# Back to Basics: Planning with Retirement Assets

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# PLANNING WITH RETIREMENT ASSETS

- Introduction/ Why Retirement Planning is Important and Retirement Assets are Unique
  - Many Americans own at least one type of retirement account
  - Income tax liability
  - Tax-deferred growth
  - Charitable planning opportunities
  - Asset protection
  - Beneficiary designation impacts the timing and tax effect of distributions

## Special considerations

- Primary and secondary beneficiaries
- Deferral of withdrawals, and deferral of income tax liability
- Using applicable estate tax exemptions
- Minimizing GST transfers
- Qualifying spousal transfers for the marital deduction
- Passing assets to a trust rather than outright

## Types of Retirement Assets

- ERISA law
- 401(k)
- 403(b)
- IRAs
- Defined Benefit Plans
- Profit Sharing Plans
- Deferred Compensation
- Qualified/Non-Qualified

# 2017 Annual Contribution Limits

- 401k
  - $18,000 (plus $6,000 catch-up if over 50 yrs old) employee elective deferral
  - Up to $54,000 with company match
- 403b
  - $18,000 employee elective deferral
  - Plan may permit $6,000 catch-up if over 50 yrs old but not required
  - Plan may permit “15 years of service catch-up”
  - Up to $54,000 with company match
- IRA
  - Traditional and Roth IRA
    - $5,500 (plus $1,000 catch-up if over 50 yrs old)
  - SIMPLE IRA
    - $12,500 (plus $3,000 catch-up if over 50 yrs old)
  - SEP IRA
    - Cannot exceed the lesser of 25% of employee’s salary or $54,000

## 2017 Annual Contribution Limits

- Traditional Pensions/Defined Benefit Plan
    - N/A
- Profit Sharing Plan
    - Employer only contributions
    - The lesser of 25% of compensation or $54,000
- Deferred Comp
    - IRC §457(b)
        - $18,000 (plus $6,000 catch-up if over 50 yrs old) employee elective deferral
    - IRC §409(A)
        - N/A

## Overview of Basic Distribution Requirements

- IRAs
  - RMDs are required in a **Traditional**, **SEP** or **SIMPLE** IRA by April 1 following the year in which you turn 70 ½.
  - **Roth** IRAs are not subject to RMD rules during owner's life, however are required after death.
- 401(k), profit sharing and 403(b) plans
  - For both **Traditional** and **Roth**, April 1st following the later of the calendar year in which you (1) reach 70 ½ or (2) retire (if allowed by your plan)

- If you do not take any distributions, or if the distributions are not large enough, you may have to pay a **50% excise tax** on the amount not distributed as required

- After the first RMD, you must take subsequent RMDs by December 31 of each year beginning with the calendar year containing your required beginning date.

## Overview of Basic Distribution Requirements

- How do I calculate my RMD?
  - The required minimum distribution for any year is the account balance as of the end of the immediately preceding calendar year divided by a distribution period from the IRS's "Uniform Lifetime Table."
  - A separate table is used if the sole beneficiary is the owner's spouse who is ten or more years younger than the owner.
- Calculating RMDs for inherited IRAs
  - Spouses vs. non-spouses
  - Did the owner survive to the required beginning date?
- Multiple withdrawals per year allowed
- May withdrawal more than RMD amount

## Potential Beneficiaries

1. Spouse
2. Children/Other Individuals
3. Trust
   - Look-through trusts (conduit and accumulation)
   - Marital trusts
   - Credit-Shelter trusts
4. Charities

Providing for Spouse

- very favorable income tax results
- law generally favors naming the spouse individually as the beneficiary, and naming a trust for the benefit of the spouse should only be done for compelling reasons

## Options of a Spouse with Respect to an IRA inherited from her Spouse

1. Treat it as her own IRA by designating herself as the owner
2. Treat it as her own by rolling it over into her own IRA
3. Treat herself as the beneficiary rather than treating the IRA has her own
4. Convert to a Roth
5. Disclaim part of all of the assets

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Outright to Spouse and Spousal Rollover

- delay distributions until she reaches 70 ½
- otherwise distributions must begin by 12/31 of the later of the year in which the owner died or the year in which the owner would have reached 70 ½
- upon reaching 70 ½ distributions made using life expectancy
- surviving spouse can name own beneficiary, who can elect to have benefits paid over beneficiaries lifetime

