

10 CRITICAL IRA ERRORS ADVISORS MUST AVOID

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MISTAKE #1

FAILING TO MAXIMIZE THE USE OF QCDS



FAILING TO MAXIMIZE THE USE OF QCDs

- IRA owners and IRA beneficiaries who are actually age 70 ½ or older
 - Not available from plans!
- Limited to \$100,000 per person annually
- Can be used to satisfy all or a portion of a client's RMD
- No charitable contribution deduction, but QCD amount is not added to AGI

FAILING TO MAXIMIZE THE USE OF QCDs

- Can only be made from the taxable portion of IRAs, Roth IRAs and inactive SEP and SIMPLE IRAs
- Must be sent directly from client's IRA to charity or via check payable to the charity
 - No split gifts
 - No private grant-making foundations
- QCD amount would have to be entirely deductible if it were made with non-IRA funds

FAILING TO MAXIMIZE THE USE OF QCDs

- Reporting is done by tax payer
 - Line 15a: QCD amount
 - Line 15b: \$0, "QCD"
- Help mitigate costs tied to AGI / MAGI
- Take on greater importance in 2018 due to TCJA's increase of standard deduction

MISTAKE #2

INCORRECT UNDERSTANDING OF CREDITOR/BANKRUPTCY PROTECTION RULES



BANKRUPTCY PROTECTION

- Plans receive protection for an uncapped amount of assets
- IRA contributions and earnings protected up to \$1,283,025*
 - *inflation-adjusted every 3 years (next in 4/1/19)
- SEP and SIMPLE IRAs are “plans”
- Plan funds rolled to IRAs retain their uncapped protection

CREDITOR PROTECTION (NON-BANKRUPTCY)

- ERISA-covered plans are generally fully protected
 - Watch out for solo plans!
 - Exceptions for ex-spouses (via QDRO) and the IRS
- Non-ERISA-covered plans and IRAs receive protection under state law
 - Uncapped protection in many states
 - Limited protection in some states
 - Different protection for traditional IRAs vs. Roth IRAs in some states
- SEP and SIMPLE IRAs are ?????????
 - *Lampkins v. Golden*
- ERISA-covered plan funds rolled to non-ERISA-covered plans or IRAs DO NOT retain their ERISA protection

MISTAKE #3

USING THE WRONG LIFE EXPECTANCY FACTOR FOR INHERITED IRA RMDs



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RMDS FOR NON-DESIGNATED BENEFICIARIES

- **Death before RBD**
 - Account must be emptied within 5 years
 - No requirement for distributions in years 1 - 4

- **Death after RBD**
 - THERE IS NO 5-YEAR RULE
 - RMDs calculating using decedent's remaining single life expectancy

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RMDS FOR NON-DESIGNATED BENEFICIARIES

- Calculating the first RMD (year after death)
 - Step #1 – ALWAYS use the Single Life Expectancy Table
 - Step #2 – Lookup factor using beneficiary's age on birthday in year after owner's death
 - Step #3 – Throw out the Single Life Expectancy Table
 - Step #4 - Divide prior-year-end balance by factor

RMDS FOR NON-DESIGNATED BENEFICIARIES

- Subsequent years' RMDs
 - Step #1 – Subtract 1 from the prior year's life expectancy factor to get factor for current year
 - Step #2 – Divide by prior-year-end balance by factor

MISTAKE #4

FAILING TO UNDERSTAND THE “99% RULE”



SPOUSAL BENEFICIARY OPTIONS*

- 1) Remain as a beneficiary of the inherited account (with special rules)
- 2) Complete a spousal rollover
- 3) Elect to treat the deceased spouse's account as their own

* Spouse must be sole beneficiary

REMAINING A BENEFICIARY

- No 10% penalty on pre-59 ½ distributions
- Properly titled inherited IRA is established
- Funds must be moved directly
- No RMDs until deceased spouse would have been 70 ½
 - Spouse beneficiaries subject to RMDs can recalculate their life expectancy (but still use the Single Life Expectancy Table)
- Special rule for successor beneficiaries

SPOUSAL ROLLOVER

- Often makes sense if surviving spouse is $\geq 59 \frac{1}{2}$
- Irrevocable election
- Treated as though money was always in the surviving spouse's IRA
- No deadline to complete

CHOOSING THE RIGHT OPTION

The #1 mistake made by spouse beneficiaries is failing to properly choose between:

- Remaining a beneficiary
- Doing a spousal rollover.

