

IRA Consolidation: The “Super IRA” Strategy

The Traditional IRA and its offshoots (SEP, SIMPLE, rollover and Roth IRAs) play a leading role in helping millions of U.S. taxpayers invest for retirement. However, many IRA owners are unaware of the opportunity they have to consolidate their multiple IRAs by using a “Super IRA” strategy. An IRA consolidation strategy can lead to reduced fees and increased buying power.

What's Inside

- Creating a “Super IRA” Strategy
- Background and Types of IRAs and the Marketplace
- The Benefits of IRA Consolidation
- The IRA Consolidation Process

Investor Summary

The following is a common scenario involving a worker (Samantha) who has changed jobs several times throughout her career. She has been diligent about saving for retirement, but her assets are scattered. An IRA consolidation strategy is suggested, and the section concludes with a three-step action plan for investors like Samantha.

Profile

- Samantha, a frequent job changer, age 62, is approaching retirement.
- She has lost track of her numerous retirement savings arrangements.
- She turns to her advisor for help with simplifying her financial affairs.

During her career, Samantha has accumulated various retirement accounts but has lost track of the status of each. She is 62 years old and is thinking of retiring from her current job. She has three retirement plans with former employers [a profit sharing plan, a target benefit plan and a 403(b) plan], four Traditional IRAs, a SIMPLE IRA, two Roth IRAs, an Individual(k) plan she established when she owned her own business and a Thrift Savings Plan she now has as an employee of the federal government. She is also the beneficiary of her deceased husband's nonqualified deferred compensation plan and his Traditional IRA. In an effort to simplify her life, she turns to her financial advisor for help. Her financial advisor suggests she consider a “Super IRA” consolidation strategy.¹

¹ Clients should take tax consequences, expenses and sales charges into account, be advised if they will incur sales charges and/or penalties for selling an investment and be advised if they will be charged additional sales charges for buying a new one.

NOT FDIC INSURED	May Lose Value
NOT BANK ISSUED	No Bank Guarantee

Step 1: Understand the Rules

- A person who owns multiple SEP IRAs and Traditional IRAs can combine them into one “Super IRA” at any time.
- If the person also owns a SIMPLE IRA, he or she can transfer or roll it to a “Super IRA” after participating in the SIMPLE IRA plan for at least two years. The two-year period begins when the first SIMPLE IRA plan contribution is made to the individual’s SIMPLE IRA.
- A “Super IRA” can receive ongoing SEP plan contributions and annual Traditional IRA contributions.
- Ongoing SIMPLE IRA plan contributions must first be contributed to the participant’s SIMPLE IRA. If the individual has participated in the SIMPLE IRA plan for at least two years, he or she can transfer or roll over the SIMPLE IRA into one “Super IRA.” (Note: special rollover rules may apply.)
- A “Super IRA” can receive rollovers of eligible assets from all types of qualified retirement plans [e.g., 401(k) plans, profit sharing plans, defined benefit plans, etc.], 403(b) plans, 403(a) plans and governmental 457(b) plans.
- A Roth IRA cannot be transferred or rolled over into a “Super IRA.” Multiple Roth IRAs can be combined to create a “Super Roth IRA.” Under the Pension Protection Act of 2006, effective in 2008, participants in qualified plans, 403(b) plans and governmental 457(b) plans can directly roll over eligible plan assets to Roth IRAs if conversion rules are satisfied.
- Spouse beneficiaries of qualified plans and SEP, Traditional and SIMPLE IRAs generally can consolidate their inherited accounts into their own “Super IRA.”

Step 2: Consider the Potential Benefits of a “Super IRA” Strategy

- Increased buying power, which allows for more sophisticated investment strategies
- One fee vs. multiple fees
- Beneficiary organization and consolidation
- Consistent service
- Streamlined paperwork
- Simplified retirement income planning

Step 3: Work With Your Advisor

Investors should work with their advisors to determine whether a “Super IRA” asset consolidation strategy makes sense for them.

