Planning Opportunities in the Retirement Marketplace

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Sophisticated Tax Planning for IRAs & Qualified Plan Distributions

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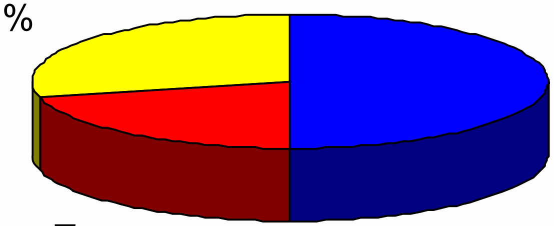

Potential tax exposure to IRA without planning

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- Maximize use of Unified Credit (where needed)
- Coordinate estate plan under will or revocable trust
- Generally, the IRA or qualified plan is the largest asset of the estate
- To minimize income tax on distributions and thereby maximize deferral

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- Fluctuation in asset value
- Increase in the applicable exclusion amount under EGTRRA
- Fixed State applicable exclusion amount
- Perceived need of surviving spouse
- Tax apportionment

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- Wills control probate assets
- Trusts control trust assets
- IRAs and qualified retirement plans are controlled by beneficiary designation form or default provisions of contract

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- IRAs are not taxed until distributed
- Distributions must begin no later than one's Required Beginning Date (RBD)
- IRA elections are required after death

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Introduction to Retirement Distribution Planning

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OPTION 1 - Withdraw 100% From IRA

Husband's Age		64	65	66	67	68
Wife's Age		59	60	61	62	63
ASSETS		**2009**	**2010**	**2011**	**2012**	**2013**
IRA						
Beginning Balance		$ 1,300,000	$ 1,216,000	$ 1,127,620	$ 1,034,553	$ 936,472
Income	7.00%	91,000	85,120	78,933	72,419	65,553
Distributions		(175,000)	(173,500)	(172,000)	(170,500)	(169,000)
Ending Balance		$ 1,216,000	$ 1,127,620	$ 1,034,553	$ 936,472	$ 833,025
Brokerage Account						
Beginning Balance		$ 1,400,000	$ 1,474,010	$ 1,551,707	$ 1,633,325	$ 1,719,113
Yield (Interest & Dividends)	2.00%	28,000	29,480	31,034	32,667	34,382
Growth	5.00%	70,000	73,701	77,585	81,666	85,956
Subtotal		$ 1,498,000	$ 1,577,191	$ 1,660,327	$ 1,747,658	$ 1,839,451
Yield Disributed		(28,000)	(29,480)	(31,034)	(32,667)	(34,382)
Stock Sales		-	-	-	-	-
Net Cash Flow Reinvested		4,010	3,997	4,033	4,122	4,266
Ending Balance		$ 1,474,010	$ 1,551,707	$ 1,633,325	$ 1,719,113	$ 1,809,335
Total Assets		**$ 2,690,010**	**$ 2,679,327**	**$ 2,667,879**	**$ 2,655,585**	**$ 2,642,360**
CASH FLOW		**2009**	**2010**	**2011**	**2012**	**2013**
IRA Distribution		$ 175,000	$ 173,500	$ 172,000	$ 170,500	$ 169,000
Interest & Dividends		28,000	29,480	31,034	32,667	34,382
Stock Sales Proceeds		-	-	-	-	-
Subtotal		$ 203,000	$ 202,980	$ 203,034	$ 203,167	$ 203,382
Less: Income Tax		(66,990)	(66,983)	(67,001)	(67,045)	(67,116)
Less: Living Expenses		(132,000)	(132,000)	(132,000)	(132,000)	(132,000)
Net Cash Flow		**$ 4,010**	**$ 3,997**	**$ 4,033**	**$ 4,122**	**$ 4,266**

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Introduction to Retirement Distribution Planning

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OPTION 2 - Withdraw 100% From Brokerage Account

		2009	2010	2011	2012	2013
Husband's Age		64	65	66	67	68
Wife's Age		59	60	61	62	63
ASSETS		**2009**	**2010**	**2011**	**2012**	**2013**
IRA						
Beginning Balance		$ 1,300,000	$ 1,391,000	$ 1,488,370	$ 1,592,556	$ 1,704,035
Income	7.00%	91,000	97,370	104,186	111,479	119,282
Distributions		-	-	-	-	-
Ending Balance		$ 1,391,000	$ 1,488,370	$ 1,592,556	$ 1,704,035	$ 1,823,317
Brokerage Account						
Beginning Balance		$ 1,400,000	$ 1,344,910	$ 1,285,459	$ 1,221,390	$ 1,152,431
Yield (Interest & Dividends)	2.00%	28,000	26,898	25,709	24,428	23,049
Growth	5.00%	70,000	67,245	64,273	61,070	57,622
Subtotal		$ 1,498,000	$ 1,439,053	$ 1,375,441	$ 1,306,887	$ 1,233,101
Yield Disributed		(28,000)	(26,898)	(25,709)	(24,428)	(23,049)
Stock Sales		(130,000)	(131,500)	(133,000)	(134,500)	(136,000)
Net Cash Flow Reinvested		4,910	4,803	4,659	4,472	4,238
Ending Balance		$ 1,344,910	$ 1,285,459	$ 1,221,390	$ 1,152,431	$ 1,078,291
Total Assets		**$ 2,735,910**	**$ 2,773,829**	**$ 2,813,946**	**$ 2,856,466**	**$ 2,901,608**
CASH FLOW		**2009**	**2010**	**2011**	**2012**	**2013**
IRA Distribution		$ -	$ -	$ -	$ -	$ -
Interest & Dividends		28,000	26,898	25,709	24,428	23,049
Stock Sales Proceeds		130,000	131,500	133,000	134,500	136,000
Subtotal		$ 158,000	$ 158,398	$ 158,709	$ 158,928	$ 159,049
Less: Income Tax		(21,090)	(21,595)	(22,051)	(22,456)	(22,810)
Less: Living Expenses		(132,000)	(132,000)	(132,000)	(132,000)	(132,000)
Net Cash Flow		**$ 4,910**	**$ 4,803**	**$ 4,659**	**$ 4,472**	**$ 4,238**

