Maximizing Your Retirement Plan Savings Under the 2002 Final Regulations™

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Retirement Plan Overview

Technical Background

1987	**Proposed Regulations**
1997	**Amended Proposed Regulations**
2001	**Amended Proposed Regulations (1/11/2001)**
2002	**Final Regulations (4/16/2002) Effective: 1/1/03**

Retirement Plan Overview

Retirement Plan Challenges

1. **Income Tax Deferral**
2. Retirement Plan Excise Tax Planning
3. Federal Estate Tax Reduction
4. Estate Planning Coordination

Income Tax Deferral

- During Lifetime
- After Death

Retirement Plan Overview

Retirement Plan Challenges

1. Income Tax Deferral
2. **Retirement Plan Excise Tax Planning**
3. Federal Estate Tax Reduction
4. Estate Planning Coordination

Excise Tax Planning

- **“Too Soon”**
  - Premature Distributions Penalty
  - 10% Excise Tax

- **“Too Little”**
  - Minimum Distribution Penalty
  - 50% Excise Tax

Retirement Plan Overview

Retirement Plan Challenges

1. Income Tax Deferral
2. Retirement Plan Excise Tax Planning
3. **Federal Estate Tax Reduction**
4. Estate Planning Coordination

Federal Estate Tax Reduction

- Avoidance (Family Trust)
- Deferral
  - Marital Trust
  - IRA Rollover

Federal Estate Tax Reduction

Will or Trust divides into 2 parts

Marital	Family
Excess	1st $1,000,000 (Today)

Federal Estate Tax Reduction

Tax Savings Determined By:

- Applicable Exclusion Amount (Determined by Congress)
- Funding of Family Trust

Federal Estate Tax Reduction

The Economic Growth and Tax Relief Reconciliation Act: "Coupon" Amount

Year	Amount
2002	$ 1,000,000
2003	1,000,000
2004	1,500,000
2005	1,500,000
2006	2,000,000

Federal Estate Tax Reduction

Taxpayer Relief Act:
"Coupon" Amount

Year	Amount
2007	$2,000,000
2008	2,000,000
2009	3,500,000
2010	Repealed
2011	1,000,000

Federal Estate Tax Reduction

Funding The Family Trust

Available	Not Available
◆ Individual Name Assets	◆ Joint Assets
◆ Living Trust Assets	
◆ Beneficiary Designations Payable to Trust	◆ Beneficiary Designations Payable to Individuals

Retirement Plan Overview

Retirement Plan Challenges

1. Income Tax Deferral
2. Retirement Plan Excise Tax Planning
3. Federal Estate Tax Reduction
4. **Estate Planning Coordination**

Estate Planning Coordination

Most Estate Plans Just Don’t Work!

Estate Planning Coordination

Definition of Estate Planning:

- I Want to Control My Property While I'm Alive and Well;
- Plan for Me and My Loved Ones if I Become Disabled;

Estate Planning Coordination

Definition of Estate Planning (Cont.)

- Give What I Have
- To Whom I Want
- When I Want
- The Way I Want

All with fully disclosed and controlled settlement costs, both to Me and Those I Love

Estate Planning Coordination

The Planning Pyramid

- Focuses on Client Goals
- “Solutions” Make Planning Easier
- Exposes Traditional Planning as “Upside Down”

Estate Planning Coordination

Personal Planning Goals

- Catastrophic Illness Protection
- Remarriage Protection
- Creditor Protection
- Divorce Protection
- Values Promotion

Mental Disability Planning

Planning for Retirement Plans

- Contact Financial Institutions (or Human Resources) in advance
  - Use their own power of attorney; or
  - Get advance approval of your personalized document

Estate Planning Coordination

Personal Planning Goals

- Catastrophic Illness Protection
- Remarriage Protection
- Creditor Protection
- Divorce Protection
- Values Promotion

