# Stretching Out Your Client's IRA:

## Planning Opportunities and Tax Pitfalls

**Presented by Wealth Management Roundtable LLC**

**&**

**Ralph Minto, Jr. & Associates**

**600 Grant Street**

**U.S. Steel Tower, Suite 5686**

**Pittsburgh, PA  15219-2702**

**(412) 201-5525**

# Introduction:

- As you know, the final IRA regulations enacted in 2002 provide post-mortem IRA planning opportunities in an area that previously had little flexibility.
- To take advantage of these planning opportunities, IRA owners and their advisors must pay close attention to planning details, because failure to do so could have near disastrous results.

# Today’s Objectives:

- Briefly discuss the IRS final regulations issued April 12, 2002 and some of the tools and opportunities that are now available to us as advisors to plan with IRAs for the benefit of our clients.
- Analyze several case studies illustrating ineffective IRA planning due to the use and/or misuse of these tools.
- Point out lessons we can learn in order to properly plan for each of our clients.

# Final Regulations: Overview

- Required Beginning Date: Required Minimum Distributions (RMDs) to the IRA owner commencing April 1 of the calendar year in which the owner turned age 70 1/2, or the beneficiaries upon the death of the IRA owner.
- IRA monies (non-Roth) are not subject to income tax until distributed to the owner, or after death, the beneficiaries. Taxed at recipient's income tax rate.

# Final Regulations: Overview

- For trust to qualify as designated bf, it must be:
  - (1) valid under state law;
  - (2) have individual, identifiable beneficiaries only; and
  - (3) state it is irrevocable by its own terms upon the IRA owner's death.
- If trust qualifies, look through trust to oldest beneficiary and use their life expectancy.
- Risking oversimplification here, but one can use individual life expectancies if use standalone trusts with single beneficiary and name trust on IRA form.

# Final Regulations: Overview

- The amount of deferral, or stretch-out, available depends on whether a beneficiary is named, and whether that beneficiary is a "Designated Beneficiary."
- "Designated Beneficiary" is a term of art: a bf must be an individual (i.e. needs a heartbeat). No corps, no charities, no estates, etc. Trust can be a DB if meets certain conditions.

# Final Regulations: Overview

- If Designated Beneficiary exists, the new post-death distribution period is based on the *life expectancy of the DB* (or beneficiaries if separate shares) that remain as of September 30 of the year after the calendar year of the IRA owner's death.
- September 30 is the determination date for determining designated bf's. Take a snapshot on that date.

# Final Regulations: Overview

- Default rules if no designated beneficiary:
  - If no DB, and owner dies *before* distributions begin, 5 year rule applies.
  - If no DB and owner dies *after* distributions have begun, distributions based on participant's single life expectancy.

# Final Regulations: Overview

- Three new post-mortem planning tools (Must use before September 30 “Snapshot Date” if a problem beneficiary, as illustrated below):
  - (1). **Disclaimer** (e.g. estate)
  - (2). **Distribution** (e.g. nonindividual bf: charity)
  - (3). **Division** (e.g. multiple bf’s and one person significantly older; Standalone trusts)

# IRA Planning Problems: Summary

- An IRA will be deemed to have no DB if an otherwise DB predeceases the IRA owner and:
  - there is no contingent bf named;
  - an estate is named;
  - multiple bf's but one is not an individual; or
  - there is some other breakdown in planning.
- The lack of a DB will cause diminished tax deferral, and indicates a breakdown in the planning process.

# Planning Problems: Examples:

- Hypothetical 1: Ideal Family:
  - H in first marriage.  3 natural children and all are financially responsible with no drug, alcohol, or divorce problems.  Spouse is financially responsible and in good health.
  - H names spouse primary bf and children contingent bfs.
  - If spouse survives H, roll-over IRA into her name and name children primary bf's. On her death, children are DBs and take distributions based upon their individual life expectancies.
  - If spouse predeceases H, children are contingent bf's and take distributions based upon their individual life expectancies.

# Planning Problems: Examples:

- Hypothetical 2: Untimely Death & Disclaimer:
  - Beneficiary survives IRA owner but not long enough to take any action.
  - Deceased inherits the IRA, and is the DB.
  - Absent action by personal representative to disclaim, RMD's from the IRA of deceased owner will be payable to estate of deceased bf based upon the single nonrecalculated life expectancy of the deceased bf.
  - IRA becomes a probate asset of deceased beneficiary.
  - No additional deferral available to children.
  - Ultimate bf's determined by Will of deceased bf or intestacy.
  - Could result in unanticipated people inheriting outside lineal descent in contravention of what IRA owner wanted.

