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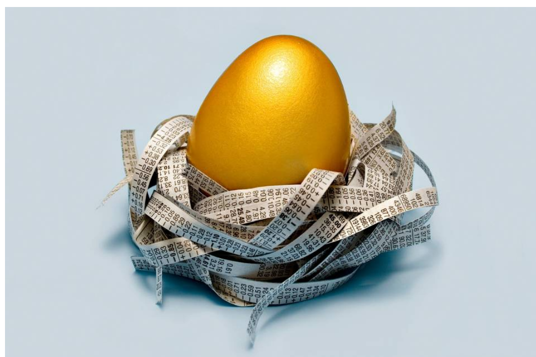
JOURNAL REPORTS: FUNDS & ETFS | NEWS CHALLENGE

Test Your Smarts on…401(k)s and IRAs

How much do you know about 401(k)s, IRAs and other retirement accounts? Try this quiz.



One of the issues for retirement accounts is the RMD: required minimum distributions. PHOTO: JOHN KUCZALA/GETTY IMAGES

By Robert Powell
Oct. 8, 2017 10:10 p.m. ET

What you don't know won't hurt you. That might be true in some circles. But it isn't the case with retirement accounts such as 401(k)s, defined-benefit plans, individual retirement accounts, profit-sharing plans and ESOP plans—especially when it comes to distribution rules.

In fact, not knowing something might cost you a lot of money in penalties and fines, as well as lost opportunities.

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Here's a quiz to test your knowledge, based on some frequently asked questions directed to Ben Norquist, president and chief executive of Convergent Retirement Plan Solutions; Beverly DeVeny, director of retirement education for Ed Slott & Co.; and Denise Appleby, the CEO of Appleby Retirement Consulting Inc. and RetirementDictionary.com.

1. True or false. Roth 401(k) owners must take required minimum distributions, or RMDs, just as owners of traditional 401(k)s do.

ANSWER: True. The Roth 401(k), a cousin of the Roth IRA, is funded with after-tax contributions that grow tax-deferred, and qualified distributions are tax-free—basically, the reverse pattern of a traditional 401(k). But the RMD situation is similar: By law, account owners generally must start taking distributions the year they reach age 70½ (except that the first RMD, due for the 70½ year, can be deferred until April 1 of the following year). However, for Roth 401(k)s, as well as traditional 401(k)s, RMDs can be deferred past age 70½ until retirement for those who are still employed by the employer that provides the 401(k) plan, if that option is available, says Ms. Appleby.

According to Mr. Norquist, you can avoid having to take RMDs from a Roth 401(k) account by simply rolling it to a Roth IRA as you approach age 70½.

Ms. Appleby cautions, however, that if you plan to do the rollover in a year that you're supposed to take an RMD from the Roth 401(k), then you must take the RMD before the rollover. "If you fail to do so, the rollover will include your RMD and could create an excess contribution in your Roth IRA," she says.

Note: Roth IRA owners—unlike inherited Roth IRA owners—don't have to take RMDs.

2. You have an IRA and a 401(k). You must take an RMD this year from both accounts. Which is correct:

A. You must take a distribution from each account separately.

B. You can add together the required distribution and take it from the IRA.

C. You can add together the required distribution and take it from the 401(k).

D. You can add together the required distribution and take it from either.

ANSWER: A. You must take a distribution from each account separately, says Ms. DeVeny: "Traditional IRA required distributions can be added together and taken from any one or several traditional IRAs. The same isn't true of employer plans. Those required distributions must be calculated separately for each employer plan and taken from each plan individually. There is an exception for 403(b) accounts [for teachers and nonprofits] which follow the IRA rules."

3. Which of these statements about Roth 401(k) accounts is INCORRECT?

A. Roth 401(k) employee elective contributions are made with after-tax dollars.

B. Both Roth 401(k) and Roth IRA contributions are subject to income limits.

C. The maximum aggregate elective contribution to a Roth 401(k) and traditional 401(k) is limited to $18,000 in 2017, plus an additional $6,000 for employees age 50 or older by year-end.

D. Withdrawals of designated Roth contributions and earnings aren't taxed provided it's a qualified distribution. A distribution is qualified if the account is held for at least five years and made on account of disability, after death, or on or after 59½.

