

## IRA; 401k; 403b AND 457 Plans Distributions

It's Your Estate  
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## Purpose of Retirement Plans

- Tax-favored way of setting aside money during “working years” for retirement
- Reduces taxable income in years that you contributed
- Idea was that your income would be less during retirement years

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## IRD

- Income in Respect of a Decedent
- Income earned during decedent's life, for which no income tax has been paid.....YET

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## IRD

- Death benefits under retirement plans are IRD
  - Because income, not yet taxed to plan participant
- Any estate tax paid on IRD is deductible for federal income tax purposes to recipient of IRD (i.e.: beneficiary of retirement account)

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## Value of Retirement Planning

1. Deferral of income tax on income originally contributed to the plan and investment profits
2. Ability to invest without current taxation of the investment profits
3. Longer the deferral, the greater the benefit

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## Huge concern:

Values of Retirement Plans are Eroded at Death  
By:

- **Income Taxes**
- &
- **Estate Taxes**

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## NEW GOAL:

Take advantage of the  
**power of tax deferral** by  
keeping the IRA  
**TAX-FREE**  
as long as possible.

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## Power of Tax Deferral

### TAX DEFERRED INVESTMENT

\$1 doubled every year for  
20 years tax-free

**\$1,048,567**

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## Basic Definitions

- **Participant**
  - Individual who established or participated in retirement plan
- **Beneficiary**
  - Person or charity who inherits a retirement plan upon death of the participant

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## Basic Definitions (continued)

- **Minimum Required Distribution**
  - Minimum amounts that a retirement plan account owner or beneficiary must withdraw annually pursuant to the Minimum Distribution Rules of the Internal Revenue Code and related Treasury Regulations
  - Prevents retirement plans from becoming wealth building tools

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## What do all the numbers mean?

- IRS Code Sections:
  1. 401(k) – contributory retirement plan generally used by companies and for-profit organizations
  2. 403(b) – retirement plan only available to tax-exempt organizations, the most common of which are schools, hospitals, and religious groups
  3. 457 – retirement plan only available to state and local public employees, but can also be offered by certain nonprofit organizations

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## What is an IRA?

- Individual Retirement Account/Arrangement
- Personal savings plan
- Many different types of IRAs
- Can roll over certain qualified retirement accounts to IRA
- Offer more flexibility

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## Minimum Required Distributions

- All retirement plans are subject to the Minimum Required Distribution rules (exception: ROTH IRA during life)
- The MRD rules define how a retirement plan is distributed both during the life of the participant and after death

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## Minimum Required Distribution Rules During Life

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## Rule #1

- MRD rules set forth the limits of what a plan must provide
- Many plan administrators of 401(k)s, 457s, and 403(b)s make the distribution rules much *more* restrictive
- IRAs provide the most flexibility for the participant and beneficiaries

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## Rule #2

- *Unless* an exception applies, distributions to a participant under 59 ½ years of age are subject to a 10% early withdrawal penalty in addition to any income tax due

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## Rule #3

### While Participant is alive:

- With limited exceptions, MRD must start in year in which participant turns 70 ½ years of age
- MRD must be taken by 12/31 of each year
- For first distribution, MRD may be taken by April 1<sup>st</sup> of year after participant turns 70 ½

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## Rule #4

### Calculating MRD while participant is alive:

**Account balance on 12/31 of prior year**  
divided by  
**Life expectancy factor**

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## Example

- Married couple. Husband age 78, wife age 72
- Husband has IRA worth \$1,000,000 as of December 31 of previous year, naming wife as beneficiary

$$\text{MRD} = \frac{\$ 1,000,000}{20.3} \longrightarrow \$49,261.08$$

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## Rule #5

- Life Expectancy Factor is taken from one of two tables published by the IRS in Publication 590
- Life Expectancy Factor is recalculated every year in determining MRD

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Appendix C. Uniform Lifetime Table

Table III (Uniform Lifetime)			
(For Use by:			
<ul style="list-style-type: none"> <li>• Unmarried Owners,</li> <li>• Married Owners Whose Spouses Are Not More Than 10 Years Younger, and</li> <li>• Married Owners Whose Spouses Are Not the Sole Beneficiaries of Their IRAs)</li> </ul>			
Age	Distribution Period	Age	Distribution Period
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115 and over	1.9

## Rule #6

- If participant has funds in more than one 401(k) plan, each MRD must be calculated separately and taken from each plan
- If participant has more than one IRA, MRD must be calculated separately for each IRA, **BUT** total MRD may be taken from one IRA or a combination of them

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## Some Exceptions to Rule #6

1. Can't aggregate Roth IRAs with other IRAs; and
2. Can't aggregate inherited IRAs with IRAs of which you are an owner

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## Minimum Required Distributions After Death

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## When did participant die?

- Options for post death distributions depend upon
  - whether participant/account owner named a designated beneficiary
  - Whether participant/account owner died before or after the Required Beginning Date

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## Participant Dies **Before** Required Beginning Date

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## Participant Dies Before Required Beginning Date

### 3 Options:

1. Spousal Rollover
2. Five year rule
3. Life expectancy of beneficiary

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## Spousal Rollover

- Only available for surviving spouse
- Surviving spouse may elect to treat IRA as his/her own
- From that moment on, spouse is treated as participant
- When might a spouse not elect to do rollover?

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## How Does a Rollover Work?

- Surviving Spouse may withdraw the IRA at any time.
- Any distributions are subject to the early withdrawal penalty if spouse withdraws prior to turning 59½.
- Spouse can defer withdrawals until age 70½, at which time MRDs must occur.