Hint: Use the “99% Rule”

THE “99% RULE”

“If the surviving spouse is under 59 ½, then setting up an inherited IRA is almost always the correct option. Once the spouse turns 59 ½, a spousal rollover can be completed.”

“If the surviving spouse is 59 ½ or older, a spousal rollover is almost always the right move.”

POTENTIAL EXCEPTIONS TO THE "99% RULE"

- Scenario #1
 - Much younger spouse (<11 years younger)
 - Deceased spouse would already be 70 ½ or older
 - Surviving spouse does not anticipate needing inherited IRA money until they are at least 59 ½
- Scenario #2
 - Older spouse
 - Younger spouse would not yet be 70 ½
 - Spouse beneficiary doesn't need/want to take distributions

MISTAKE #5

IGNORING THE POTENTIAL BENEFITS OF QLACS



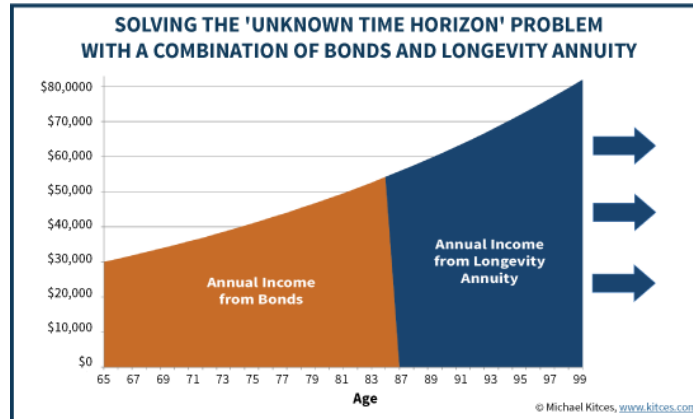
QUALIFYING LONGEVITY ANNUITY CONTRACTS

- FMV excluded from a retirement account owner's prior year-end balance for RMD calculation purposes
- Distributions must begin in the month after attainment of age 85.
- May be purchased with the lessor of 25% of retirement funds or \$130,000
 - 25% limit is applied to each employer plan separately
 - 25% limit is applied in aggregate to IRAs
- Limited death benefit options
 - Return of premium
 - Life annuity

QUALIFYING LONGEVITY ANNUITY CONTRACTS

- Must be fixed annuities
- May not offer any commutation benefit, cash surrender value or similar feature
- Can be purchased with IRA, 401(k), 403(b) and governmental 457(b) plan funds
- QLAC overpayments must be returned by the end of the year following the year the premium payment was made

QUALIFYING LONGEVITY ANNUITY CONTRACTS



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QUALIFYING LONGEVITY ANNUITY CONTRACTS

- Offer more liquidity than immediate annuities with similar lifetime guarantees
- Should QLACs “replace” fixed income, or equity positions?
- Mortality credits are key!

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MISTAKE #6

FAILING TO CONSIDER ALTERNATIVES TO NAMING A TRUST AS BENEFICIARY



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TRUST BENEFICIARY ALTERNATIVES

- Can an UGMA/UTMA be used for minor beneficiaries?
 - Beneficiary will generally have access to funds at 18 or 21
 - “Jim Smith as custodian for John Doe, under the [State] Uniform Transfers to Minors Act”
- Can a disclaimer be used to avoid estate taxes?
- Can *the* trust beneficiary be contingent upon the trust’s beneficiary surviving the IRA owner?

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TRUST BENEFICIARY ALTERNATIVES

- QTIP trusts
 - Can the IRA be split between the surviving spouse and the children?
 - Can life insurance be used to provide a benefit to the surviving spouse and/or other beneficiaries?
- Can a conduit trust give the IRA owner enough post-death control?
 - Lower the potential for drafting issues

MISTAKE #7

NOT FIXING MISTAKES WHEN YOU
CATCH THEM



A PROBLEM THAT WON'T GO AWAY

- Robert K. Paschall et ux. v. Commissioner; 137 T.C. No. 2; Nos. 10478-08, 25825-08, July 5, 2011
- There may be no statute of limitations!

