

Retirement Planning

Retirement Estate Planning

Estate planning with Individual Retirement Accounts (IRAs) and qualified retirement plans such as 401(k) plans and profit sharing plans requires a complete understanding of the IRS regulations governing distributions from all types of retirement plans and IRAs. The regulations use the term "employee" to describe both a qualified retirement plan participant and an Individual Retirement Account owner.

The regulations specify the way lifetime and after death required minimum distributions from IRAs and qualified retirement plans are calculated. Lifetime required minimum distributions specify the minimum an employee must withdraw each year from his IRA or retirement plan while he is living. After death required minimum distributions specify the minimum amount the employee's beneficiaries must withdraw each year from the balance left in an IRA or retirement plan after the employee's death. The employee or the beneficiaries may always withdraw more than an annual required minimum distribution amount. However, if the employee or the beneficiaries withdraw less than an annual required minimum distribution amount, a penalty will be imposed of 50% of the amount of the required annual minimum distribution not withdrawn. The final regulations permit employees to significantly reduce required annual minimum distributions during their life. They also reduce the required annual minimum distributions for the employee's beneficiaries after the employee's death. The reductions in required minimum distributions will permit the employee or his beneficiaries to stretch out the periods of withdrawals and reduce income taxes paid each year on the withdrawals.

The regulations allow the stretch out of the payments of an employee's IRA or qualified retirement plan to his children or grandchildren and reduce the income taxes they will pay. The following is a summary of the regulations with respect to minimum distributions.

The fundamental principle of IRAs and qualified retirement plans is that they are designed to provide tax-deferred earnings and growth for retirement purposes. They are not the best assets to leave to heirs. The tax-deferral that provides these assets their retirement planning benefits causes them to be the most highly taxed asset upon death. An employee's heirs must pay both estate and income taxes on the IRAs and qualified retirement plan accounts left to them. Without good advice and planning, the total of these taxes may be as high as 70%!

Under the regulations, at the required beginning date (April 1 of the year following the year the employee becomes 70½) the employee must begin taking minimum distributions

from his or her IRAs and retirement plans. When an employee reaches his required beginning date, his lifetime minimum distributions are calculated from the uniform table set forth at the end of this section. This uniform table determines minimum distributions on a joint-life expectancy of the employee and a hypothetical beneficiary that is 10 years younger than the employee. Using this uniform table, an employee's required minimum distributions at age 70½ will be 1/27.4 or 3.649% of his account balance. The next year's minimum distribution (at age 71) would be 1/26.5 or 3.773% of the employee's account balance. The table automatically recalculates minimum distributions each year giving the employee the benefit of the fact that the longer he lives the longer his life expectancy becomes. Even a person 115 years old has a remaining life expectancy of 1.9 years and only has to withdraw 52.631% of his account balance.

The only time an employee does not use the uniform table is if his spouse is more than ten years younger than him. In that event, the employee's minimum distributions are based on the actual joint life expectancy of the employee and his spouse recalculated annually. This will provide even lower required minimum distributions than under the uniform table.

The regulations permit an employee to change his designated beneficiary before or after his required beginning date without any impact upon his lifetime required minimum distributions. In addition, after death distributions are not determined by the designated beneficiary at the required beginning date. Instead, they will be determined by the designated beneficiaries the employee had at his death as finally determined by September 30th of the year after death. As an example, suppose an employee had his spouse as the first beneficiary and his children as equal share contingent beneficiaries of his IRA at the time of his death. If the employee's spouse had sufficient property of her own and decided she did not need the remainder of his IRA, she could disclaim or refuse the IRA and it would go to the children. In that case, the payout to the children would not be based on the wife's life expectancy, but on the children's individual life expectancies. This result occurs because the spouse's disclaimer made the children the only remaining designated beneficiaries on September 30th of the year after the employee's death.

This designation of a date to determine designated beneficiaries provides a tremendous opportunity for post mortem planning. The regulations permit the elimination of some date of death beneficiaries through disclaimers and by distribution of their benefit before the September 30 date. However, a new beneficiary cannot be added after the date of death. To take advantage of this opportunity, it is very important for the employee to make proper primary and contingent beneficiary selections for all his IRAs and retirement plans. If an employee has a spouse, children, and grandchildren, he may want to consider naming his spouse the first beneficiary, his children or separate share trusts for them as the second beneficiaries, and separate share trusts for his grandchildren as the third beneficiaries. Such beneficiary designations would preserve optimal flexibility for making adjustments after the employee's death.

Trust as Beneficiary

If a trust established by the employee or the employee's estate is the plan or account designated beneficiary at death, the regulations do not permit the executor or trustee to change the designated beneficiary by making distributions of plan or account benefits to individual beneficiaries of the estate or trust. Also, if a trust for several individuals is the designated beneficiary at the employee's death, a later division of the trust into separate trusts for each beneficiary does not permit each beneficiary to take distributions over his or her life expectancy. Life expectancy distributions must be made over the life expectancy of the oldest trust beneficiary.