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## Five Year Rule

- IF no designated beneficiary, the account must be distributed in full no later than December 31<sup>st</sup> of the year that includes the 5<sup>th</sup> anniversary of the participant's death.
- May wait until 5<sup>th</sup> year

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## Life Expectancy

- IF there is a designated beneficiary, MRDs can be based on beneficiary's single life expectancy (unless plan mandates 5 year rule)
- Generally, 1<sup>st</sup> post-death MRD is due by 12/31 of year following participant's death
- Identity of designated beneficiary(ies) is determined on September 30 of the calendar year following the year of the IRA owner's death

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## Life Expectancy Example

- John died in 2010 with an IRA worth \$100,000 on 12/31/2010.
- John's son Frank, who turns 53 years old in 2011, is the sole beneficiary of his father's IRA.
- Frank's life expectancy in 2011 is 31.4 years (see table).
- Frank's MRD for 2011 is \$3,185 ( $\$100,000 \div 31.4$ ).
- If the value of the IRA at the end of 2011 was again \$100,000, Frank's MRD for 2012 would be \$3,289 ( $\$100,000 \div 30.4$ ).

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## Participant Dies On or After Required Beginning Date

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## Participant Dies On or After Required Beginning Date

### 3 Options:

1. Spousal Rollover
2. Account owner/participant's remaining life expectancy
3. Life expectancy of beneficiary

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## Option #2: Participant's Remaining Life Expectancy

- Gives relief if no designated beneficiary
- First year of post-death MRDs is year following participant's death.
- Divisor is participant's single life expectancy in year of death, minus 1
- Divisor reduced by 1 for each following year

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## Example

- IRA owner dies in 2010 at the age of 80.
- There is no named beneficiary and the IRA pays to his estate.
- The account balance at the end of 2010 was \$100,000.
- In 2011, the MRD would be \$10,870 ( $\$100,000 \div 9.2$ ). (The owner's life expectancy in the year of death, 10.2, reduced by one.)

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## What is a designated beneficiary?

- These are words of art under the IRC
- Only a “Designated Beneficiary” qualifies to stretch-out an IRA

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## Who counts as a designated beneficiary?

- Only individuals are recognized as designated beneficiaries under the MRD rules.
- The following DO NOT qualify as designated beneficiaries:
  - Charities, Businesses, Estates or Trusts
- However, beneficiaries of certain trusts may be treated as the designated beneficiary in certain circumstances

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## Considerations in Naming Beneficiaries

- Most should name spouse as primary beneficiary
- Name children or other person(s) as beneficiary in separate shares
- Advantages/Disadvantages of trust as beneficiary
- What about minor children?

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## Naming Individual Beneficiaries

- If spouse is beneficiary, can do rollover
- If other beneficiaries, may be able to establish separate shares
  - Each beneficiary may be able to take distribution over own life expectancy
- Many potential problems with naming individual beneficiaries
  - Divorce protection, special needs beneficiary, creditor protection, etc.

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## Trusts as Beneficiaries

Beneficiaries of a trust will be treated as having been named as beneficiaries if all of the following are true:

1. The trust must be valid under state law
2. The trust is irrevocable, or will become irrevocable upon the death of the participant
3. Trust beneficiaries are identifiable from the trust instrument
4. Trust provided to plan administrator or other document requirements are satisfied (see IRS Publication 590)

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## Trusts as Beneficiaries

Most common:

1. Revocable Living Trust
2. Standalone Retirement Plan Trust

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## Conduit Trust v. Accumulation Trust

### Conduit Trust:

- Trustee **must** withdraw and distribute all MRDs – generally over life expectancy of the oldest current beneficiary
- Trustee **may not** accumulate distributions within the trust

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## Conduit Trust v. Accumulation Trust

### Accumulation Trust:

- Trustee is **not** required to distribute withdrawals to the beneficiary
- In other words, withdrawals can be held in the Trust

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## Conduit Trust v. Accumulation Trust

### Conduit Trust:

- MRDs are based on life expectancy of oldest current trust beneficiary

### Accumulation Trust:

- MRDs are based on life expectancy of the oldest of **ALL** current and remainder beneficiaries (unless “mere potential successor” beneficiary)

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## Pros/Cons of Conduit Trusts

### CONS

- Conduit trusts provide no asset protection for the distributions (no protection from creditor's, predators, or spouses)
- If beneficiary lives to life expectancy, nothing left in trust

### PROS

- Can automatically stretch distributions out based on life expectancy of oldest beneficiary
- Beneficiary cannot take out greater than MRDs
- Hard to mess up this type of trust

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## Benefit of Accumulation Trusts

- Accumulation Trusts can be drafted to qualify as a designated beneficiary; thus, maximum stretch-out is available.
- Beneficiary cannot cash-out.
- Asset Protection: RMDs don't have to be distributed to the beneficiary.

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## Distributions to Charity During Life

- IRA owner age 70 ½ or older may make tax-free IRA distributions to qualified charities
- Limited to \$100,000
- Qualifies as MRD
- Extended through 2013 only

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## Distributions to Charity After Death

Benefits of naming charity as beneficiary of retirement plan

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## Creditor Protection

- Qualified based plans are protected in both bankruptcy proceedings and from creditors
- IRAs rolled over from qualified plans are protected
  - Keep segregated from other IRAs

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## Creditor Protection

- Other IRAs protected in CA from levy to the extent the funds are likely to be necessary for the support of the judgment debtor and dependents
- NO PROTECTION FOR INHERITED IRA if left outright to beneficiary

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## Durable Power of Attorney for Financial Matters

For Financial Assets:

- Appoints agent to handle financial affairs should you be unable to do so.
- Very important with Retirement Plans
- May avoid conservatorship
- Authorizes person to stand in your shoes (i.e.: access assets, apply for benefits, sue on your behalf, etc.)

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QUESTIONS?  
THANK YOU FOR ATTENDING.

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