ANSWER: B. Roth 401(k)s aren't subject to any income limits, whereas Roth IRAs are. According to Mr. Norquist, higher-income individuals, such as those married filing jointly with modified adjusted gross income (MAGI) equal to or greater than $196,000, are precluded from making regular contributions to a Roth IRA. Those same restrictions don't, however, apply to Roth 401(k) contributions. "So, you can make Roth contributions through a 401(k) regardless of how high your income is," Mr. Norquist says. "And, if you happen to be self-employed, an owner-only 401(k) plan with a Roth funding feature may be just the ticket."

4. John reached age 70 on Jan. 31, 2017. What is the deadline for him to take his first required minimum distribution from his traditional IRA?

A. Dec. 31, 2017

B. Oct. 15, 2017

C. April 1, 2018

D. Jan. 1, 2018

ANSWER: C. The required begin date according to the Internal Revenue Service, for your first RMD for IRAs (including SEP and Simple IRAs) is April 1 of the year following the calendar year in which you reach age 70½. The required begin date for 401(k), profit-

sharing, 403(b) or other defined-contribution and pension plans is, generally, April 1 following the later of the calendar year in which you reach age 70½, or retire.

5. Which of the following is subject to the one-per-year rollover rule, limiting an individual to perform only one 60-day rollover during a 12-month period?

A. A rollover from a Simple IRA to a traditional IRA

B. A rollover from a 401(k) to a 403(b)

C. A rollover from a pension plan to a governmental 457(b) plan

D. A rollover from a traditional IRA to a 401(k) plan

ANSWER: A. According to the IRS, beginning in 2015, you can make only one rollover from an IRA to another (or the same) IRA of the same type (Roth or non-Roth) in any 12-month period, regardless of the number of IRAs you own. This limit will apply by aggregating all of an individual's IRAs, including SEP and Simple IRAs as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of this limit.

"Any rollover that breaks this rule is considered an 'ineligible rollover' which would create an excess contribution in your IRA if the amount is over your IRA contribution limit for the year," says Ms. Appleby.

6. Usually there is a 10% penalty for tapping your retirement funds before age 59½. There are exceptions. Which one of these is FALSE?

A. The exception is effective for those who leave in the year they turn age 55 (age 50 for public-safety employees).

B. Plan participants who leave before the year they reach 55 can keep their funds in the plan until they reach 55, and then take a distribution from the employer plan with no 10% penalty.

ANSWER: B. According to Ms. DeVeny, the exception applies only to those who actually separate from service in the year they reach age 55 or later (or 50 for public-safety employees). "If you separate from service at age 53, for example, you will be subject to the 10% early distribution penalty rules even if you take the distribution after turning 55," she says.

7. Divorce will affect many retirement-plan account owners. The account might be split as part of the divorce settlement. Which of these is FALSE?

A. Employer plans are split using a qualified domestic relations order (QDRO).

B. IRAs are split using a divorce decree or legal-separation agreement.

C. Retirement assets should be directly transferred from one spouse's account to the other spouse's account to avoid taxation to the original spouse owner who is giving up the assets.

D. A distribution from an employer plan to the ex-spouse who is under 59½ is subject to the 10% early distribution penalty.

ANSWER: D. There is an exception to the 10% early distribution penalty for distributions made from an employer plan to an ex-spouse under a QDRO, says Ms. DeVeny. "There is no corresponding exception for distributions to an ex-spouse from an IRA that split as part of the divorce decree."

8. A retirement account owner has died. He was 82 years old and hadn't taken his RMD yet for the year of death. Who takes his distribution?

A. Since he died before the required distribution, there is none for the year.

B. It must be distributed under his Social Security number and included on his final income-tax return.

C. Since he had a required distribution, it must be distributed to his estate.

D. The plan beneficiary(ies) is responsible for taking any remaining, that is, undistributed, RMD for the year of death, by Dec. 31 of the year of death.

ANSWER: D. Any required distribution not taken by a deceased retirement account owner in the year of death must be distributed to the beneficiary, says Ms. DeVeny. It will go to the estate only if the estate is the beneficiary. If the distribution isn't taken, the beneficiary is subject to a 50% penalty on the amount not taken.

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