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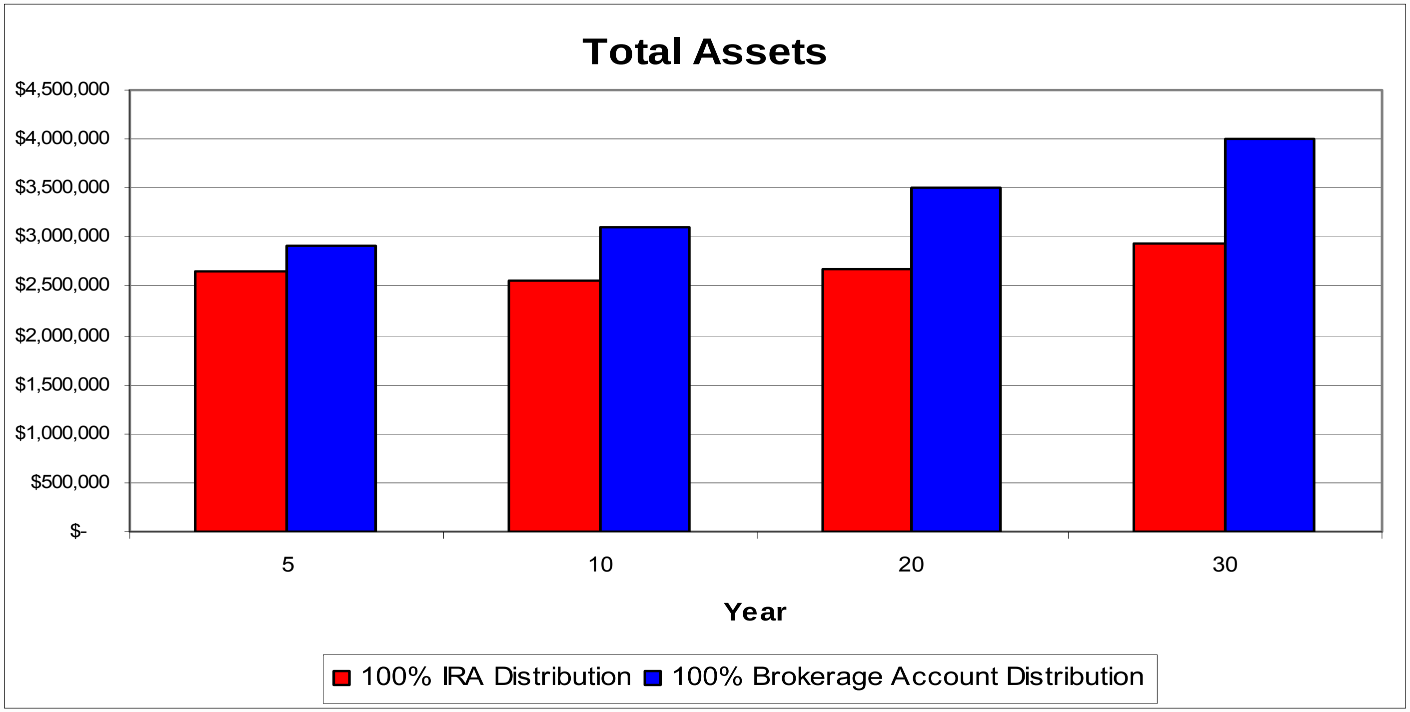
Introduction to Retirement Distribution Planning



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Understanding the Primary Issues

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- When should a client do a Roth conversion?
- Does the client have adequate liquidity to pay the estate tax?
- Who should be the beneficiary of the IRA?
- How to utilize disclaimer plans
- When to have an IRA payable to a trust
- Understanding the advantages and disadvantages of taking stock from a qualified plan

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Understanding the Primary Issues

- When to have an IRA payable to a charitable remainder trust
- How to design life insurance trusts to compliment a large IRA
- The advantages and disadvantages of the inherited IRA
- Post mortem planning, including the September 30th deadline

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2005 Bankruptcy Act

- Bankruptcy Abuse Prevention and Consumer Protection Act of 2005
- Signed by President on April 20, 2005
- Main Purpose – to stop perceived abuses in the bankruptcy system

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2005 Bankruptcy Act

- 11 U.S.C. §522
  - Retirement Asset Protections
    - IRA and Roth IRA Limitations
    - $1 Million
  - Rollover IRA Protections
    - Separate Accounts
  - Protection for Business Owners
- 11 U.S.C. §541
  - Coverdell Accounts and 529 Plans

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Retirement Rollover Strategies

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- The Taxpayer must complete the rollover no later than "the 60th day following the day on which the distributee [Taxpayer] received the property distributed."
  - Note: The IRS can waive the 60 day rule.
- The Taxpayer must rollover the same property as received.
  - Exception: If the taxpayer sells the property, he or she can rollover the proceeds.

Failure to rollover = Distribution = Taxable income

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IRA Rollover Advantages

- The primary advantage of a rollover is to preserve stretch out capability for the designated beneficiary
- Ability to convert to a Roth IRA
- Greater investment choices through an IRA
- Greater investment expertise through the investment adviser who set up the IRA (as opposed to the company's human resource office)
- Account consolidation

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Exception to 60-Day Rollover Rule

- IRC § 408(d)(3)(I) provides that the Secretary may waive the 60-day requirement where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual.

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- **Relief available under Rev. Proc. 2003-16**
  - IRS will consider all relevant facts and circumstances, including:
    - Errors committed by a financial institution;
    - Inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error;
    - The use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and
    - The time elapsed since the distribution occurred.

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Situations Where IRS Granted 60-Day Rollover Relief

- PLR 200651040 - Failure due to financial institution error.
- PLR 200646022 - Failure due to medical condition.
- PLR 200644030 – Failure due to taxpayer being distraught over death of spouse.
- PLR 200623076 - Failure due to misappropriation of funds.

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Rollover of IRA Lawsuit Proceeds

- PLR 200452043-54 and 200724040 - Amounts received by taxpayers from lawsuit settlement from insurance company and placed into IRA were valid rollover contributions
- Cannot exceed amount of actual IRA loss
- Attorney fees issue

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Excess Accumulation Penalty

A 50% penalty is assessed to the extent that a taxpayer has not taken his/her RMD for the tax year.