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3. Treat herself as the beneficiary rather than treating the IRA has her own

   • spouse leaves assets in the account, delays distributions until 70 ½, and recalculates life expectancies annually

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4. Convert to a Roth

• consult a professional!!! May be helpful if spouse thinks she will be in a higher tax bracket later in life

5. Disclaim part of all of the assets

• pass assets to younger beneficiaries who are named as contingent beneficiaries; keeps assets out of spouse's estate

Special Issues for Roth IRAs

- name spouse individually, not a trust.
- if paid to a trust the Roth has to be paid over the spouse's life expectancy
- if left outright, the spouse can roll it over into her own Roth and never touch it

Marital Trust Issues

- Overlap of the estate tax rules and the income tax rules
- Must consider rules for qualifying the trust for the marital deduction and the rules which qualify the trust as a “look-through” trust
- Essentially a conduit trust, but with additional language

Marital Trust Issues cont'd:

- Trust must contain special language directing the Trustee to withdraw and pay to the spouse all plan income, or the RMD, whichever is greater, OR
- Trust must give the spouse the power to compel the Trustee to withdraw all plan income and distribute it to the spouse annually (Rev. Ruling 2006-26)

Providing for Children/Non-Spouse

- Individuals may take distributions based on their own life expectancy
- Allows them to "stretch" distributions for a longer period of time, which extends the tax-deferred growth of the retirement asset
- NOTE: if account owner dies before his required beginning date, individual may be required to withdraw the assets over a period of 5 years

## Tremendous Value in Tax-Deferred Compounding

- Studies show that deferring over a child's lifetime can double the after-tax receipts, and deferring over a grandchild's lifetime can multiply the after-tax benefits seven-fold.
- The effect is even more dramatic for Roths. Four times for children, thirteen to twenty-two times for grandchildren.

Designating Multiple Beneficiaries

- generally life expectancy of the oldest is used to determine the timing and amount of distributions to all the beneficiaries
- but if by 12/31 of the year following the account owner's death each beneficiary creates his own inherited IRA, the inherited IRA owner will be able to take distributions based on his own life expectancy

Required Minimum Distribution Depends on if there's a "Designated Beneficiary"

- defined in Treas. Reg. §1.401(a)(9)(5)
- included: individuals and certain qualified trusts
- excluded: estates, charities, and businesses entities – Treas. Reg §1.401(a)(9)-4

Options of a Non-Spouse

1. Transfer assets into an Inherited IRA – must take RMD but based on her age and life expectancy; can always get the money sooner and accelerate the tax owed

2. Disclaim part or all of the assets – make sure beneficiary designation facilitates disclaimer to younger generation, i.e. use per stirpes

Non-Spouse Inheriting an IRA

1. funds must be transferred to an inherited IRA by 12/31 following the year of death to stretch the plan assets over his lifetime

2. custodians/plan administrators are not required to calculate RMDs for inherited IRAs

3. must take RMDs from their inherited IRAs yearly starting the year after the death of the owner

Trusts as Beneficiary

- trust is not a person, has no life expectancy, cannot take advantage of the lifetime stretch-out opportunity
- only certain types of trusts are permitted Designated Beneficiaries
- exercise caution when naming a trust as the beneficiary of a retirement account

# Reasons to Use a Trust and Give Up the Income Tax Deferral Benefits

- beneficiary is disabled, has special needs, relies on governmental benefits such as SSI or Medicaid
- beneficiary is a minor
- beneficiary is a spendthrift
- beneficiary has substance abuse or mental health issues
- beneficiary is a second spouse and owner wants to limit the spouse's access to principal
- trusts limit the beneficiary's control over the assets
- trusts may provide asset protection
- trusts may be used to exclude the trust assets from estate tax at the beneficiary's death

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When Using a Trust Does Not Matter

- retirement plan does not allow a life expectancy payout (so can name a revocable trust as the beneficiary)
- retirement plan requires a lump sum distribution (but after retirement owner should look into rolling the plan assets into an IRA that allows a lifetime stretch-out)
- Income tax deferral is not important if beneficiary will withdraw entire account to pay estate taxes or support minor children
- Size of the account is so minor that a lump sum withdrawal will not cause substantial income tax