In our scenario, Samantha’s advisor asks her the following key questions:

- Do you have the most recent statements from each of your retirement accounts?
- What type of investments do the plans hold?
- Are any of your retirement plans invested in employer securities?
- Is your goal to consolidate your accounts as much as possible?
- How long has it been since you first participated in the SIMPLE IRA plan?

Samantha’s goal is to consolidate as many of her retirement accounts as she can into one “Super IRA.” She obtains copies of her most recent retirement account statements to review with her advisor. She first participated in the SIMPLE IRA plan a year and a half ago. She does not hold employer securities as a plan investment.

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After reviewing the statements, Samantha and her advisor determine she could combine the following retirement accounts into a “Super IRA”:

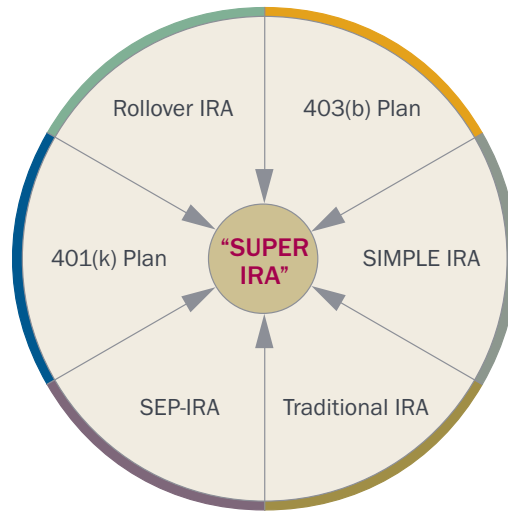
- Profit sharing plan
- Target benefit plan
- 403(b) plan
- Five Traditional IRAs (the four she owns outright and her inherited IRA)
- Individual(k) plan

In another six months (two years after first participating in the SIMPLE IRA plan), she could transfer or roll over that balance to her “Super IRA” as well. Samantha cannot combine her two Roth IRAs into her “Super IRA,” although she could consolidate them into one “Super Roth IRA.” And she cannot roll over the nonqualified deferred compensation plan. Although she could combine the plans as outlined above into one “Super IRA,” it would be best for Samantha and her advisor to carefully examine the types of investments currently held by the various plans to see if a rollover is the wisest course of action from a taxation standpoint. For example, special tax rules apply to distributions of employer securities from qualified retirement plans. Keep in mind, a consolidation strategy may not always be suitable. An advisor, or a tax or legal professional, can help identify the best course of action.

Potential Advantages of the “Super IRA” Strategy

Half of all IRA owners have multiple IRAs.² Clients are often unaware of the many potential advantages of combining their IRAs into a single “Super IRA,” which may include:

- Increased investment buying power
- More sophisticated investment strategies
- Possibility of reduced fees
- Beneficiary organization and consolidation
- Consistent service
- Streamlined paperwork
- Simplified retirement income planning



² Investment Company Institute, 2007

A Closer Look at Creating a “Super IRA” Consolidation Strategy

The year was 1974. Richard Nixon was president (until impeachment proceedings stemming from the Watergate scandal led to his August resignation, when Gerald Ford took office); fallout from the Vietnam War was ongoing; unemployment and inflation were soaring. Among other issues, Congress was concerned with boosting the economy, setting minimum standards for private industry pension plans and encouraging taxpayers to take more personal responsibility for retirement saving. To this end, Congress passed the Employee Retirement Income Security Act (ERISA) of 1974, which included a provision creating the Individual Retirement Arrangement (IRA), a personal, tax-advantaged retirement savings plan, which became effective in 1975. The IRA’s purpose was twofold: to provide a means of investing for retirement for workers not covered by an employer plan and to serve as a tax-deferred vehicle for rollover purposes.