Example

Assume Peter was required to take out $30,000 from his IRA in 2008, but only withdrew $20,000. In this case, Peter would be subject to a $5,000 [($30,000 - $20,000) x 50%] excess accumulations penalty. Further, Peter would still be required to withdraw the $10,000 deficiency from his IRA.

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- Under IRC §4974(d), the tax may be waived if the taxpayers can establish that the shortfall in distributions was due to reasonable error and reasonable steps are being taken to remedy the shortfall. An accumulation occurs because of “reasonable error" when it occurs through no fault of the plan participant.
- Complete Form 5329
- Attach letter requesting waiver

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Tax Planning Opportunities When a Qualified Plan Has Employer Securities

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Tax Planning Opportunities When a Qualified Plan Has Employer Securities

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- Key issues
- Income tax
- Estate tax
- Excise tax

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IRC §402(d)(4)(D) Triggering Event

- On account of employee's death
- After the employee attains age 59½
- On account of employee's separation from service
- After the employee has become disabled (within the meaning of section 72(m)(7)

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Lump-Sum Distribution

Prior Distribution Problem

> If prior year distributions have been made after one triggering event, the taxpayer must wait until another triggering event to qualify for lump sum distribution "within one taxable year" rule.

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Taxation of Rollout

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- Ordinary income recognized on cost basis
- Difference between Fair Market Value (FMV) at rollout and basis is Net Unrealized Appreciation (NUA)
- NUA is taxed long-term capital gain tax rates (5%/15%)
- Note - $O Basis position

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Additional Taxation of Rollout

> If under age 55, a 10% excise tax penalty is imposed on the basis of the securities

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Taxation of Net Unrealized Appreciation

> Fair Market Value (FMV) of stock	$ 750,000
> Employer basis	$ 150,000
> Net Unrealized Appreciation (NUA)	$ 600,000
> Amount taxable if stock is rolled out	$ 150,000

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The $600,000 of NUA is Deferred Until the Stock is Sold

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Capital Gain Taxation Upon Sale of Stock

- 15% rate
- 5% rate
- 0% rate (2008, 2009 and 2010)

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Lump-Sum Distribution

Grandfathered Rule

- **10-year averaging and 20% capital gain**
  - Only available to those individuals born before January 2, 1936
  - 20% capital gain only applies to pre-1974 contributions

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A Key Issue is the Proper Holding Period to Obtain Capital Gain Treatment

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Post Distribution Gain

- 1 year or less -- Short-term
- Greater than 1 year -- Long-term

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Warning:
a PLR will be required

> Shifts property to spouse
> Potential of gift to family
> Potential charitable gifts
> Potential CRT planning
> Potential GRAT

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Treatment at Death

- The $600,000 of rollout gain does not receive a step-up in basis
- Subsequent gain (above $600,000) should receive a step-up in basis

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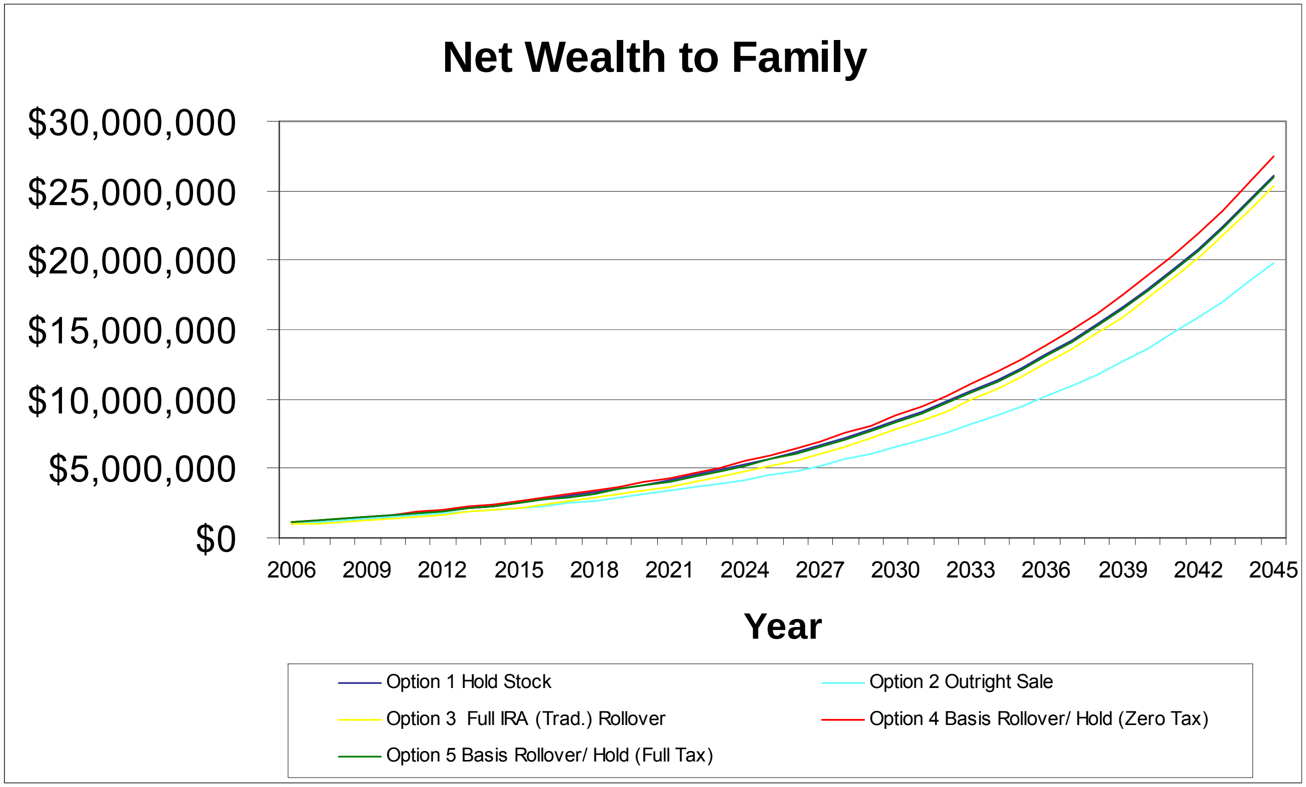
Comparison of Strategies



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Lump-Sum Distribution Options

> 100% Rollout

> 100% Rollover to IRA

> Partial Rollout / Partial Rollover

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- **Advantages**
  - Has greatest tax advantage over time due to favorable tax attributes (i.e. capital gains vs. ordinary income)
  - Allows for greater flexibility from an estate planning perspective (gifting, estate equalization, etc…)

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100% Rollout

> **Disadvantages**
  – Understanding the tax issues (basis, NUA, post-distribution gain, etc…) can be onerous over time
  – Immediate taxation on the cost basis of securities rolled out of the qualified plan
  – Generally not advisable from a financial planning perspective because the retiree has a significant exposure "diversifiable risk".