## Look-Through Trusts

- very strict IRS requirements for qualification
- lawyers must be familiar with the rules and required language in order to avoid serious tax consequences
- if a properly structured “look-through” trust is designated as the beneficiary, the IRS will allow the assets to be distributed over the life of the sole trust beneficiary or over the life expectancy of the eldest beneficiary if there are multiple beneficiaries

Trust must satisfy 5 tests to qualify (Treas. Reg. §1.401(a)(9)-4:

1. trust must be valid under state law
2. trust must be irrevocable or become irrevocable at the taxpayer's death
3. trust beneficiaries must be identifiable
4. certain documentation must be provided to the custodian/plan administrator by 10/31 of the year after the taxpayer's death
5. it must be possible to determine the identity of the eldest beneficiary of the trust and only individuals may be beneficiaries of the trust

Conduit Trusts

- requires trustee to distribute to or for the benefit of the income beneficiary all of the retirement account distributions received by the trustee
- all RMDs and any other withdrawals from the account received by the trustee must pass through the trust to the beneficiary

(PLR 200537004)

Conduit Trusts cont'd:

- may not accumulate any assets withdrawn from the retirement account
- advantages: this type of trust is specifically described and permitted in the Regulations
- disadvantages: does not allow accumulation inside the trust, which tends to be contrary to the client's wishes, who is using a trust to prevent the assets from being distributed to the beneficiary

## Accumulation Trust

- the RMD and any other account withdrawals are distributed to the trust, but the trustee has the option to "hold" the distribution and accumulate it with the principal of the trust
- requires very careful drafting, and certain provisions must be included in the trust to qualify as a Designated Beneficiary
- many practitioners recommend obtaining a private letter ruling before naming a trust as the beneficiary
- if the RMD is accumulated, the trust must pay the tax on the income from the IRA and trusts are taxed at a much higher rate than individuals

Credit-Shelter Trusts

- generally not desirable as a beneficiary
- consider increased exemptions and the uncertainty of the future of the estate tax
- consider loss of spousal rollover and life expectancy payout option

Credit-Shelter Trusts cont'd:

- conduit credit shelter trusts push the retirement account out to the spouse during the spouse's life expectancy, which moves the assets into the spouse's estate, so it will not save estate tax dollars
- accumulation credit shelter trusts are better because the trust can retain distributions, which means the retirement account withdrawals not distributed out of the trust will pass free of estate tax. But there are still disadvantages including the loss of the spousal rollover, the costs and complexity of drafting a qualifying trust and obtaining a private letter ruling

Charities

- attractive beneficiaries of tax-deferred retirement accounts because charities are income tax-exempt and will receive the benefit tax free whereas noncharitable beneficiaries will pay income tax
- also attractive because the owner's estate can receive an estate tax charitable deduction under §2055(a) for the value of the gift

Ways to Give to Charity

1. Name charity as sole plan beneficiary

2. Leave benefits to charity and noncharitable beneficiaries in fractional shares.

3. leave pecuniary gift (fixed dollar amount) to charity and residue (balance) to individuals

4. Formula bequest in beneficiary designation (formula based on the size of the estate and adjusted for other amounts passing to the charity, for example, through the decedent's Will or Trust)

Ways to Give to Charity cont'd:

5. Leave benefits to charity through a trust (minimum RMDs and fiduciary income taxes cause complexity)

6. Leave benefits to charity through an estate (slightly preferable than a trust because estate is entitled to an income tax deduction for amounts either paid to or set aside for charity, whereas a trust is entitled to the deduction only for amounts "paid" to charity)

7. Disclaimer-activated gift (individual as primary beneficiary, charity as secondary beneficiary)

Permissible Charities

- 501(c)(3) public charities, donor-advised funds, private foundations, or charitable remainder trusts (CRTs)

## Final Thoughts on Beneficiary Designations

- understand the terms of the plan before deciding on a beneficiary
- hard to fit beneficiary language on the form, so better approach is to write "see attached" and submit an attachment with the form
- make sure the custodian/plan administrator accepts the form; maybe submit forms with a receipt that requires them to sign and date an acknowledgment accepting the designation and its effectiveness

## Other Issues for Executors and Beneficiaries

- Executor Responsibility
  - Find documents
  - Manage the deceased's property
  - Distribute the assets to the beneficiaries
- Probate
- Estate as a Beneficiary

## Post death transfers, rollovers, conversions

- You just inherited an IRA, now what?

