The Wealth Advisor

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What's Inside

New Law Creates Exciting Planning Opportunities

The purpose of this newsletter is to inform you of changes in the law and to provide planning information and general financial news. These newsletters also give me a chance to share new techniques to enhance your planning, as well as to help you to stay current with tactics designed to maximize the effectiveness of your plan. I hope you will read each newsletter carefully to keep up to date on these important topics. Please feel free to contact me if you have any questions about this or any matters relating to your planning.

The new Pension Protection Act of 2006 (signed into law last Fall) creates significant planning opportunities for those 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 a plan participant / 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, a grandchild or unmarried partner) has been forced to withdraw the qualified plan in full – and pay income tax on this full amount – over the period set forth in the plan agreement, typically within one to five years of the

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plan participant's death. Thus, a non-spouse beneficiary could not defer income tax by "stretching out" distributions over his or her life expectancy.

Effective January 1, 2007, a non-spouse beneficiary can roll over a qualified plan to an "Inherited IRA" after the plan participant's death. If the plan participant 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: Naming 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.

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, over the beneficiary's lifetime.

Planning Tip: It is critical that your beneficiaries work with an advisor that understands these new rules. Any distribution directly to a non-spouse beneficiary (or to an existing IRA in his or her own name) will subject the entire account to ordinary income tax.

Are You Impacted by This Change?

Anyone with qualified plans, or those named as the beneficiary of a qualified plan, will potentially benefit from this new provision.

Charitable Contribution of IRA During Lifetime

For tax years 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 qualified plan do not qualify because they are not distributions from an IRA. If you have one of these accounts and would like to take advantage of this new law, contact us to discuss whether it makes sense to roll out the qualified plan assets into an IRA.

With contributions made by direct transfer from the IRA custodian to a "public" charity, the IRA owner need not report the distribution as taxable income.

Planning Tip: Unlike a typical IRA distribution, the distribution will not appear as taxable income on your income tax return. Because the distribution does not appear as income, however, you do not receive an offsetting charitable income tax deduction to reduce the income created by the IRA distribution.

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. These are just a few traps in the new law. Therefore, it is critical that you work with an advisor or team of advisors that understand the new law.

Significantly, charitable contributions that meet these requirements satisfy required minimum distributions for the year of distribution; in other words, the distributions the government makes you take from your IRAs once you reach 70 1⁄2.

Planning Tip: Consider life insurance to replace the wealth contributed to charity. If owned by and payable to a wealth replacement trust, the death proceeds will be income and estate tax free, as well as protected from creditors, divorce and spendthrift beneficiaries.

Are You Impacted by This Change?

There are two critical questions: (1) Do you have IRAs from which you can make direct contributions to charity or, alternatively, can you roll out of a qualified plan into an IRA?; and (2) Are you currently making or contemplating charitable gifts? If so, you may benefit from this new law, particularly if one or more of the following applies to you.

1. You Claim the Standard Federal Income Tax Deduction

For those 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.

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2. You Would Otherwise 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. You 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. Your State of Residency Does 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.