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100% Rollout Solution

> **Advantages**

- Easy to implement
- Easy to understand
- No taxation on rollover
- Allows retiree to create a balanced portfolio

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100% Rollout Solution

- **Disadvantages**
  - **Pre-59½ rules**
  - **No capital gain treatment**
  - **Limits estate tax planning options**

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Partial Rollover - Example

Retiree has $1,200,000 in his qualified plan. The plan is 90 percent invested in employer stock

- **Step One** - Take a $200,000 lump sum distribution
- **Step Two** - Basis in employer stock is taxed at rollout
- **Step Three** - Transfer remaining $1,000,000 to an IRA
- **Step Four** - File proper tax elections
  - Basis allocation election
  - Taxation of employer basis election

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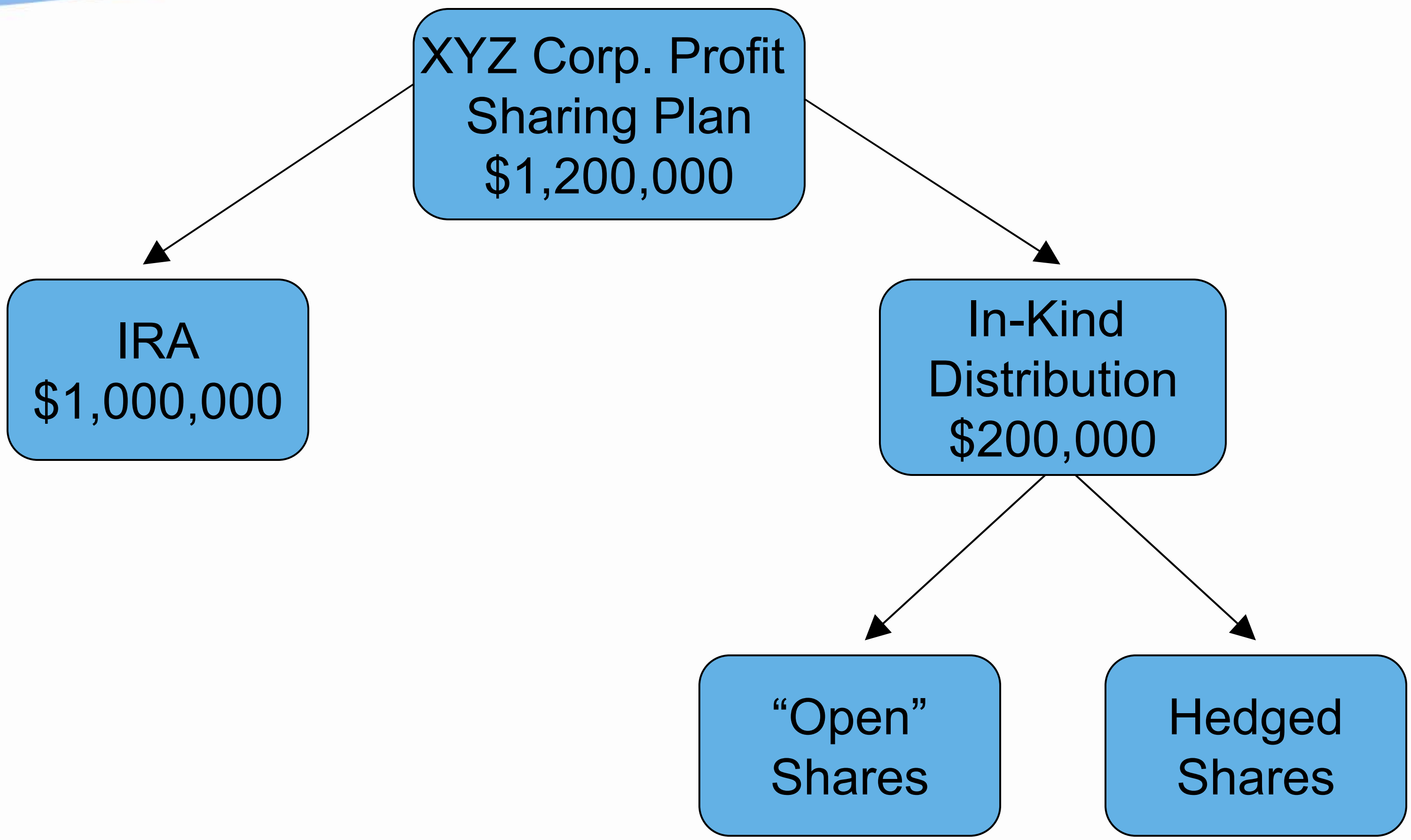
Partial Rollover - Example



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Understanding Roth IRA Conversions

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Roth IRAs

- 100% of growth is tax-exempt
- No required minimum distributions at age 70½
  - NOTE: Distributions from Roth IRAs cannot be used to fulfill the RMD from a traditional IRA
- $100,000 Modified Adjusted Gross Income (MAGI) limitation
- RMDs on Inherited Roth IRAs
- Roth 401(k) plans

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Roth IRAs

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- Starting in 2010, the $100,000 Adjusted Gross Income (AGI) limitation no longer applies
  - The taxable income recognized on a Roth IRA conversion in 2010 may be spread over the following two tax years (i.e. 2011 and 2012)
- Married Filing Separately taxpayers can convert to a Roth IRA

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Computation of MAGI - New Rule (Conversions After 12/31/2004)

