5 Tips for Retirees Without Multiple Retirement Accounts,
According to Financial Advisors

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Written by **G. Brian Davis (https://www.gobankingrates.com/author/bdavis/)**

Edited by **Cory Dudak (https://www.gobankingrates.com/author/cdudak/)**

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Different retirement accounts come with different rules and different tax treatment. That gives you far more flexibility to minimize taxes both before and in retirement.

So why — and how — should you combine these different account types and assets to maximum effect?

Types of Retirement Accounts

“There are three basic categories of accounts and investments: taxable, tax-deferred, and tax-free,” explains Theresa Cagle Fry, Manager of IRAs & Retirement Planning at Benjamin F. Edwards Financial Services (https://www.benjaminfedwards.com/).

She explained that, “Taxable assets include things like your investment brokerage accounts and Certificates of Deposit (CDs). With a taxable account or investment, you pay taxes on the interest or dividends as you earn them.

"Tax-deferred assets include those in traditional IRAs and other employer-sponsored retirement plans, and annuities. With tax-deferred assets, you do not pay taxes on your contributions or investment earnings as you earn them. Instead, you pay income taxes on the withdrawals you take in retirement.

"Tax-free accounts and investments are pretty limited. They include Roth IRAs (when certain conditions are met), withdrawals from cash value life insurance policies that don't exceed your basis, and income from tax-free municipal bonds."

Why You Need Multiple Accounts

If you're unsure if you need various types of retirement accounts, consider these reasons for having them.

1. Flexibility to Take Early Distributions

Traditional IRA and workplace retirement accounts like 401(k)s offer few and narrow exceptions to let owners withdraw funds before age 59 ½ without paying a penalty.

But Roth accounts offer far more flexibility to withdraw funds early. You can withdraw contributions at any time, tax- and penalty-free. And you can withdraw earnings without paying a penalty if you've held the account for at least five years, or if you use the money for any number of authorized reasons such as buying your first home, education expenses or an emergency.

Standard "taxable" investment accounts also let you withdraw money at any age.

2. Flexibility to Convert Pre-Tax to After-Tax Funds

"If you don't have a Roth account, but you have assets in a traditional 401(k) or IRA, doing a Roth conversion is one way to shift assets from the tax-deferred category into the tax-free category," noted Cagle Fry. "However, Roth conversion comes at a cost. You will pay income taxes in the year of the conversion and once you do a conversion."

Of course, taxes sting more in some years than others. Maxing out your traditional IRA or 401(k) contributions often makes sense in a year when you earned a high income as it could drop you into a lower income tax bracket.

In leaner years when you earn less, you could convert some of those traditional retirement funds to your Roth account. "If you are in a year where your taxable income has come down it may be the best way forward," recommended Stephen Akin, Registered Investment Advisor at Akin Investments.

The tax hit hurts less in these years when you pay taxes at a lower rate. But without at least one traditional retirement account and one Roth account, you can't make a Roth conversion.

3. Higher Contribution Limits

Different account types come with different contribution limits.

While IRAs offer the most flexibility and control over your investments, they come with low annual limits. In 2024, investors under 50 can contribute up to $7,000, while adults 50 and over can contribute $8,000.

Workplace retirement accounts offer fewer investment options, but much higher annual limits. Workers under 50 can contribute $23,000 to 401(k) or 403(b) accounts in 2024, while workers 50 and over can contribute up to $30,500.

And as long as you don't surpass the income ceilings, you can contribute to both an IRA and a workplace retirement plan.

4. Managing Required Minimum Distributions

"Often having multiple retirement accounts can simplify the management of your required minimum distributions (RMDs)," notes Akin.

The IRS requires you to start withdrawing money from your traditional retirement accounts at a certain age so they can tax them. But they don't require you to drain your Roth IRA.

Cagle Fry expanded on this, "If all of your retirement savings is in traditional 401(k) plans or IRAs, not only will withdrawals in your retirement be taxable to you, you are also forced to draw down your retirement savings due to required minimum distributions once you reach age 73 or 75 for individuals born in 1960 or after."

5. Estate Planning

Akin added that you can set beneficiaries for each retirement account, to skip the lengthy probate process. "If you have multiple accounts be sure to update your beneficiary on each account. The advantage to doing this is the account will go directly to your designated beneficiary without probate of a will. If your net worth is modest this may even help to avoid probate altogether."

Some of the tax benefits can pass along to your heirs as well. Cagle Fry explained how it works, "Roth accounts are great for legacy planning purposes. Although there are withdrawal requirements for most non-spouse beneficiaries, the withdrawals are typically tax-free.

"Non-spouse beneficiaries are generally required to withdraw retirement account assets they inherit within 10 years, although there are a few exceptions where they can be distributed over the beneficiary's single life expectancy. Because of the 10-year rule, inheriting a large traditional IRA or 401(k) can create significant income tax consequences for your beneficiaries.

"Inheriting a Roth IRA, on the other hand, would allow the beneficiary to not only take whatever amounts they want during those 10 years, but if they left the entire inherited Roth IRA alone until year 10, they would make the most of the tax-free earnings that the Roth IRA provides."

A Word of Caution

Note that more accounts aren't always better. You can consolidate the same types of accounts together, rolling your old 401(k) into your IRA, for example.

"We tend to advise consolidating like-kind retirement accounts like IRAs," says Jill Fopiano, CEO at O'Brien Wealth Partners. "Many clients come to us with multiple IRA or 401(k) accounts from former employers. To the extent these can be consolidated, calculating the required minimum distributions becomes more straightforward and the administration is simplified."

Have options that make sense to you, such as a traditional and Roth IRA or a traditional and Roth workplace account. But you don't need a dozen retirement accounts.