Designating the employee's spouse as the beneficiary of a retirement account or plan provides significant opportunities. When a spouse is the beneficiary, the spouse may rollover the account and treat it as his or her own after the employee's death. This rollover option permits the spouse to reassess the family situation during his or her remaining life and make adjustments in primary and contingent beneficiaries to receive any remaining balances after her death. After a spousal rollover, the spouse may use the uniform table to determine her lifetime payments and plan to extend income tax deferral after her death by designating the children or grandchildren or a trust for them as her beneficiaries.

The IRS regulations state rules for making a trust the designated beneficiary of retirement accounts or plans. A copy of the trust must be provided to the plan trustee or account custodian by October 31 of the year following the year of the employee's death. When a trust is the designated beneficiary, the trust beneficiary with the shortest life expectancy will be used to determine the beneficiaries' minimum distributions. If an employee wishes to create separate accounts for trusts, a proper method is to name each individual trust as a separate beneficiary to receive a specified percentage or fraction of the employee's retirement plan or account benefit at his death. As long as those separate trusts are created and funded by December 31 of the year following the year of the employee's death, the individual beneficiaries of the trusts will be able to elect life expectancy distributions based on their individual ages.

Charity as Beneficiary

If a charity or corporation is a beneficiary of a retirement account or plan either directly or through a trust, it will be considered to have a zero life expectancy. If the employee died after his required beginning date, the beneficiaries of the estate or the charity may take their distributions over the employee's remaining life expectancy as of the date of his death. If the employee died before his required beginning date, the charity or estate beneficiaries may take distributions over a five-year period beginning with the year of the employee's death.

However, a charity or corporation may be eliminated as a counted beneficiary, if the share of the charity or corporation is distributed prior to September 30 of the year following the employee's death. If only individual beneficiaries remain after elimination of the charity or corporation, the life expectancies of the individuals will be used to determine their required minimum distributions. To avoid the possibility that a share for a charity may not be paid out by September 30 of the year following the employee's death,

the employee may want to designate the charity as the beneficiary of a separate account or separate trust. As long as the separate account or trust for the charity is created and funded by December 31 of the year following the employee's death, the share of the charity will have no impact on availability of life expectancy distributions for individual beneficiaries.

Roth IRAs

Roth IRAs have lifetime and estate planning benefits not available to traditional IRAs and qualified retirement plans. Contributions to a Roth IRA are not tax deductible, but all earnings and growth of a Roth IRA are income tax free. Also, there is no age limit for making contributions to a Roth IRA. An employee can continue making contributions to a Roth IRA as long as he has earned income.

There is no requirement to take minimum distributions from a Roth IRA when an employee reaches the age of 70½. In fact, there is no requirement for minimum distributions from a Roth IRA during an employee's lifetime or during the lifetime of his surviving spouse. The IRS regulations do apply to Roth IRAs to determine designated beneficiaries and the required minimum distributions beneficiaries must take after the employee's death.

Unlike traditional IRAs, Roth IRAs are not subject to both estate tax and income tax after the employee's death. A Roth IRA remains free from income tax even after the employee dies, however, if the deceased employee has a large enough estate to warrant estate tax, the Roth IRA will be included in the property subject to estate tax.

If a traditional IRA is a substantial part of your estate, the opportunity to convert to a Roth IRA offers some unique estate planning benefits. Conversion to a Roth IRA requires payment of income tax on the deferred earnings and growth of the IRA being converted, but once the conversion is completed the IRA is free of income tax forever. If after retirement you expect to be in an income tax bracket equal to or close to your present bracket, conversion to a Roth IRA could save you significant after retirement income taxes. You may also convert to a Roth IRA to elect out of minimum distribution requirements. For example, if you are already past 70½ and required to take minimum distributions that you neither need nor want, you can end the distributions by converting the IRA to a Roth. A person close to death could also reduce the size of their estate and convert their IRAs to tax free assets by making the conversion and paying any tax due from other assets before they die.

Conclusion

Estate planning for retirement accounts is far too complex to make specific recommendations. Making the right beneficiary choices, converting existing IRAs to Roth IRAs, and integrating retirement assets into your estate planning can save thousands of dollars in taxes. If your employment give you the opportunity to participate in a retirement plan or you own IRAs, make sure you fully inform your estate planning

attorneys of these assets. Also, make sure that you consult with an estate planning attorney who understands retirement account estate planning. This consultation is critical to insure you make the right choices to avoid excessive taxation after your death.

Table for Determining Required Minimum Distributions

Age	Divisor	Age	Divisor
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 older	1.9