- Rollovers
  - What assets can be rolled over into which accounts?
  - “One-per-year” rule
  - Direct vs. trustee-to-trustee vs. 60-day

- Roth Conversions
  - Why convert?
  - How do you convert?
  - Tax consequences

# PLANNING WITH RETIREMENT ASSETS

## ROLLOVER CHART

1/23/201

| Roll From ↓ / Roll To → | Roth IRA | Traditional IRA | SIMPLE IRA | SEP-IRA | Governmental 457(b) | Qualified Plan[1] (pre-tax) | 403(b) (pre-tax) | Designated Roth Account (401(k), 403(b) or 457(b)) |
|---|---|---|---|---|---|---|---|---|
| Roth IRA | YES[2] | NO | NO | NO | NO | NO | NO | NO |
| Traditional IRA | YES[3] | YES[2] | NO | YES[2] | YES[4] | YES | YES | NO |
| SIMPLE IRA | YES,[3] after two years | YES,[2] after two years | YES[2] | YES,[2] after two years | YES,[4] after two years | YES, after two years | YES, after two years | NO |
| SEP-IRA | YES[3] | YES[2] | NO | YES[2] | YES[4] | YES | YES | NO |
| Governmental 457(b) | YES[3] | YES | NO | YES | YES | YES | YES | YES[3,5] |
| Qualified Plan[1] (pre-tax) | YES[3] | YES | NO | YES | YES[4] | YES | YES | YES[3,5] |
| 403(b) (pre-tax) | YES[3] | YES | NO | YES | YES[4] | YES | YES | YES[3,5] |
| Designated Roth Account (401(k), 403(b) or 457(b)) | YES | NO | NO | NO | NO | NO | NO | YES[6] |

[1] Qualified plans include, for example, profit-sharing, 401(k), money purchase and defined benefit plans
[2] Only one rollover in any 12-month period
[3] Must include in income
[4] Must have separate accounts
[5] Must be an in-plan rollover
[6] Any amounts distributed must be rolled over via direct (trustee-to-trustee) transfer to be excludable from income
For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans.

www.irs.gov

Recent Tax Developments

- Permanent Extension of IRA Charitable Rollover
- Inherited IRAs not protected in bankruptcy

## Permanent Extension of IRA Charitable Rollover

- Signed by President Obama in late 2015, the PATH Act made the IRA Charitable Rollover permanent.
- Incentives allows IRA owners 70 ½ and older to transfer up to $100,00 annually tax-free directly from their IRA to qualifying charities of their choosing.
- Transfer counts towards the donor's annual RMD from his IRA without being included in the donor's taxable income.

Inherited IRAs not protected in bankruptcy

- In *Clark v. Rameker* (134 S. Ct. 2242 (2014)), the Supreme Court held in a unanimous decision that funds held in an IRA inherited by a non-spouse beneficiary after the death of the owner are not “retirement funds” within the meaning of federal bankruptcy law and are therefore not exempt from the bankruptcy estate.
- Has the practical effect of making inherited IRA assets available to satisfy creditors’ claims.

## Recent Tax Proposals

- Eliminating Stretch IRAs
- Romney Rule
- Required Minimum Distributions

Eliminating Stretch IRAs

- Under current law, minimum distribution rules permit an inherited IRA or qualified plan benefit to be paid out over the lifetime of the beneficiary.
- Under the proposal, non-spouse beneficiaries would be required to take distributions over no more than five years, with the exception for "eligible beneficiaries."
- Eligible beneficiaries include a disabled individually, a chronically ill individual, an individual who is not more than 10 years younger than the participant or IRA owner, or a child who has not reached the age of 18. For eligible beneficiaries, distributions would be allowed over the lifetime of the beneficiary, and for minor children, the account would need to be fully distributed no later than five years after the child reaches the age of 18.
- This would eliminate an incredibly effective tool which allows retirement assets to grow and compound tax-free and distributions to be made over an extended period of time.
- Both the Obama Administration and Congress have proposed legislation on this topic.