# Planning Problems: Examples:

- Hypothetical 2 (Cont.): Disclaimer: Lessons:
  - Layer bf designations to provide maximum flexibility.
  - Surviving spouse bf's should roll-over an inherited IRA or name their own bf's *as soon as possible* after death of IRA owner.
  - Nonspouse bf's should designate their own bf's *as soon as possible* to avoid a probate problem.
  - A timely *disclaimer* of the IRA interest by the personal representative of the deceased beneficiary might correct the problem and allow contingent beneficiaries of IRA owner to get additional deferral based upon their own life expectancy.

# Planning Problems: Examples:

- Hypothetical 3: Missing BF Designation:
  - Many times, unrelated to dispositive intent, IRA's are moved by the IRA owner within the same institution or between institutions.
  - Accounts are sometimes combined or divided.
  - It is important not to disturb any beneficiary planning that has been put into place when an IRA owner moves or transfers an account.
  - In the event the original BF designation cannot be found, most IRA agreements provide a default beneficiary: the IRA owner's estate.
  - As such, the IRA is treated as having no DB and tax deferral determined by the age of the IRA owner at death. As a probate asset, recipients will be determined by will or intestacy.

# Planning Problems: Examples:

- Hypothetical 4: Reappearing Spouse: Divorce
  - One estate planning issue often overlooked when there's been a divorce is changing BF designations.
  - Plan owner gets divorced, then dies without changing the BF designation which named his or her former spouse.
  - Most states provide without specific reference in a property settlement agreement in divorce regarding the insurance proceeds or IRA assets, the contract controls. The "Ex" may then stand to inherit.

# Planning Problems: Examples:

- Hypothetical 4: Reappearing Spouse (Cont.)
  - Pennsylvania law is rather progressive in this area.
  - See 20 Pa.C.S. § 6111.2 “Effect of Divorce on Designation of Beneficiaries.”
  - Lesson remains, however, that in divorce, our clients MUST review their IRAs, plans at work, life insurance contracts, etc. and change their BF designations as they desire.

# Planning Problems: Examples:

- Many IRA owners also own IRA annuities.  In most cases, if an IRA owner wants to consolidate accounts for ease of record keeping, it is possible to transfer the IRA annuity into another IRA.
- The IRA owner is still the annuitant, but the IRA is the owner and beneficiary of the annuity.
- If the ownership and bf designation cannot be changed to reflect the IRA, the IRA owner should be advised of such and the IRA annuity should be handled as a separate account. BUT...

# Planning Problems: Examples:

- Hypothetical 5: Wrong Beneficiaries
  - H & W have large estate. Children are all successful.  IRA owner decides to leave his IRA of $1.5M to grandchildren, and signs a new BF designation as such.
  - Next month's statement reflects grandchildren as IRA beneficiaries.
  - Two months later, IRA owner dies….

# Planning Problems: Examples:

- Hypothetical 5: Wrong Beneficiaries (Cont)
  - CPA and attorney discover IRA contains 5 different IRA annuites, with 5 different BF's, at 4 different companies
  - Some bf forms named children and some named a defunct irrevocable trust.
  - How could advisors preserve IRA owner's intent regarding grandchildren….?

# Planning Problems: Examples:

- Hypothetical 5: Wrong Beneficiaries (Cont)
  - Primary BF's children all disclaimed;
  - Trustee of Irrevocable Trust disclaimed;
  - The estate of the IRA owner disclaimed;
  - And finally a settlement agreement was reached and agreed to by all parties and filed with the probate court, documenting IRA owner's intent for grandchildren to inherit

# Planning Problems: Examples:

- Hypothetical 5: Wrong Beneficiaries (Cont)
  - The brokerage firm in question listed the annuities on the statement as a courtesy, but
  - There was no disclaimer stating that the annuities may have different beneficiaries than the rest of the IRA.
  - To the untrained eye, it would appear everything was in order…

# Planning Problems: Examples:

- Hypothetical 5: Wrong Beneficiaries (Cont)
  - Lesson: It is not enough to review the beneficiary designation forms or even keep copies of them.  It is imperative for the IRA owner and their professionals to periodically review the IRA agreements that govern their accounts, and review their statements as well. Verify all IRA BF designations are in order.

# The End.

- Thanks For Coming!

- Please fill out your evaluation forms.