Adjusted Gross Income		$XX,XXX
Less:		
Income from Roth Conversion	($XX,XXX)	
Required Minimum Distribution **(IRAs Only)**	(XX,XXX)	(XX,XXX)
Add-in:		
Traditional IRA Deduction	$X,XXX	
Student Loan Interest	X,XXX	
Tuition & Fee Deduction	X,XXX	
Foreign Income/Housing Exclusion	X,XXX	
Foreign Housing Deduction	X,XXX	
Exclusion of Interest on U.S. Series EE Savings Bonds	X,XXX	XX,XXX
Modified Adjusted Gross Income (Must be less than $100,000)		**$XX,XXX**

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Convertible accounts

- Traditional IRAs
- 401(k) plans (Starting in 2008)
- Profit sharing plans (Starting in 2008)
- 403(b) annuity plans (Starting in 2008)
- 457 plans (Starting in 2008)

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- Non-convertible accounts
  - "Inherited" IRAs
  - Education IRAs

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- The 5-year period for all of a participant's Roth IRAs begins on January 1 of the first year for which a contribution was made to any Roth IRA owned by that participant.
  - Except a surviving spouse gets to treat an inherited Roth IRA as one of her own for purposes of the 5-year rule.
  - The 5-year period continues to run with the participant dies.
    - If a participant dies within the 5-year period, distributions to a beneficiary are taxable until the 5-year period ends.

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- **Qualified** distributions are not subject to income tax

- **Non-qualified** distributions will be subject to income tax

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- Basis Can be Withdrawn Tax-Free (FIFO Method)
- Distributions are not subject to income tax if they do not exceed aggregate contributions and/or conversions to the Roth IRA.

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- Withdrawals made within five years of conversion if owner under age 59½ and no other exception applies

- Five-year period independent of five-year period for qualified distribution

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- **If attributable to a regular contribution: applicable to amounts includible in gross income**

- **If attributable to a rollover contribution: applicable to amounts that were included in gross income at rollover**

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(1) Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, etc.

(2) Suspension of the minimum distribution rules at age 70½ provides a considerable advantage to the Roth IRA holder.

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(3) Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax.

(4) Taxpayers who can pay the income tax on the IRA from non IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields.

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(5) Taxpayers who need to use IRA assets to fund their Unified Credit bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds.

(6) Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.

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(7) Because federal tax brackets are more favorable for married couples filing joint returns than for single individuals, Roth IRA distributions won't cause an increase in tax rates for the surviving spouse when one spouse is deceased because the distributions are tax-free.

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Roth IRAs

Advantage of Paying Income Tax on a Roth IRA Conversion Before Incurring an Estate Tax

	Estate Tax First Traditional IRA	Income Tax First Roth IRA
IRA Balance	$ 2,500,000	$ 2,500,000
Less: Federal & State Income Taxes @ 40%	-	(1,000,000)
Subtotal	$ 2,500,000	$ 1,500,000
Less: Federal Estate Tax @ 45%	(1,125,000)	(675,000)
Less: State Estate Tax @ 10%	(250,000)	(150,000)
Subtotal	$ 1,125,000	$ 675,000
IRA Balance	$ 2,500,000	
Less: IRC §691(c) Deduction*	(1,125,000)	
Subtotal	$ 1,375,000	
Less: Federal & State Income Taxes @ 40%	(550,000)	
Net Wealth to Family	**$ 575,000**	**$ 675,000**

PROOF: ($2,500,000 - $1,500,000) x 10% state estate tax = $100,000

*NOTE: Under IRC §691(c), a deduction is allowed ONLY for federal estate taxes paid.

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- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
  - The annual growth rates are the same
  - The tax rate in the conversion year is the same as the tax rate during the withdrawal years

    (i.e. A x B x C = D; A x C x B = D)

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	Traditional IRA	Roth IRA
2008 Account Balance	$ 100,000	$ 100,000
Less: Income Taxes @ 40%	-	(40,000)
Net Balance	**$ 100,000**	**$ 60,000**
Growth Until Death	300.00%	300.00%
Account Balance @ Death	$ 300,000	$ 180,000
Less: Income Taxes @ 40%	(120,000)	-
Net Account Balance to Family	**$ 180,000**	**$ 180,000**

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Critical decision factors

- Tax rate differential
  - Year of conversion vs. withdrawal years
- Use of "outside funds" (i.e. non-qualified retirement accounts) to pay the income tax liability
- Time horizon
- IRC §691(c) "effect"

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- **The key to successful Roth IRA conversions is to keep as much of the conversion income as possible in the current marginal tax bracket**
  - However, there are times when it may make sense to convert more and go into higher tax brackets

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Roth IRAs

Understanding the Mechanics

Tax Brackets

	Single	Married Filing Jointly	Head of Household
10%	$8,350	$16,700	$11,950
15%	$33,950	$67,900	$45,500
25%	$82,250	$137,050	$117,450
28%	$171,550	$208,850	$190,200
33%	$372,950	$372,950	$372,950
35%	> $372,950	> $372,950	> $372,950