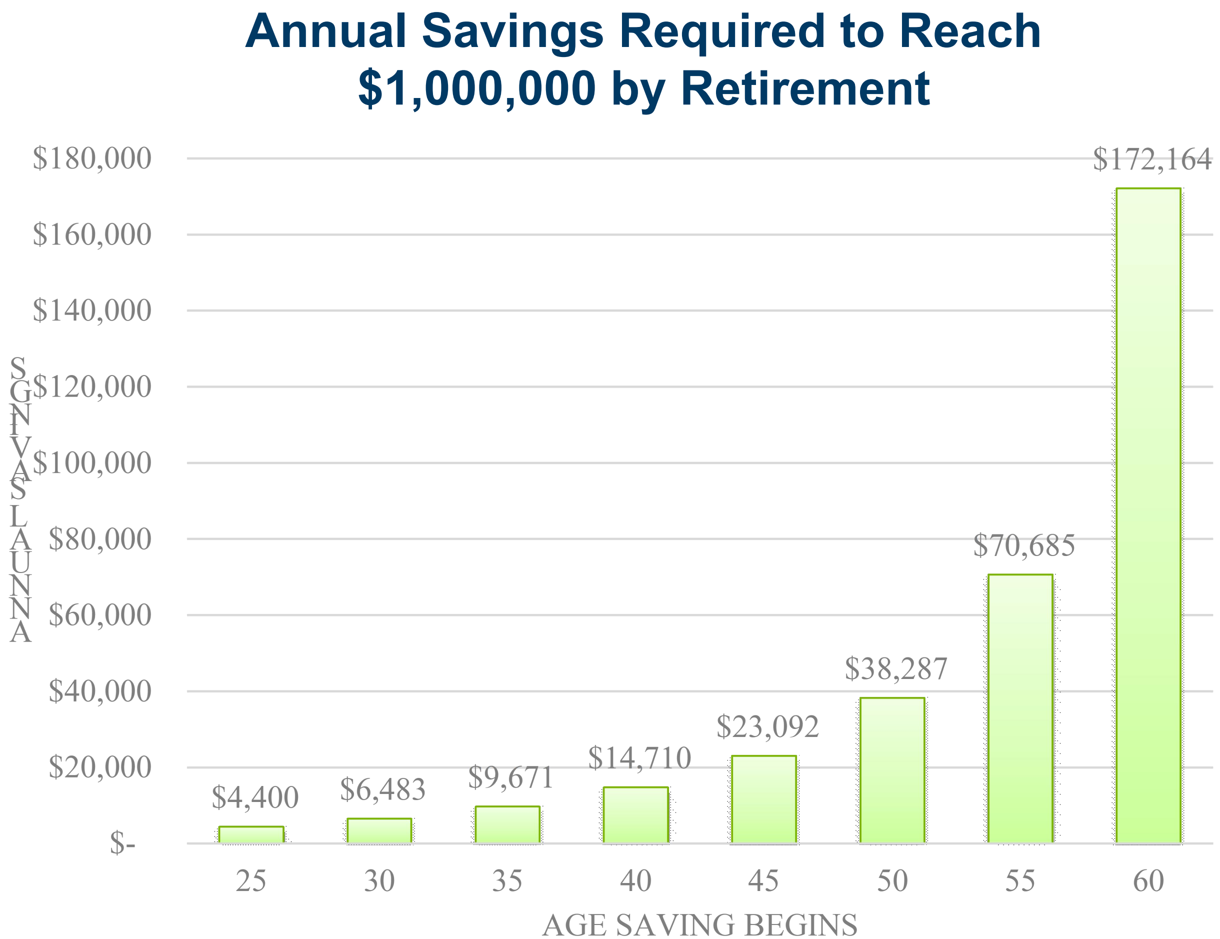
Romney Rule

- After news emerged during the 2012 President campaign that former Governor Mitt Romney had an IRA holding more than $100,000,000, the Obama Administration considered a tax proposal which would limit the total accrual of tax-favored retirement benefits.
- Proposal would prohibit additional contributions to retirement plans once an established cap is reached.
- This proposal would mostly target wealthy executives who have substantial retirement plans who are advised by their tax and financial advisors to maximize the tax-deferred balances and these plans.

