between the cost basis and current fair market value) is not taxed until the stock is sold, and it will be taxed as long-term capital gains. Cost basis is the amount the qualified plan paid to purchase the employer securities over the period of years that the retiree was a participant in the plan.

Talking to your tax and financial advisors before taking a distribution can help you avoid mistakes. There are very specific rules you need to follow to take advantage of NUA.

Make the most of IRA savings

6 Roth IRAs

- Tax benefits: now or later?



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6. Not taking advantage of a Roth IRA when appropriate.

A Roth is almost a retirement account in reverse. A traditional retirement account can lower your taxable income now but is generally taxable in retirement. A Roth won't decrease your taxable income now but can be tax free in retirement.

A Roth IRA is potentially a valuable retirement resource. Not only are qualified withdrawals tax free, but Roth IRA distributions do not impact the taxability of Social Security and qualifying Roth IRAs pass to beneficiaries income tax free. There are income limits that affect eligibility for a Roth IRA, so be sure to talk over this option with your financial advisor.

Make the most of IRA savings

7 Contribution limits

- \$5,000 per individual for 2010 and 2011
- Catch-up contributions
 - \$1,000 per individual age 50 or older for 2010 and 2011



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7. Not taking advantage of increased contribution limits

For tax years 2010 and 2011, investors can contribute up to \$5,000 per individual.

Also, many individuals still don't take advantage of the \$1,000 catch-up provision, which allows investors over age 50 to make bigger contributions to IRAs. This means that a married couple over age 50 can contribute a combined \$12,000 to an IRA for 2010 and 2011. Catch-up contributions are a great opportunity to "jump start" a retirement savings plan.

Here's another IRA savings tip: Make IRA contributions early in each year, potentially maximizing the tax-deferred growth of assets over the life of the IRA.

You might want to make a nondeductible contribution now to potentially have more available to convert to a Roth IRA should you decide to do so after consulting your CPA.

Remember, conversions to Roth IRAs are taxable, but there is no longer an income limit on conversions.

Make the most of IRA savings

- 8 Spousal contributions
 - Earned income requirement



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8. Mistake number eight is assuming a nonworking spouse cannot contribute to an IRA.

- You need earned income to make an IRA contribution which makes it seem as if a nonworking spouse can't make an IRA contribution.
- Nonworking spouses can fund IRAs, up to the same limits as a working spouse by using the working spouses earned income to qualify.

Make the most of IRA savings

9 Missing important dates

- 9 months
 - Disclaim deadline
 - Estate taxes due
- 9/30: Beneficiaries determined
- 9/30: Multiple beneficiary payout determined
- 12/31: RMD deadline



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9. Missing important dates

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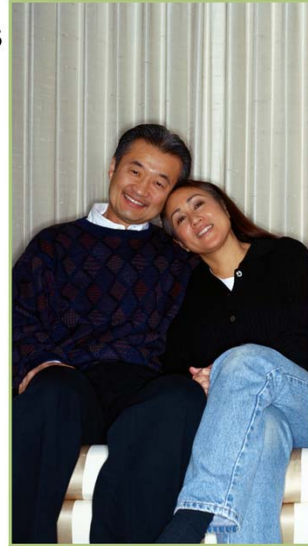
The first deadline is nine months after the IRA owner's death.

- Any beneficiary who wish to disclaim must do so.
- Estate taxes are due by this date.
- The next deadline is September 30 of the year following the year of the owner's death. By this date
 - Any beneficiary who disclaims or cashes out their entire interest by this date is disregarded in calculating the payout period for any remaining beneficiaries.
 - The beneficiary whose life expectancy will be used to control payout is based on who remains a beneficiary as of this date.
- For IRAs with multiple beneficiaries, there are regulations to determine how IRA assets will be paid:
 - The payout period is based on the life expectancy of the oldest beneficiary who remains a beneficiary as of September 30 in the year after the owner's death.
 - The exception to this rule is if the IRA is split into separate accounts for each beneficiary by December 31 of the year following the year of death. (The MFS[®] IRA document provides that separate accounts are established for each beneficiary on the owner's death.) Then, each beneficiary can use his or her own life expectancy. However, if the beneficiary is a trust, the trust beneficiaries must use the life expectancy of the oldest beneficiary to determine the pay-out period.
 - Finally, December 31 of the year following the year of the IRA owner's death is another important deadline. By this date beneficiaries must take the total RMD due to them for that year, depending on the IRA's terms. Failing to do so may result in a 50% penalty on the amount that should have been taken, or they could lose the right to use the life expectancy method and be required to take their entire interest within five years. (Note: If the owner dies after 70½ years of age, the owner's RMD for year of death must be paid out in year of death, not the following year.)

Make the most of IRA savings

10 Required minimum distributions

- Tips to avoid the 50% penalty
 - Asset consolidation
 - Recalculation upon reaching age 70½
 - 401(k) vs. IRAs



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10. The number-10 common IRA mistake is taking the wrong required minimum distribution or RMD.