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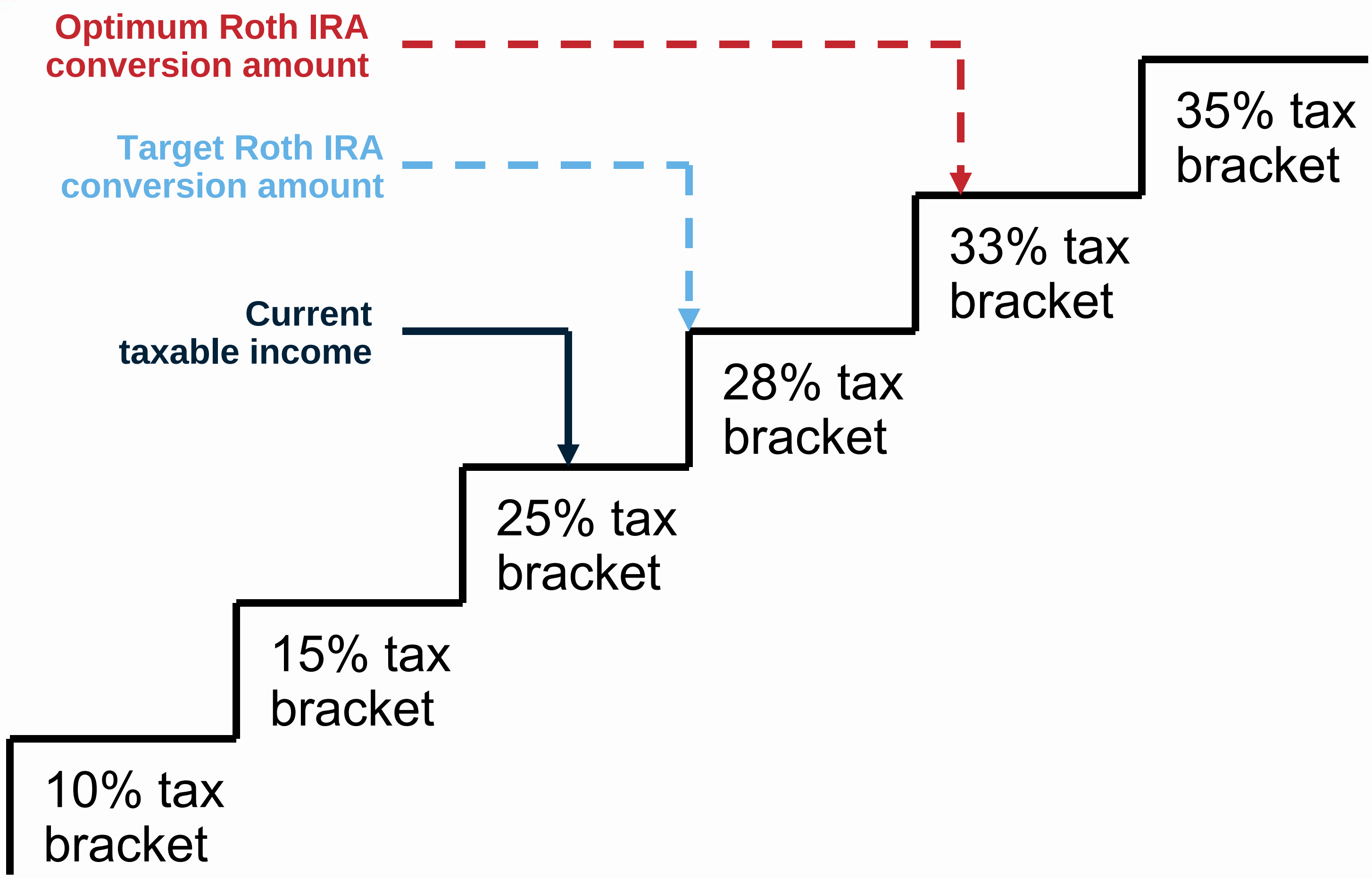
Roth IRAs

Understanding the Mechanics



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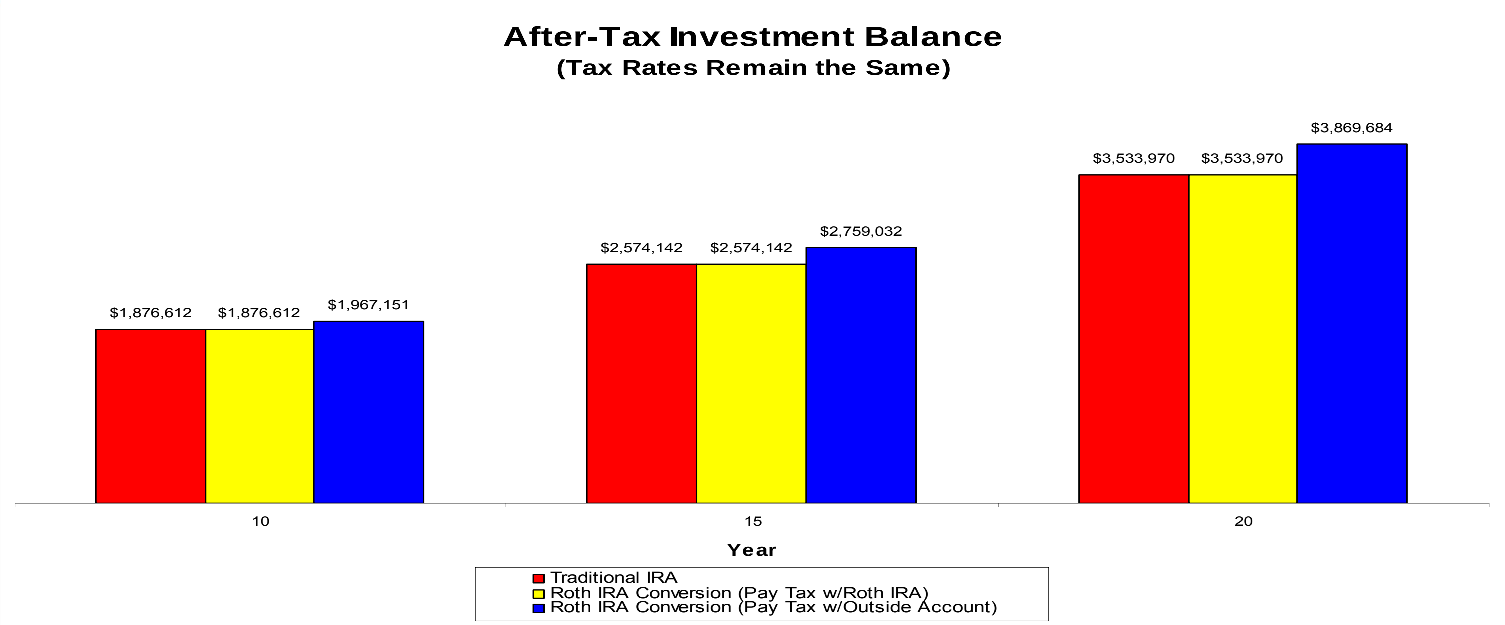

