IRA Planning For Baby Boomers

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Part 1

Required Minimum Distributions

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Required Beginning Date (RBD)

- IRA owners (including, SEP & SIMPLE IRAs)
  - April 1 of year following year client turns 70 ½
- Plan participants
  - ***Generally*** April 1 of year following year client turns 70 ½
  - May be extended in certain circumstances

Plan RBD Exceptions

- Still Working Exception
  - Plan must "allow"
  - Participant must own 5% or less of company
  - Participant must still be employed at the end of the year
- 403(b) "Old Money" Exception

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Your RMD is *Your* Problem

"Who calculates the amount of the RMD?

Although the IRA custodian or retirement plan administrator may calculate the RMD, the IRA or retirement plan account owner is ultimately responsible for calculating the amount of the RMD."

- From IRS webpage: Retirement Plans FAQs regarding Required Minimum Distributions

Calculating the RMD

- Select the right life expectancy factor
- Use the right prior-year-end balance. Begin with year-end statement and adjust for:
  - Outstanding rollovers/transfers
  - Excess QLAC payments
  - Recharacterizations of prior-year conversions

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

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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

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

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Qualified Charitable Distributions (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

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Qualified Charitable Distributions (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

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Qualified Charitable Distributions (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

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Qualifying Longevity Annuity Contracts (QLACs)

- 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

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Qualifying Longevity Annuity Contracts (QLACs)

- 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

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Correcting RMD Errors

- Calculate and take missed RMDs
- File Form 5329 for each year of RMD shortfall
- Attach a statement providing reasonable cause

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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
- No statute of limitations if you haven't filed Form 5329!!

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Other RMD Concerns

- Liquidity issues
- Timing within the distribution year
- "First-money-out rule"
- Rollovers vs. Transfers

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Part 2

Roth IRA Conversions

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Do We Look At Roth Accounts Correctly?

John Doe

- $500,000 mortgage
- $1MM house
- $1MM cash in bank
- $1MM IRA
- Net Worth: $2.5MM?

Jane Doe

- $500,000 mortgage
- $1MM house
- $1MM cash in bank
- $1MM Roth IRA
- Net Worth: $2.5MM?

How do these two clients have the same net worth!?

Why Roth IRAs?

- No lifetime required minimum distributions
- Tax-free distributions during retirement
- Reduce the number of retirement projection variables
- Tax diversification
- "Tax insurance"

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Roth IRA Conversion Basics

- Pretax portion of conversion is added to client's income in year of conversion
- Conversion year is dictated by when funds *leave* the distributing account
- Anyone with an eligible account can convert!
  - No minimum or maximum income
  - No minimum or maximum age
  - No filing status restrictions

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Roth Conversion Planning Post-TCJA

- Roth IRA conversions can no longer be recharacterized
- Eliminates certain strategies
  - Cherry-picking the winners/losers
  - "Old-school" Roth conversion cost averaging
  - Convert now and decide how much to keep later

Roth Conversion Planning Post-TCJA

- Makes pre-conversion planning MUCH more important
- 3 key steps BEFORE making any Roth conversion
  - Get a Rough estimate of the conversion's potential impact on your client's tax bill
  - Make sure you have a reasonable expectation that the benefits of "pre-paying" taxes via a Roth IRA conversion make sense in the client's overall plan
  - Develop a strategy for paying the additional taxes your client will owe as a result of the conversion

Roth Conversion Planning Post-TCJA

- There are still strategies savvy advisors can use to maximize Roth IRA conversions
- 2018 Roth-conversion-cost-averaging
- Roth conversions "barbelling"

Life After a Conversion

- Revisit asset allocation strategy
- Revisit asset location strategy
- Revisit retirement spenddown plan

Part 3

Post-Death Payouts

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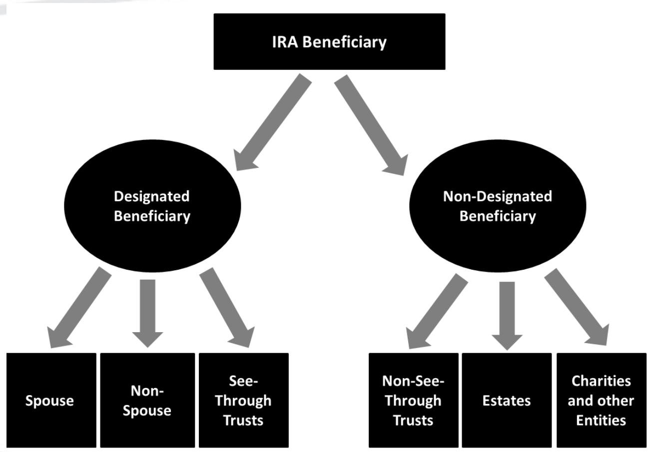
The IRA Beneficiary "Family Tree"



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Year-of-Death RMD

- Year-of-death RMD taken by beneficiaries
  - Beware of automatic RMDs
- Taking RMD does not preclude disclaimer of remaining funds
  - Revenue ruling 2005-36

Calculating RMDs for Non-Designated Beneficiaries

- Death before owner's RBD
  - 5-Year rule
- Death on/after RBD
  - Deceased IRA owner's remaining single life expectancy
  - Maximum of 15.3 years

Calculating RMDs for Non-Designated Beneficiaries

- Use the right life expectancy table
  - ALL beneficiaries use the Single Life Table
- Select the right factor
  - Use the beneficiary's age in the year after the year of death
- Subtract by one to arrive at factor in future years

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Special Considerations for Designated Beneficiary RMDs