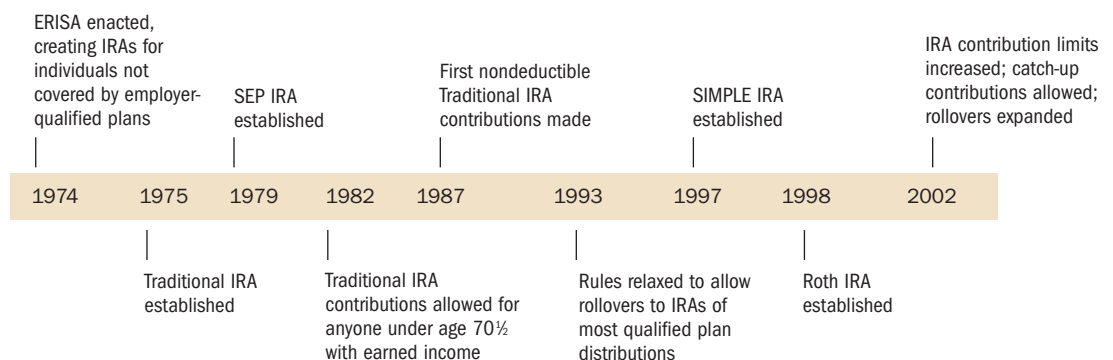
Today, the Traditional IRA and its offshoots (simplified employee pension [SEP], savings incentive match plan for employees [SIMPLE], rollover and Roth IRAs) play a leading role in helping millions of U.S. taxpayers invest for retirement. However, many IRA owners are unaware of the opportunity to consolidate their

multiple IRAs by using a “Super IRA” strategy. (Please note this is not a new product type.) The opportunity and the resulting benefits are the focus of this paper. Clients should take tax consequences, expenses and sales charges into account, be advised if they will incur sales charges and/or penalties for selling an investment and be advised if they will be charged additional sales charges for buying a new one.

History

The U.S. marked the 30th birthday of the IRA in 2005. Through the years, Congress transformed the IRA, allowing SEP plan contributions to IRAs in 1979 and expanding deductible IRA coverage to anyone under age 70½ with earned income in 1982. In 1987, Congress eliminated the universality of tax-deductible IRA contributions and introduced a complicated formula for determining contribution deductibility for workers meeting certain income limits who were covered by employer-sponsored retirement plans. In 1997, the first SIMPLE IRAs were established. The Roth IRA — the nondeductible alternative to Traditional IRAs — was officially established in 1998, although taxpayers have been able to make nondeductible Traditional IRA contributions since 1987.

IRA Timeline



Size of the IRA Market

IRA assets totaled \$4.3 trillion in the first quarter of 2007, which represents 26% of total U.S. retirement assets.³ Approximately 41% of U.S. households, representing 47 million individuals, own IRAs; 50% hold multiple IRAs.⁴

Types of IRAs

Traditional

A Traditional IRA is a personal savings plan that gives its owner tax advantages for retirement investing. Contributions to a Traditional IRA may be tax deductible — either in whole or in part. These deductible contributions remain tax deferred until they are distributed.⁵ Also, the earnings on deductible and nondeductible contributions remain tax deferred until they are distributed. A Traditional IRA can be established at many different financial institutions, including banks, insurance companies and brokerage firms.

Roth

The Roth IRA is also a personal investment plan, but operates somewhat in reverse compared to a Traditional IRA. For instance, contributions to a Roth IRA are not tax deductible. Also, while a Traditional IRA owner generally will be taxed on distributions, a Roth IRA owner can take tax- and penalty-free distributions if certain requirements are met. Qualified Roth IRA distributions are not subject to taxation and usually are not subject to state and local taxation in most states. However, distributions that are considered nonqualified may be subject to the 10% federal tax penalty if taken prior to age 59½. Earnings that remain in a Roth IRA account are not taxed. A Roth IRA also can be established at the same types of financial institutions as a Traditional IRA if certain requirements are met.