There's good reason to be careful when calculating RMDs. If you take out too little, a 50% penalty could be owed to the IRS on the amount that should have been distributed.

Here's another reason to be careful: As of 2004, IRA trustees are required to do more thorough reporting to the IRS, including RMDs due and year-end IRA balances through Form 5498, making it easier for the IRS to spot individuals who are taking out too little.

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No one wants to pay a 50% penalty on anything, especially on hard-earned retirement assets.

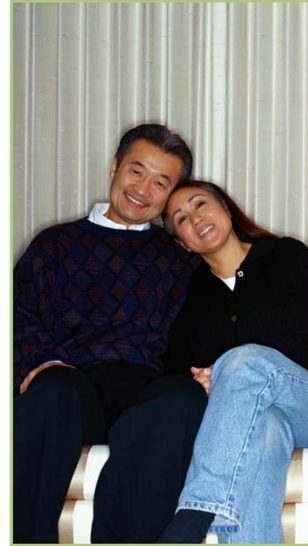
Here are two tips to avoid the 50% penalty.

- The amount of your RMD each year is based on the balances of all your non-Roth IRAs. Multiple IRAs at multiple firms may make it harder to remember and calculate RMDs. Consider consolidating IRAs to minimize this risk.
- Some investors take regular distributions prior to age 70½, then at 70½ assume they are taking enough. They don't realize they may need to take more to meet RMD requirements. For example, an investor who was previously taking \$600 per month turns 70½ and is subject to an RMD that equals \$700 per month. Neglecting that additional \$100 per month could result in a 50% penalty on a \$1,200 shortfall for the year, resulting in a \$600 penalty.
- RMD requirements from a 401k or other employer sponsored retirement plan can not be satisfied with a distribution from your IRA or vice versa. If you still have assets in a former employer's plan be careful and talk to your tax advisor.

Make the most of IRA savings

11 Trusts

- Ownership
- Beneficiaries



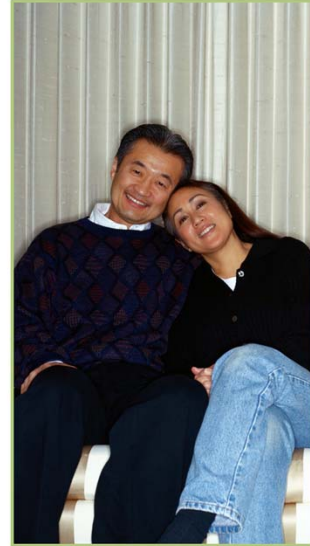
11. Placing the title of an IRA into a trust.

- Transferring ownership of an IRA to a trust will cause its assets to become immediately taxable, including the 10% penalty if the owner is younger than age 59½.
- You may consider naming the trust as a beneficiary; however, there may even be reasons not to name a trust as beneficiary because it could limit the payout options available to trust beneficiaries.
- Be sure to talk to an estate planning professional who is knowledgeable about IRAs before deciding to name a trust as an IRA beneficiary.

Make the most of IRA savings

12 Unnecessary penalties

- Early distribution penalty
- “SEPP”
- Warning



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12. Big IRA mistake number 12 is paying unnecessary penalties on early (pre-59½) IRA distributions.

Paying an extra 10% in taxes is unpleasant at best

IRS code Section 72(t) allows for individuals who are not yet 59½ years old to take a “series of substantially equal periodic payments” from an IRA, without incurring penalties (income taxes, however, would still be due).

Under Section 72(t), withdrawals must be made from an IRA for five years or until age 59½, whichever is later. Distributions are calculated using one of three methods:

- life expectancy (which generally results in the smallest distributions)
- annuitization
- amortization (which generally results in the largest distributions)

As long as withdrawals are made in accordance with the requirements of Section 72(t), there are no penalties on distributions from IRAs before the owner is age 59½.

Be careful. A failure to follow the rules can cause a retroactive 10% penalty on all the distributions.



**Stay on course on the
road to retirement**

Keeping these common mistakes in mind will help you keep on course on the road to retirement and avoid those wrong turns. Please keep in mind that tax and estate planning issues can be complicated. One of the best ways to make the most of your retirement savings is to work with a qualified professional.




Here are three steps investors take to stay on course:

STEP 1: This one is key, as neither MFS® nor any of its agents gives legal or tax advice. The laws and regulations that govern IRAs are complex and subject to change. A financial advisor, attorney, or tax advisor will always be your go-to resource for objective guidance and advice appropriate to your unique situation.

STEP 2: Start taking advantage of any suitable IRA planning and investing opportunities as soon as possible. The earlier you act, the more time you'll have to let the power of tax-deferred investing work for you, and the better chance you'll have to meet your retirement income or estate planning goals.

STEP 3: Keep in touch with your financial advisor. Changes in tax laws, interest rates, inflation, and Social Security benefits can all affect the success of your long-term plan. You could make the most of your retirement savings by regularly reviewing your plan with your financial advisor.



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Thank you.

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