3 Step Strategy™

- **Work with a Counselling Oriented Attorney**
- **Establish and Maintain a Formal Updating Program**
- **Assure Controlled Settlement Costs After Your Death**

Estate Planning Overview

Keys to an Effective Estate Plan

- Proper Asset Ownership

- Control of Process
  - What to Do
  - How to Do It
  - How to Pay for It

Retirement Plan Overview

Retirement Plan Challenges

- Income Tax Deferral
- Retirement Plan Excise Tax Planning
- Federal Estate Tax Reduction
- Estate Planning Coordination

Retirement Plan Overview

Retirement Planning Strategy

- Master Options Under Plan Document
- Name Multiple Beneficiaries
  - Primary and Contingent
- Build a Professional Team
- Review with Professional Team
  - At age 70 and After Death

Retirement Plan Overview

THE
MYTH
OF
IMMEDIATE
INCOME TAXATION

Retirement Plan Overview

Keys to Retirement Plan (Income) Taxation

- Distribution of Proceeds
- Tax Formula Clause
- Minimum Distribution Calculation Method

New Law Comparison

Keys to Retirement Plan (Income) Taxation

- Distribution of Proceeds
- Tax Formula Clause
- Minimum Distribution Calculation Method (non-amended Qualified Plans)

Retirement Plan Overview

Naming Your Retirement Plan Beneficiary Affects Both After-Death Income Taxation and Estate Taxation!

The Dirty Dozen:
The Minimum Distribution Rules

The First Seven Rules Deal Primarily with Distributions During Life:

- Required Beginning Date
- The Distribution Methods
- The Calculation Methods
- Changing Beneficiaries
- Separate Account/ Combined Withdrawals
- No Credit for Withdrawals Prior to RBD
- Minimums are Minimums

Minimum Distribution Rules

Rule #1 - Required Beginning Date

- April 1 of Year Following Year Participant Turns 70 & _
- Separate From Service for Those Still Employed

Minimum Distribution Rules

Rule #2 - Distribution Methods (Lifetime & After Death)

- Annuity
- Life Expectancy
  - » Single
  - » Joint

Minimum Distribution Rules

Rule #3 - Calculation Methods

- Recalculation
- Non-recalculation (Countdown)

New Law Comparison

Rule #2 – Lifetime Distribution Methods (IRAs and Amended Qualified Plans)

- Annuity
- No Single Life Expectancy
- Joint Life Expectancy (if beneficiary is spouse more than ten years younger)
- Uniform Table

New Law Comparison

Rule #2 – Lifetime Distribution Methods (Non-amended Qualified Plans)

- Annuity
- Life Expectancy
  - Single
  - Joint (subject to MDIB)

New Law Comparison

Rule #3 - Calculation Methods

- Recalculation – Mandatory During Participant’s Lifetime
- Non-recalculation – Mandatory After Participant’s Death

Effect of Final Regulations

Rule #3 - Calculation Methods

- Consistent with 2001 Proposed Regs
  - No need to elect Recalc or Nonrecalc
  - No need to have DB as of RBD
  - Use Uniform Lifetime Table during P's lifetime except where spouse more than 10 years younger
  - For Lifetime RMDs P's marital status determined as of 1/1 of distribution year

Minimum Distribution Rules

Minimum Distribution Incidental Benefit (MDIB Rule)

- Applied only to non-spouse beneficiary
- Applied only during participant's lifetime

Minimum Distribution Rules

MDIB Rule (cont.)

- During Participant's Lifetime Beneficiary was treated as 10 years younger than Participant
- To ensure that beneficiary received only an "incidental benefit"

New Law Comparison

Rule # 2 – Distribution Methods

- Lifetime
  - Annuity
  - Joint Life Expectancy (if beneficiary is spouse more than ten years younger)
  - Uniform Table

Effect of Final Regulations

Rule #2 – Distribution Methods

(Lifetime and After Death)

- Three New Life Expectancy Tables reflecting current mortality and resulting in slightly smaller RMDs:
  - Single LE: generally used after P's death
  - Uniform Lifetime Table
  - Joint & Last Survivor Table: generally used during P's lifetime when spouse is sole DB and more than 10 years younger

Minimum Distribution Rules

Rule # 4 - Changing Beneficiaries

- Can Always Change Beneficiaries (Who Gets the Money!)
- Must Change the Calculation if in Favor of the IRS!