- Death of owner prior to RBD
  - Beneficiary may elect 5-year rule
- Death of owner on/after RBD
  - If beneficiary is older than decedent, beneficiary may use decedent's remaining single life expectancy
- Custodian may not allow "stretch"

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PART 4

TRUSTS AS IRA BENEFICIARIES

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REASONS TO NAME A TRUST AS AN IRA BENEFICIARY

- The primary reason to name a trust as the beneficiary of an IRA should be some form of <u>control.</u>
- Common scenarios where a trust might be considered include:
  - Situations involving beneficiaries who are
    - Minors
    - Disabled
    - Incompetent
    - Unsophisticated
  - Concerns when there is a second marriage

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Reasons to Name a Trust as an IRA Beneficiary

- Other common scenarios where a trust might be considered include:
  - Cases where the owner wants to guarantee the stretch IRA is used
  - Planning to help avoid estate taxes*
    *Can also be done without a trust
  - Situations where creditor protection may be an issue
  - Clients who are concerned about beneficiaries' spouses
  - Plans that involve the use of charitable trusts

See-Through Trusts

- Also known as look-through trusts
- Allow trust to "stretch" distributions over oldest applicable trust beneficiary's life
- No separate account treatment for trust beneficiaries
- Must meet certain requirements

See-Through Trust Requirements

- Regulation 1.401(a)(9)-4, A-5
  - Valid under state law
  - Irrevocable at death
  - Trust beneficiaries are identifiable
  - Proper documentation is provided to the custodian by October 31st of the year following the year of death

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Life-Cycle of AIRA Trust

1) Owner determines there is a post-death control issue that requires the use of a trust
2) Trust is drafted by a qualified estate planning attorney (can be a testamentary trust)
3) The trust is named as the beneficiary on the beneficiary form
   - John Doe IRA trust
   - John Doe IRA trust established under Article X Section X of John Doe Last Will and Testament

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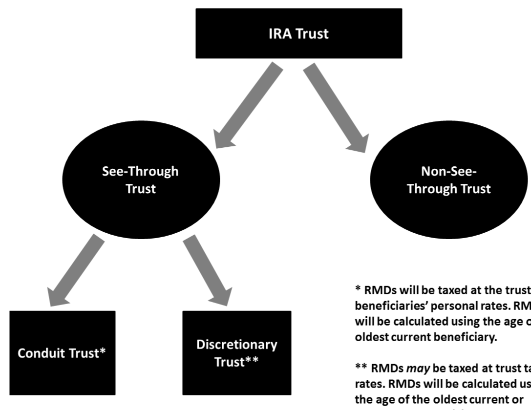
Life Cycle of an IRA Trust

4) IRA Owner Dies
5) Properly titled inherited IRA is established FBO the trust
   - John Smith (deceased January 3, 2017) IRA fbo John Smith Trust
6) Distributions go from the inherited IRA to the trust
7) Distributions go from the trust to the trust beneficiaries per the terms of the trust

Two Types of See-Through Trusts

- Conduit Trusts
- Discretionary Trusts
  - Also known as accumulation trusts

Two Types of See-Through Trusts



* RMDs will be taxed at the trust beneficiaries' personal rates. RMDs will be calculated using the age of oldest current beneficiary.

** RMDs *may* be taxed at trust tax rates. RMDs will be calculated using the age of the oldest current or future trust beneficiary.

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Conduit Trusts

- No less than the RMD required to be distributed to trust beneficiaries each year
- Trust beneficiaries pay income tax on RMDs at their own personal rates
- Only income beneficiaries of the trust are looked at to consider oldest age for RMDs

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Discretionary Trusts

- RMDs from the inherited IRA <u>may</u> be accumulated in the trust
  - RMDs <u>may</u> also be distributed out of the trust, depending on the language of the trust
- Distributions from an inherited IRA not passed along to trust beneficiaries within the same year are taxed at trust tax rates
  - Consider using the 65-day rule
- All current and potential beneficiaries of the trust are looked at to consider oldest age for RMDs
  - Current beneficiaries
  - Remaindermen

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5 Costly IRA Trust Mistakes

1) Moving an IRA "into" the trust
2) Trust language that calls for debts and expenses of the estate to be paid from trust assets
3) Not understanding what constitutes trust income
4) Naming a trust as an IRA beneficiary without first considering alternatives
5) Failing to add flexibility to the overall plan

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Part 5

Spousal Beneficiary Planning

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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

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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

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SPOUSAL ROLLOVER

- Often makes sense if surviving spouse is ≥59 ½
- Irrevocable election
- Treated as though money was always in the surviving spouse's IRA
- No deadline to complete

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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"

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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."

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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

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Part 5

Beneficiary Form Issues

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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

Beneficiary Form Disasters

- The importance of the beneficiary form…
- Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, U.S. Supreme Court, No. 07-636, January 26, 2009

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Beneficiary Form Disasters

- But sometimes the form can be trumped!
- Cajun Industries, LLC vs. Robert Kidder, et al. United States District Court; Middle District of Louisiana, No. 09-267-BAJ-SCR – April 26, 2011

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Beneficiary Form Disasters

- So how about a prenuptial agreement? (NOPE!)
- Greenebaum Doll & McDonald PLLC v. Sandler, U.S. Court of Appeals for 6th Circuit, No. 06-6496, December 3, 2007

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Beneficiary Form Disasters

- So what *can* you do?
- Charles Schwab & Company v. Chandler, U.S. Court of Appeals for 9th Circuit, No. 07-15261, January 22, 2010

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Beneficiary Form Disasters

- Sometimes just being a spouse isn't enough!
- "The Pension Pickle," New York Post, January 31, 2005

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QUESTIONS?

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