SEP

Section 408(k) of the Internal Revenue Code describes a SEP as an employer-sponsored plan under which an employer can make contributions to Traditional IRAs established for its employees. The term SEP IRA means a Traditional IRA that receives contributions made under a SEP plan. The term SEP includes a salary reduction SEP (or SARSEP), as described in section 408(k)(6) of the Internal Revenue Code. In a SARSEP arrangement, employees may defer a portion of their salaries into Traditional IRAs. Congress disallowed new SARSEPs in 1997. Employers with SARSEPs established prior to that date, however, may continue to maintain them.⁵

SIMPLE

Section 408(p) of the Internal Revenue Code describes a SIMPLE IRA plan as an employer-sponsored plan under which employees may defer a portion of their salaries, and employers must make contributions to SIMPLE IRAs established for eligible employees. The term SIMPLE IRA means an IRA that may only receive contributions under a SIMPLE IRA plan or rollovers or transfers from another SIMPLE IRA. SIMPLE IRA plans are subject to certain percentages of pay and dollar limits, and sponsoring employers may not maintain other retirement plans in conjunction with the SIMPLE IRA plan.⁵

Rollover

A rollover IRA is merely a Traditional IRA that holds assets distributed from a qualified retirement plan or assets from another IRA.

³ Investment Company Institute, Quarterly Update, March 2007

⁴ Investment Company Institute, *Fact Book*, 2007

⁵ Withdrawals are subject to ordinary income tax and may be subject to a 10% federal tax penalty if taken prior to age 59½. For SIMPLE IRAs, the federal tax penalty increases to 25% if taken during the first two years of plan membership.

Major Players in the IRA Market

The financial institutions that hold IRA assets fall into four major categories: banks and thrifts; life insurance companies; mutual funds and brokerage firms. As the following table illustrates, the IRA investment mix has shifted over the

decades from being predominantly bank and thrift deposits early on, to mutual fund and brokerage account deposits in recent years. This shift, which is expected to continue, is primarily the result of a rising trend toward equity ownership among investors in the United States.

IRA Assets (billions of dollars, 1990–2006)

	Mutual Funds ⁶	Bank and Thrift Deposits ⁷	Life Insurance Companies ^{6,8}	Securities Held Directly Through Brokerage Accounts ^{6,9}	Total IRA Assets
1990	138	266	40	193	637
1991	185	282	45	264	776
1992	233	275	50	316	874
1993	315	263	62	353	993
1994	342	255	70	390	1,056
1995	464	261	81	483	1,288
1996	582	258	92	534	1,467
1997	763	254	136	576	1,728
1998	960	249	157	784	2,150
1999	1,257	244	203	948	2,651
2000	1,232	252	203	943	2,629
2001	1,168	254	211	986	2,619
2002	1,044	263	268	957	2,533
2003	1,312	268	285	1,128 ^e	2,993 ^e
2004	1,494	270	282	1,238	3,284 ^e
2005	1,666	278	308	1,381 ^e	3,632 ^e
2006	1,971	292	336 ^e	1,634 ^e	4,232 ^e

⁶ Data are preliminary.

⁷ Bank and thrift deposits include Keogh deposits.

⁸ Life insurance company IRA assets are annuities held by IRAs, excluding variable annuity mutual fund IRA assets, which are included in mutual funds.

⁹ Category excludes mutual fund assets held through brokerage accounts, which are included in mutual funds.

^e Data are estimated.

Note: Components may not add to the total because of rounding.

Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

Demographics of the Typical IRA Holder

IRA households generally are headed by middle-aged individuals with moderate household incomes. These investors may be more likely to hold mutual funds, especially long-term mutual funds, in their IRA portfolios than any other type of investment. The Investment Company Institute

found that half of IRA owners have more than one type of IRA. IRA ownership in the immediate future will be shaped by:

1. the baby boomer generation transitioning into their wealth harvesting years;
2. the propensity to invest exhibited by the members of generation x;
3. legislative developments that promote more personal responsibility for retirement income.