New Law Comparison

Rule # 4 - Changing Beneficiaries

- Can Always Change Beneficiaries (Who Gets the Money!)
- Changing Beneficiaries Has No Impact on Calculation
- Will normally use Uniform Lifetime Table regardless of who is DB or if the participant has a DB (Exc: if S is sole DB and more than 10 years younger

Minimum Distribution Rules

Rule # 5 - Separate Accounts/Combined Withdrawals

- Each Account Requires Separate Withdrawal Calculation
  - For IRAs, Total Distribution is All That's Required (Can Be Taken From Any IRA)
  - For Qualified Plans, Required Withdrawal Must Be Made From Each Separate Plan

Effect of Final Regulations

Separate Accounts

- for determining DB, must be formed by 9/30 of year following Participant's Death
- for determining Applicable Distribution Period, must be formed by 12/31 of year following Participant's Death
- If trust is named as DB, separate accounts will not allow LE of each DB - must use oldest beneficiary as LE

Minimum Distribution Rules

Rule # 6 – No “Credit” for Withdrawals Prior to Required Beginning Date

- Doesn’t Affect Required Minimum Distributions (No “Credit” or Carry Forward)

Minimum Distribution Rules

Rule # 7 -

Minimums are Minimums!

- You can always take out more!

The Dirty Dozen: The Minimum Distribution Rules

The Last Five Rules Deal Primarily with Distributions After Life:

- Participant's Death Before RBD
- Participant's Death After RBD
- Designated Beneficiary
- Multiple Beneficiary Rule; and
- After Death Planning Opportunities

Minimum Distribution Rules

Rule # 8 - Participant's Death Before the Required Beginning Date

- If no DB: "Five Year Rule"
  - » Exceptions:
    - Spouse: Rollover or Spouse LE
    - Designated Beneficiary: LE of DB

Minimum Distribution Rules

Rule # 9 - Participant's Death After the Required Beginning Date

- "One Year Rule" if no Designated Beneficiary
- "At Least As Rapidly Rule" if Designated Beneficiary

New Law Comparison

Rule # 8 - Participant's Death Before the Required Beginning Date (SAME AS OLD LAW)

- If no DB: "Five Year Rule"
  - » Exceptions:
    - Spouse: Rollover or Spouse LE
    - Designated Beneficiary: LE of DB

New Law Comparison

Rule # 9 - Participant's Death After the Required Beginning Date

(SIMPLER & BETTER)

- No Designated Beneficiary - Use Participant's Life Expectancy
- Designated Beneficiary - Use Beneficiary's Life Expectancy

Effect of Final Regulations

Participant's Death After the Required Beginning Date

- **If there is a Designated Beneficiary:**

  use the longer of:

  - **Participant's LE or**
  - **Designated Beneficiary's LE**

Minimum Distribution Rules

- Importance of Designated Beneficiary
  - Determined as of Required Beginning Date (with Calculation, Distribution, and Division Methods)
  - Determined Lifetime and After Death Distributions

New Law Comparison

- Importance of Designated Beneficiary
  - No Impact on Lifetime Distributions
  - Determines After Death Distributions
  - Determination Date: 12/31 of year following Participant’s Death (but this was changed by Final Regs)

Effect of Final Regulations

Importance of Designated Beneficiary

- **Determination Date: 9/30 (NOT 12/31) of year following Participant's Death (to give plan administrator and taxpayer more time to determine MRD)**

- **If DB dies after Participant but before 9/30, still use LE of deceased DB**

Minimum Distribution Rules

Rule # 10 - Designated Beneficiary

- Term of Art
- Must Have “Heartbeat”

Minimum Distribution Rules

Qualifying a Trust as a Designated Beneficiary

- Valid Under State Law
- Individual Beneficiaries
- Identifiable Beneficiaries

Minimum Distribution Rules

Qualifying a Trust as a Designated Beneficiary – (cont.)