ASSUMPTIONS	
IRA Owner's Age	50
IRA Balance	$ 1,000,000
Outside Account Balance	$ 400,000
Yield Rate	2.00%
Growth Rate	6.00%
Total Return (Pre-Tax)	8.00%
Less: Income Tax on Yield @ 40%	-0.80%
Less: Income Tax on Growth @ 20%*	-0.60%
Total Return (After-Tax)	6.60%
Tax Rate - Current Year	40.00%
Tax Rate - Future Years	40.00%

* Assumes 50% annual turnover on growth

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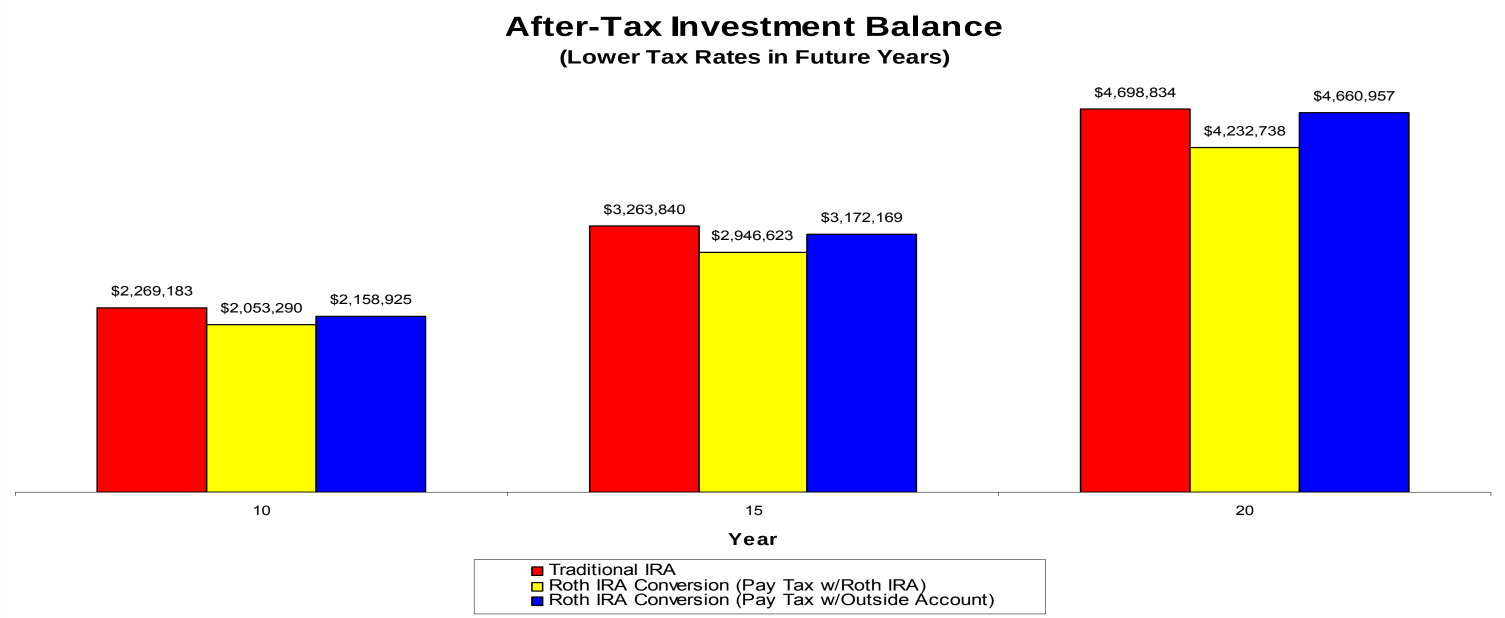
Roth IRAs

Understanding the Mechanics – Case Study



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Total Return (After-Tax)	6.60%
Tax Rate - Current Year	40.00%
Tax Rate - Future Years	30.00%

* Assumes 50% annual turnover on growth

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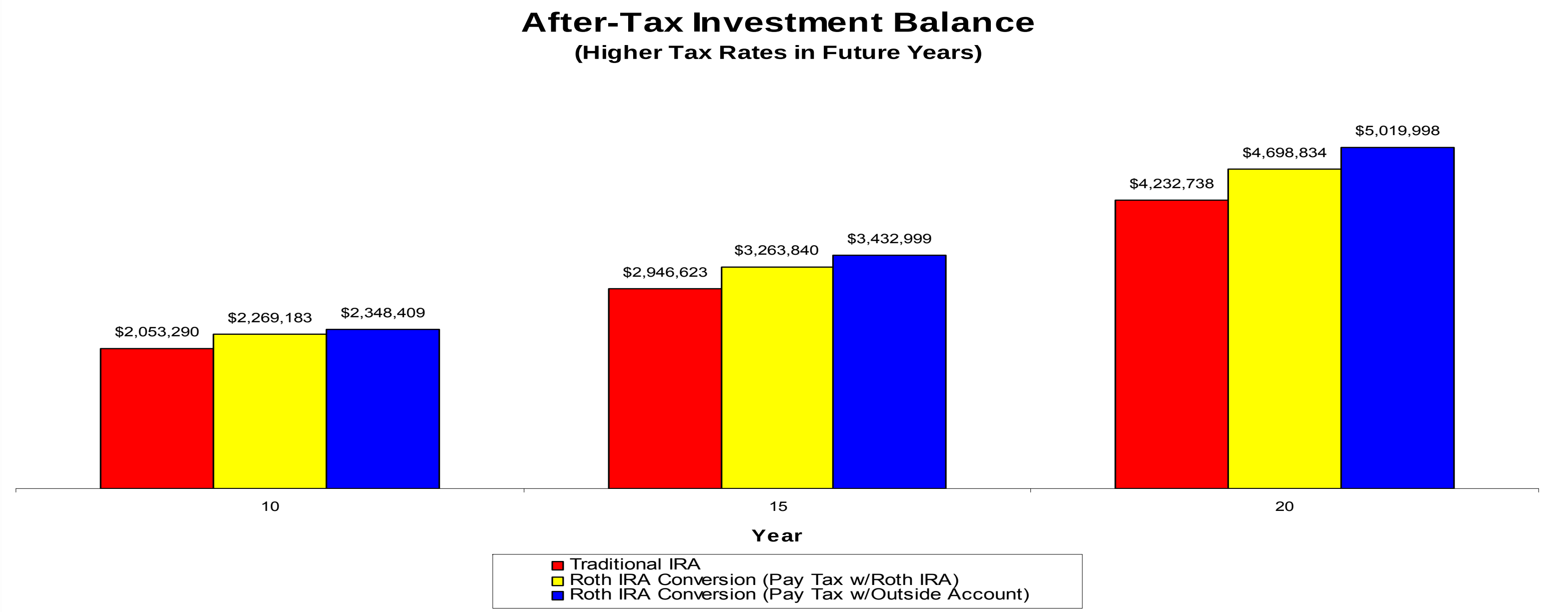
Roth IRAs