Characteristics of U.S. Households Owning IRAs, 2005

Median per household	Households owning IRAs	Type of IRA Owned			Households not owning IRAs
		Traditional IRA	Roth IRA	Employer-sponsored IRA	
Age of household sole or co-decision maker for investing	52 years	54 years	45 years	47 years	45 years
Household income	\$70,000	\$63,800	\$70,000	\$64,500	\$35,000
Household financial assets	\$150,000	\$250,000	\$137,000	\$200,000	\$21,700
Household financial assets in all types of IRAs	\$10,000	\$30,000	\$10,000	\$25,000	N/A
Share of household assets in type of IRA indicated	25%	230%	9%	11%	N/A

Source: Investment Company Institute, 2005 Annual Tracking Survey

Benefits of IRA Consolidation

Clients with multiple IRA types (that is, Traditional, SEP, SIMPLE and rollover) are often surprised and elated to learn they can combine them into one Traditional IRA, which may be referred to as a “Super IRA.” A “Super IRA” is simply a Traditional IRA that holds multiple types of IRA contributions. The most compelling reasons to consolidate may include the following:

- Increased buying power, which may allow for more sophisticated investment strategies
- Fee consolidation and reduction
- Beneficiary organization and consolidation
- Consistent service
- Streamlined paperwork
- Simplified retirement income planning

Consolidation Process

IRA consolidation can occur in two ways: trustee-to-trustee transfer or rollover. IRS Publications 590 and 560 cover Traditional IRA, rollover, SEP and SIMPLE IRA plan rules. They are good resources and can be viewed and downloaded from the IRS Web site at www.irs.gov.

Millions of Households Own IRAs

	Number of U.S. households, with type of IRA, 2006	Percent of U.S. households with type of IRA, 2006
Traditional IRA	34.8 million	30.4%
SEP IRA SARSEP IRA SIMPLE IRA	7.9 million	6.9%
Roth IRA	14.4 million	12.6%
Any IRA	42.2 million	36.9%

Note: Multiple responses are included.

Sources: Investment Company Institute and U.S. Bureau of the Census.

Special Considerations for Consolidation

SEP IRA

Because a SEP IRA is simply a Traditional IRA, SEP and SARSEP IRAs generally can be transferred or rolled over into a “Super IRA” at any time. The “Super IRA” can receive ongoing SEP (and SARSEP) contributions in addition to annual Traditional IRA contributions. Many clients mistakenly believe they must keep their SEP plan and Traditional IRA contributions separate. There is no tax reason for the IRA owner to track these contribution types separately.

SIMPLE IRA

A SIMPLE IRA can be transferred or rolled over into a “Super IRA” after two years. The two-year participation period begins when the first SIMPLE IRA plan contribution is made to the individual’s SIMPLE IRA. Ongoing SIMPLE IRA plan contributions must first be contributed to the participant’s SIMPLE IRA.

Roth IRA

Multiple Roth IRAs cannot be transferred or rolled over into a “Super Traditional IRA.” However, they can be combined in one “Super Roth IRA.” Under the Pension Protection Act

of 2006, participants in qualified plans, 403(b) plans and governmental 457(b) plans can directly roll over eligible plan assets to Roth IRAs if conversion rules are satisfied (effective 2008).

Rollover IRA

A “Super IRA” can receive rollovers from all types of qualified retirement plans [for example, 401(k) plans, profit sharing plans, defined benefit plans, etc.], 403(b) plans and governmental 457(b) plans.

Spouse Beneficiary

Spouse beneficiaries of qualified plans and SEP, Traditional and SIMPLE IRAs generally can consolidate their inherited accounts into their own “Super IRA”. Similarly, spouse beneficiaries of Roth IRAs may consolidate their inherited Roth IRAs into their own “Super Roth IRA.”

Conclusion

Owners of multiple types of IRAs (Traditional, SEP, SIMPLE and rollover) are often unaware of their ability to consolidate their IRA assets into a “Super IRA.” The steps to IRA consolidation are relatively few, while the benefits can be numerous. Keep in mind, a consolidation strategy may not be suitable for everyone. A tax or legal advisor can help identify the best action.

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