- Copy of Trust to Plan Administrator when Distributions Begin
- Trust Must Be IRREVOCABLE as of the Date of Death

New Law Comparison

Qualifying a Trust as a Designated Beneficiary – changed by 2001 Proposed Regulations

- **Copy of Trust to Plan Administrator:**
  - By the Required Beginning Date; or
  - By End of Year Following Year of Death

Effect of Final Regulations

Qualifying a Trust as a Designated Beneficiary

- Copy of Trust to Plan Administrator
  - During Lifetime: only if spouse is named as DB & more than 10 years younger
  - After Death: by <u>10/31</u> of year following Participant's Death
  - Amnesty period for old trusts: can by delivered by 10/31/03

Minimum Distribution Rules

Rule # 11 - Multiple Beneficiary Rule

- Must Always Use the Oldest

New Law Comparison

Rule #12 – After Death Planning Opportunities

The 3-Ds of After Death Planning

- Disclaimer
- Distribution
- Division

Minimum Distribution Rules

Disclaimer Strategy

(Legal "No Thank You")

Name Contingent Beneficiaries

- Provides Payment Flexibility
- Tax Planning

New Law Comparison

Disclaimer Strategy

- "Direct" Toward Favorable Beneficiary
- Retain in Family Trust for Federal Estate Tax Reduction
- Retain in Marital Trust for Distribution Control
- IRA Rollover for Income Tax Deferral

New Law Comparison

Distribution Strategy

- "Cash Out" Unfavorable Beneficiary
- "Direct" Toward Favorable Beneficiary

Effect of Final Regulations

Distribution Strategy

- **Must "cash out" beneficiary by 9/30 of year after death**

Minimum Distribution Rules

Division Strategy

- Separate Account Rule Allows:
  - Account or Trust for Each Beneficiary (Separate Accounts formed **prior to Required Beginning Date**)
  - Distributions over Each Beneficiary's Life Expectancy

New Law Comparison

Division Strategy

- Separate Account Rule Allows:
  - Account or Trust for Each Beneficiary (Separate accounts formed prior to December 31st of year after death)
  - Distributions over Each Beneficiary's Life Expectancy

Effect of Final Regulations

Separate Accounts

- for determining DB, must be formed by 9/30 of year following Participant's Death
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- If trust is named as DB, separate accounts will not allow LE of each DB - must use oldest beneficiary as LE

New Law Comparison

Planning Strategy

- Review Plan Document to Determine Options
- General Rule: Name Spouse as Primary and Trust as Secondary Beneficiary
  If Single, Name Trust as Primary and Individual as Secondary Beneficiary
- Review With Professional Team at Age 70

Disadvantages of Retirement Plan Assets

- Ordinary Income Tax on Distributions
- Death Benefits Subject to IRD
- Included in Estate
- Many Clients don’t Spend
- Can’t Give Away Without Gift & Inc. Tax
- Combined Inc. & Estate Tax Can Exceed 70%

Good Assets to Die With

- Real Estate
- Mutual Funds
- Securities
- Business Interests
- Life Insurance
- Roth IRA

Retirement Planning Strategy #1

“Stretch-out” IRA - IRAs Are Good

- Provides Maximum Long-term Income Tax Deferral
- Keeps All Retirement Plan Proceeds in the Family

Retirement Planning Strategy #1

"Stretch-out" IRA (cont.)

