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LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS

BY
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As an elder law attorney and estate planner, I have noticed that a large percentage of the wealth of my clients is in retirement plans. While studying for the Certified Financial Planner™ exam, I was reminded of the large number of retirement plans with different sets of rules. These plans include pension, profit sharing, 401(k), IRA, Roth IRA, SEP-IRA (Simplified Employee Pension Plan), SIMPLE IRA, 403(b) and 457.

To improve my planning skills, I decided to read Natalie Choate's book, *Life and Death Planning for Retirement Plan Benefits*, 6th Edition 2006. Ms. Choate is a nationally known expert on retirement plan benefits and previous editions of her book have been in my library for years. The book is well written, with numerous examples to explain complex rules. It includes a discussion of the applicable provisions of the 2006 Pension Protection Act. At 576 pages, this lengthy tome confirms that tax, estate and financial planning for retirement plan benefits is an extremely complex area. I question whether as a matter of public policy retirement plans should be so complex. The book also points out many issues that have not been resolved by the regulations of the Internal Revenue Service (IRS).

Ms. Choate's book left me with a much better understanding of retirement plans, and I make the following observations:

- Income tax deferral is the most valuable feature of qualified retirement plans and IRAs. Preserving tax deferral is an important goal of estate planning. The choice of the payable-on-death beneficiary determines the maximum deferral that will be available.
- The biggest income tax planning errors made by participants include: overlooking Net Unrealized Appreciation (NUA) planning opportunities, overlooking ten year averaging, choosing a beneficiary

without considering the beneficiary's income tax bracket, and overlooking the deduction for federal estate taxes paid on the account.

- The tax laws generally favor naming the participant's surviving spouse, individually, as the beneficiary of retirement benefits and using other assets to fund a credit shelter trust. The rules for naming a Qualified Terminal Interest Property (QTIP) marital trust as the beneficiary of retirement plan benefits are complex and may result in substantial loss of potential income tax deferral.
- In Rev. Rul. 2006-26, the IRS has stated that a retirement plan designating a QTIP trust using the definition of income in the Virginia Uniform Principal and Income Act (UPIA) will not qualify for the estate tax marital deduction. Until the Virginia UPIA is amended, the QTIP trust should define the trust income to include the income earned in the retirement plan account.
- The federal Retirement Equity Act (REA) preempts state spousal rights laws. The REA requires a retirement plan to provide a benefit to a surviving spouse, unless expressly waived by the spouse.
- Upon the death of the participant, all plan and IRA beneficiary designations should be reviewed as soon as possible. No beneficiary should exercise any control over the retirement plan or account until the review is complete. If any beneficiary designation appears undesirable, then one should consider using a qualified disclaimer to redirect the benefits.
- When preparing a designation of beneficiary, one should name: (1) a primary beneficiary, (2) a contingent beneficiary if the primary beneficiary disclaims his or her benefit, and (3) a contingent beneficiary if the primary beneficiary does not survive the participant.
- One should consider assisting a young family member by funding a Roth IRA when it is likely that this family member's income tax bracket will increase in the future.
- In view of the substantial complexity and disadvantages involved in naming a trust as the beneficiary of a retirement plan or IRA, participants should generally favor naming an individual(s) as beneficiary, unless there is a compelling reason to name a trust. These compelling reasons will include minor or disabled beneficiaries.
- If an individual wants to make charitable gifts as part of the individual's estate plan, then consider using retirement plan benefits as a tax efficient way to fund the gift.
- Distributions before the age of 59 ½ years generally will trigger a 10% penalty in addition to income taxes.

Life and Death Planning for Retirement Benefits is an excellent resource for estate and financial planners. You may purchase this book at www.ataxplan.com. My next book report will be on Prof. Lawrence Frolik's book, *The Law of Later-Life Health Care and Decision Making*. Stay tuned.

Andrew H. Hook is a principal at Oast & Hook. He is a Certified Elder Law Attorney and a Certified Financial Planner®.

Oast & Hook

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