The Wealth Counselor

A monthly newsletter for wealth planning professionals

From Michael Wittick

Law Offices of Michael J. Wittick, a Professional Law Corporation
7700 Irvine Center Drive, Suite 800
Irvine, CA
92618
949-753-2829

My practice is people oriented and exclusively devoted to estate planning, estate and trust administration, estate and trust litigation, asset protection and business planning. My newsletter highlights wealth planning issues designed as helpful insights to your practice

Volume 1, Issue 1

The Pension Protection Act: New Opportunities for Retirement Planning

The new Pension Protection Act of 2006 (signed into law on August 17, 2006) creates significant planning opportunities for advisors and their clients who understand it. This newsletter focuses on two key provisions: (1) non-spousal rollovers from a qualified plan to an inherited IRA and (2) charitable contributions of IRAs during lifetime.

Non-Spousal Rollovers from Qualified Plans

In the past, only a surviving spouse could roll over a qualified plan (for example, a 401(k)) to an IRA after the plan owner's death. Once rolled over, it is as if the surviving spouse created the IRA—he or she can defer required minimum distributions from the IRA until reaching age 70 1/2 and can withdraw these required minimum distributions over his or her lifetime.

> **Planning Tip:** The new law does not impact spousal rollovers; a spouse can still rollover a qualified plan to his or her own IRA after the death of the owner.

Alternatively, a beneficiary other than a surviving spouse (for example, a child or unmarried partner) has been forced to withdraw the qualified plan in full and pay income tax on this amount over the period set forth in the plan agreement, typically within one to five years of the plan owner's death. Thus, a non-spouse beneficiary could not defer income tax by stretching out distributions over his or her life expectancy.

Beginning January 1, 2007, a non-spouse beneficiary can roll over a qualified plan to an Inherited IRA after the plan owner's death. If the owner names a trust as beneficiary of the qualified plan, the trustee of that trust can roll over the qualified plan to an inherited IRA for the benefit of the trust beneficiary.

> **Planning Tip:** Clients who name a trust as designated

> beneficiary can protect the assets from creditors (including former spouses of the beneficiary) and spendthrift beneficiaries, who often withdraw far more than the required minimum distributions. **Naming a trust also allows the owner's financial advisor to continue to manage the assets as the owner desired.**

With an Inherited IRA, a non-spouse beneficiary can use his or her own life expectancy to determine required minimum distributions. This significantly reduces the amount that the beneficiary must withdraw each year, thereby deferring income tax and allowing the account balance to continue to grow income tax free.

> **Planning Tip:** A non-spouse beneficiary must begin taking required minimum distributions from the Inherited IRA by December 31st of the year following the year of the owner's death. This is different from a spousal rollover, where the surviving spouse can defer required minimum distributions until attaining 70 1/2.

A rollover to a non-spouse beneficiary must be directly from the trustee of the qualified plan to the trustee of the Inherited IRA (a trustee-to-trustee transfer). In addition, and unlike a spousal rollover, the IRA must remain in the name of the deceased owner.

> **Planning Tip:** Avoid re-titling the qualified plan in the name of the non-spouse beneficiary. Also avoid transferring the qualified plan to an existing IRA in the non-spouse beneficiary's name. Both constitute a taxable distribution of the entire account. The Inherited IRA should be titled like this: **Susan Participant, deceased, IRA f/b/o Emily Participant (beneficiary).**

> **Planning Tip:** Any distribution to a non-spouse beneficiary is a taxable distribution, subject to income tax. **Therefore, the check should be made payable directly to the Inherited IRA.**

Until January 1, 2007, a non-spouse beneficiary must continue to use the payout schedule dictated by the qualified plan agreement. Thus, if the plan agreement provides that all funds must be distributed within three years of the owner's death, the beneficiary must withdraw, and therefore pay income tax on, the entire plan balance within three years, thereby eliminating potentially significant growth through income tax deferral.

Member of

WealthCounsel Advisors Forum

> **Planning Tip:** If possible, delay post-death distributions from a qualified plan to a non-spouse beneficiary until after December 31, 2006 to take advantage of these new

provisions.

Example

On October 1, 2006, Susan Participant dies having named a trust for her daughter Emily's benefit as the death beneficiary with her 401(k) plan. Anytime after December 31, 2006, the trustee of Emily's trust can request a trustee-to-trustee transfer of the 401 (k) to an inherited IRA for Emily's trust's benefit, using Emily's life expectancy to determine the required minimum distributions from the inherited IRA.

Clients Impacted by This Change

All clients with qualified plans and clients named as the beneficiary of a qualified plan will potentially benefit from this new provision.

Charitable Contribution of IRA During Lifetime

In 2006 and 2007 only, a taxpayer who is at least 70 1/2 years old can contribute to charity up to $100,000 per year from one or more Individual Retirement Accounts (IRAs).

> **Planning Tip:** Distributions from a SEP IRA, SIMPLE IRA or qualified plan do not qualify because they are not distributions from an IRA. Consider rolling out qualified plan assets into an IRA where appropriate to take advantage of this opportunity.

If the contribution is made by direct transfer from the IRA custodian to a public charity, the taxpayer need not report the distribution as taxable income. In other words, unlike a typical IRA distribution, the distribution will not appear as taxable income on the taxpayer's income tax return. Because the distribution does not appear as income, the taxpayer does not get an offsetting charitable income tax deduction to reduce the income created by the IRA distribution.

> **Planning Tip:** The check must be made payable to the charity. If the check is made payable to the IRA owner who endorses it to the charity, the owner must report the distribution as taxable income.

> **Planning Tip:** Public charities include religious organization, schools, etc. Unfortunately, Donor Advised Funds, Supporting Organizations and Charitable Remainder Trusts are not public charities, and therefore distributions to these types of charities do not qualify.

Significantly, charitable contributions that meet these requirements **satisfy the taxpayer's required minimum distributions for the year of distribution.**

Clients Impacted by This Change

There are two critical questions: (1) Does the client have IRAs from which they can make direct contributions to charity or, alternatively, can the client roll out of a qualified plan into an IRA; and (2) Is the client currently making or contemplating charitable gifts. Consider the following classes of clients who will benefit from this provision.

1. **Clients Who Claim the Standard Federal Income Tax Deduction**
   For clients who do not itemize, this new law provides the equivalent of an unlimited federal charitable income tax deduction for up to $100,000 of the charitable gifts that they make from an IRA.
2. **Clients Who Would Lose Phased-Out Deductions with Increased Income**
   Under the new law, a direct contribution of an IRA up to $100,000 does not increase the taxpayer's Adjustable Gross Income (AGI). Correspondingly, it does not impact other deductions.
3. **Clients Who Are Subject to the 50% Limitation on AGI**
   A direct contribution to charity of up to $100,000 is not subject to the typical 50% of AGI cap for cash contributions to a public charity.
4. **Clients Who Live in States That Do Not Permit State Income Tax Charitable Deductions**
   For clients in Indiana, Michigan, New Jersey, Ohio and Massachusetts, direct contributions from IRAs will result in the highest possible net state tax savings.

Law Offices of Michael J. Wittick, a Professional Law Corporation 7700 Irvine Center Drive, Suite 800 Irvine, CA 92618