Required Minimum Distributions

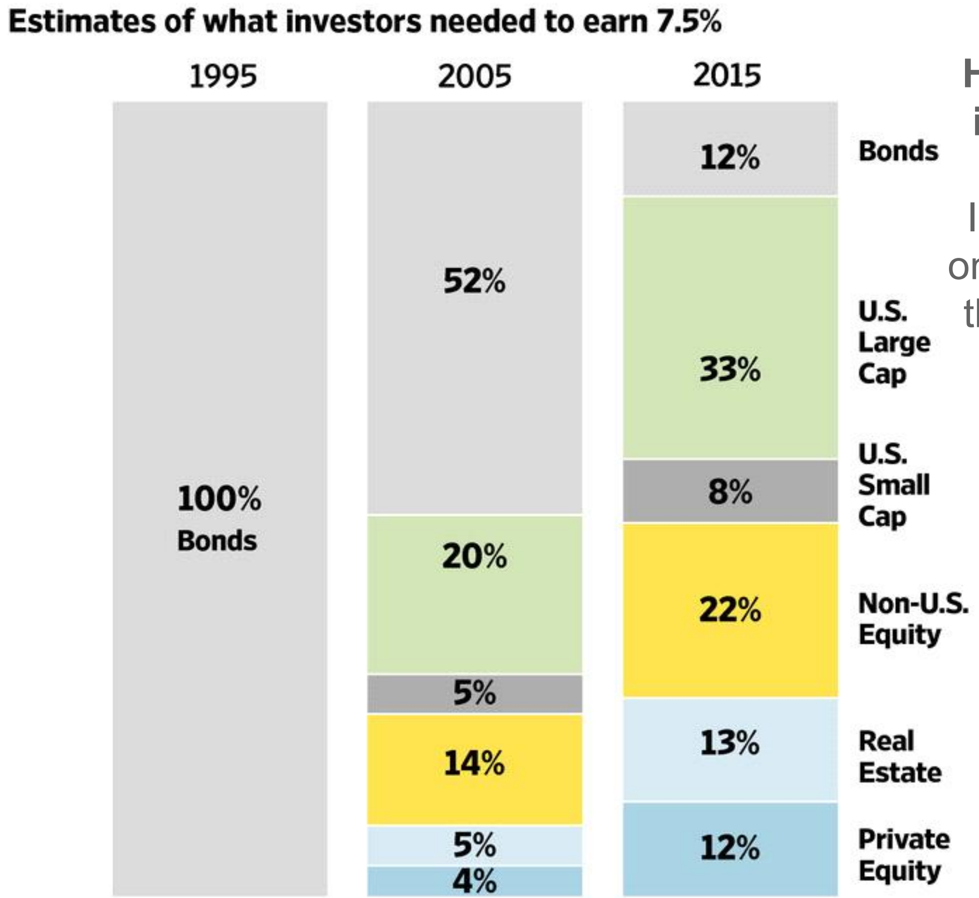
- Under current law, IRA owners and qualified plan participants must generally take RMDs upon attaining the age of 70 ½. No RMD is required during life for a Roth IRA.
- The Administration has proposed to eliminate RMDs for individuals who have a total of $100,000 or less in all of their tax-favored retirement accounts.
- Measurement date would be the beginning of the year in which the taxpayer reached 70 ½, and additional measurement dates would occur at the beginning of every year in which there are additional contributions, rollovers, or transfers.
- Administration also proposes to require RMDs on Roth IRAs in the same way they are imposed on traditional IRAs.

# Investment Considerations - Compounding




Annual savings calculated assuming 7.5% growth rate.