MISTAKE #8

RMD AGGREGATION ERRORS



RMD AGGREGATION RULES

- Widely misunderstood
 - CPAs and advisors alike
- Horseshmouth, LLC survey
 - 18% of those initially surveyed answered correctly
 - Multiple choice questions with only four choices!

LET'S SEE HOW YOU DO!

- Client's goals
 - Avoid potential penalties
 - Take distributions from as few accounts as possible
- Client has 6 total retirement accounts
 - 2 IRAs
 - 2 401(k)s
 - 2 403(b)s

RMD AGGREGATION RULES

- IRAs
 - Calculate RMD on each account individually
 - IRA RMDs can be added together and taken from any one or combination of IRA accounts (this includes SEP and SIMPLE IRAs)
 - Special rules generally apply to annuitized IRA annuities

RMD AGGREGATION RULES

- Employer Plans
 - Calculate RMD for each plan individually
 - RMDs must be taken from each plan
 - Employer plan RMDs **cannot** be aggregated
 - 403(b) exception

Under no circumstances can an RMD from one type of retirement account be taken from a different type of retirement account

RMD AGGREGATION RULES

- Annuities
 - Pre-annuitization - IRA or 403(b) annuities can be aggregated
 - Post-lifetime annuitization – The annuity payment IS the RMD
 - Possible exception in year of annuitization
 - Grey area – Period-certain (only) annuitization

ADDITIONAL RMD AGGREGATION RULES

- No aggregating between spouses
- No aggregating between RMDs for a client's own account(s) and an inherited account
- No aggregating inherited RMDs for accounts of different decedents

MISTAKE #9

ROTH IRA 5-YEAR RULE CONFUSION



THERE ARE TWO 5-YEAR RULES!

“Please explain *the* Roth IRA 5-year rule to me?”

Which one?



ROTH IRA 5-YEAR RULE – DISTRIBUTIONS OF CONVERTED FUNDS

- Used, in part, to determine if 10% penalty applies to distribution
 - Only applies to clients under 59 ½, AND
 - Only applies when a distribution of converted funds is made within five years of the conversion
- Separate 5-year rule clock applies to each conversion
 - Roth IRA ordering rules apply

ROTH IRA ORDERING RULES

- Contributions come out first
- Conversions come out next
 - FIFO
 - Multiple conversions within same year treated as one
 - Taxable portion of conversion first
- Earnings come out last

ROTH IRA 5-YEAR RULE – QUALIFIED DISTRIBUTIONS

- Used, in part, to determine if distribution is a qualified distribution
 - Tax and penalty free
- Clock starts w/ first contributions to Roth IRA
 - “One clock to rule them all”

MISTAKE #10

BENEFICIARY FORM ERRORS



WHERE THERE'S A WILL...

- Generally overridden by beneficiary form
- Estate beneficiaries can receive IRA proceeds, but can't "stretch" distributions
 - An inherited IRA FBO an estate may be retitled to inherited IRA FBO estate beneficiary, but the distribution schedule remains
 - You may encounter difficulties with the custodian

SELECT BENEFICIARY FORM CASES

- Kennedy v. Plan Administrator for DuPont Savings and Investment Plan
 - U.S Supreme Court, No. 07-636, January 26, 2009
- Cajun Industries, LLC vs. Robert Kidder et al.
 - U.S. District Court; Middle District of Louisiana, No. 09-267-BAJ-SCR – April 26, 2011
- Greenebaum Doll & McDonald PLLC v. Sandler
 - U.S. Court of Appeals for 6th Circuit, No. 06-6496, December 3, 2007

SELECT BENEFICIARY FORM CASES

- Charles Schwab & Company v. Chandler
 - U.S. Court of Appeals for 9th Circuit, No. 07-15261, January 22, 2010
- The Pension Pickle
 - New York Post, January 31, 2005

QUESTIONS?

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Contact: questions@kitces.com