- Requires Mastery of the Minimum Distribution Rules
  - MDIB Rule
  - Multiple Beneficiary Rule
  - Separate Share/Account Rule

New Law Comparison

"Stretch-out" IRA (cont.)

- Requires Mastery of the Minimum Distribution Rules
  - Designated Beneficiary Rule
  - Multiple Beneficiary Rule
  - Separate Account Rule

Retirement Planning Strategy #1

"Stretch-out" IRA -- Keys to Use

- Qualified Plans Seldom Provide Option
  - Default Beneficiaries Named
  - Lump sum Payment Required
- Consider IRA Rollover

Retirement Planning Strategy #1

Spousal Rollover

- Spouse Delays Distributions until S's RBD
- MRDs based on new Uniform Table
- Spouse Names Children as DBs of new IRA
- Children take Distributions over their Life Expectancy after Spouse's Death

Retirement Planning Strategy #1

"Stretch-out" IRA -- Keys to Use

- Separate Account Rule Allows:
  - Account or Trust for Each Beneficiary (Separate Accounts formed **prior to Required Beginning Date**)
  - Distributions over Beneficiary's Life Expectancy

New Law Comparison

"Stretch-out" IRA -- Keys to Use

- Separate Account Rule Allows:
  - Account or Trust for Each Beneficiary (Separate accounts formed prior to December 31st of year after death)
  - Distributions over Each Beneficiary's Life Expectancy

Effect of Final Regulations

Separate Accounts

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- If trust is named as DB, separate accounts will not allow LE of each DB - must use oldest beneficiary as LE

Retirement Planning Strategy #1

“Stretch-out” IRA -- Keys to Use

- Separate Account Rule Allows:
  - Each Beneficiary to Control Voluntary Withdrawals from own Share
  - Generation-Skipping Planning

Retirement Planning Strategy #1

"Stretch-out" IRA -- Keys to Use

- Must provide liquidity to pay death taxes
  - Best option is usually insurance owned by life insurance trust
  - When uninsurable, use non-retirement plan funds to pay tax

Retirement Planning Strategy #1

“Stretch-out” IRA

- Involves INCREASED estate and income taxes!
- Assures Larger Distributions even after the increased taxes are paid!

Retirement Planning Strategy #1

Three Reasons to Use “Stretch-out” IRA

- DEFERRAL
- DEFERRAL
- DEFERRAL

Retirement Planning Strategy #2

Spend Down or Reposition IRA-IRAs are Bad

- Spend down IRA while alive & pass good assets to heirs
- If distributions aren’t needed reposition into more favorably taxed assets

Retirement Planning Strategy #2

Spend Down or Reposition IRA

- Take Distributions
- Pay Income Tax
- Gift After Tax Amount to ILIT
- Trust Assets Pass Free of Tax
- Provides Needed Estate Tax Liquidity

Retirement Planning Strategy #2

Spend Down or Reposition IRA

- Income Tax is going to be paid anyway, why not pay now & remove future growth from taxation
- ILIT can leverage ultimate amount passed to heirs

Retirement Planning Strategy #3

- Roth IRA for Estate Planning
  - No minimum distributions until death of participant
  - Passes Income Tax Free at Death
  - Either Convert or Contribute
  - Good Asset for Family Trust

Retirement Planning Strategy #4

- Charitable Bequest of Plan Balance
  - Give Bad Assets to Charity in Order to Avoid IRD
  - Keep Good Assets Which Pass Inc. Tax Free
  - Removes Plan Balance from Estate
  - Replace with Life Insurance in ILIT

Retirement Planning Strategy #4

- Testamentary CRT
  - Create CRT at Death of Participant or Spouse
  - Estate Tax and Income Tax Deduction for Amount to Charity
  - No IRD Upon Transfer to CRT
  - Heirs Receive Income Stream for Term of Years or for Life
  - Eliminates MRD Requirements While Still Providing Tax Deferred Installments

Please don’t forget to fill out and hand in your Retirement Planning Workshop Evaluation Form