# Investment Considerations: Asset Allocation




| | 1995 | 2005 | 2015 |
|---|---|---|---|
| Expected return | 7.5% | 7.5% | 7.5% |
| Standard deviation* | 6.0% | 8.9% | 17.2% |

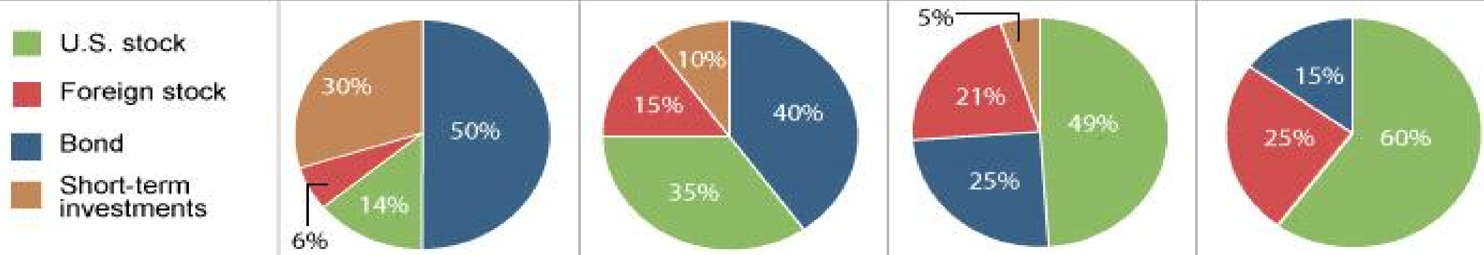
**How Savings Are Invested is Important to Achieving Retirement Goals:**

Investors today have to take on significantly more risk than they did twenty years ago in order to achieve the same expected return

Source: Wall Street Journal.

DCBA Sections

# Investment Considerations: Age & Asset Allocation




| | Conservative | Balanced | Growth | Aggressive growth |
|---|---|---|---|---|
| **Annual return %** | | | | |
| Average | 6.01 | 7.98 | 8.97 | 9.64 |
| Best 12 months | 31.06 | 76.57 | 109.55 | 136.07 |
| Worst 12 months | –17.67 | –40.64 | –52.92 | –60.78 |
| Best 5 years | 17.24 | 23.14 | 27.27 | 31.91 |
| Worst 5 years | –0.37 | –6.18 | –10.43 | –13.78 |

Data Source: Ibbotson Associates, 2014 (1926–2014). **Past performance is no guarantee of future results.** Returns include the reinvestment of dividends and other earnings. This chart is for illustrative purposes only and does not represent actual or implied performance of any investment option.

## Investment Considerations and Strategic Planning

- Age of retiree
- Near term and long term goals
- Asset allocation
- Roth conversion and tax consequences

# PLANNING WITH RETIREMENT ASSETS

Other Issues/Things to Watch Out For

- Reviewing beneficiary designations after significant life events such as marriage, divorce, and births of children and grandchildren.
- Beneficiary designations trump testamentary arrangements in Wills and Trusts, so make sure your client's designations coordinate with their estate planning objectives.
- Under federal law, spouses are the default beneficiary for qualified retirement plans, so if there is no designated beneficiary, the assets will pass according to the default.

Federal Supremacy/Preemption/ERISA Requirements

- If plan-holder wants to name someone other than his spouse as the beneficiary of an ERISA-governed plan, the spouse must waive her right to receive the plan assets and give consent to the plan-holder naming someone else.
- That waiver and consent must be kept on file with the plan administrator.
- This is important in Premarital Agreements! The Agreement must contain the contractual obligation to give consent and sign the waiver, and then the parties must take steps to sign the waiver <u>after</u> the marriage.

## *Kennedy v. Plan Administrator for DuPont Savings & Investment Plan*, 555 U.S. 285 (2009)

- Supreme Court held that ERISA-covered employee benefit plans must pay death benefits to a participant's properly-named beneficiary under the written plan document, regardless of any state-law claim that the beneficiary had waived his or her right to receive the benefit

Conclusion

- Retirement accounts create unique problems because withdrawals after the owner's death trigger income tax.
- Trusts should be avoided as beneficiaries unless there is a major nontax reason.
- Some practitioner's recommend drafting estate planning documents to ensure that any estate tax is paid from nonretirement assets.
- Pay close attention to tax apportionment clauses in Wills and Trusts of clients with significant retirement assets.
- Get confirmation from the custodian/plan administrator confirming the designation.
- Ask the custodian/plan administrator to given written responses to any appropriate questions.