Understanding the Mechanics – Case Study



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Less: Income Tax on Growth @ 20%*	-0.60%
Total Return (After-Tax)	6.60%
Tax Rate - Current Year	30.00%
Tax Rate - Future Years	40.00%

* Assumes 50% annual turnover on growth

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- Utilize unused charitable contribution carryovers
- Offset current year ordinary losses
- Utilize current year Net Operating Losses (NOL) or carryovers from prior years
- Utilize Alternative Minimum Tax (AMT) carryovers

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> Taxpayers may recharacterize (i.e. "undo") the Roth IRA conversion in current year or by the filing date of the current year's tax return

- Recharacterization can take place as late as 10/15 in the year following the year of conversion

> Taxpayers may choose to "reconvert" their recharacterization

- Reconversion may only take place at the later of the following two dates:

(1) The tax year following the original conversion ***OR***

(2) 30 days after the recharacterization

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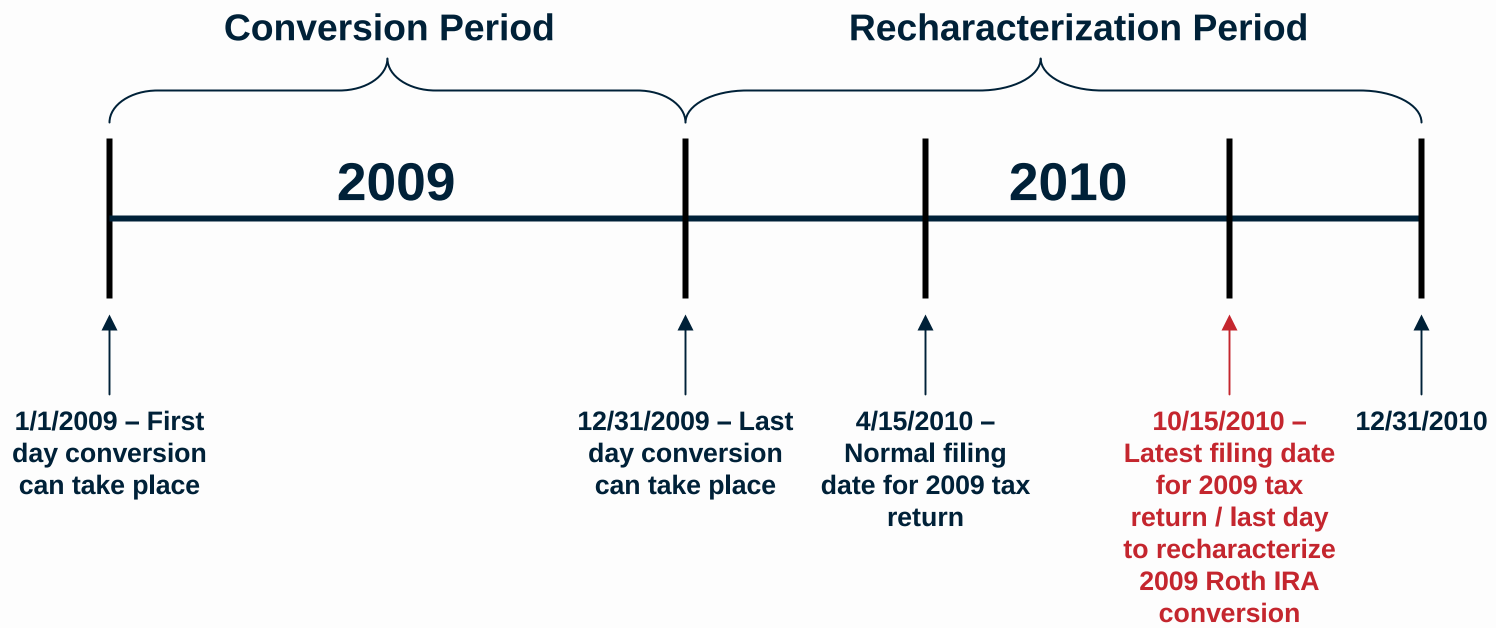
Roth IRA Conversion Timetable



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Roth IRA Conversion Dilemma

- Taxpayers cannot recharacterize a portion of a Roth conversion by “cherry picking” only those stocks that decline in value (IRS Notice 2000-39)
- All gains and losses to the entire Roth IRA, regardless of the actual stock or fund re-characterized, must be pro-rated

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Roth IRA Conversion Dilemma - Example

On January 2, 2008, when John Smith's IRA was worth $500,000, he converted the entire amount to a Roth IRA. John will owe ordinary income tax on the entire $500,000. The IRA consisted of 50% ABC Fund ($250,000) and 50% YYZ Fund ($250,000). As of April 15th, 2009 the ABC fund had declined in value to $125,000, while the YYZ fund had increased in value to $275,000. Thus, the total value of the IRA account declined in value to $400,000.

Even though John would like to re-characterize all of his ABC fund and leave the YYZ fund in his Roth IRA, he must allocate the total loss to each fund pro-ratably. As a result of this loss allocation, John may only recharacterize $156,250 (31.25% * $500,000) instead of $250,000.

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Roth IRA Conversion Dilemma - Example

	Initial Value on Date of Conversion	Value on Date of Recharacterization	Relative Percentages of overall Roth IRA on Date of Recharacterization	Increase / Decrease in Value
ABC Fund	$ 250,000	$ 125,000	31.25%	$ (125,000)
YYZ Fund	$ 250,000	$ 275,000	68.75%	$ 25,000
Total	$ 500,000	$ 400,000	100%	$ (100,000)

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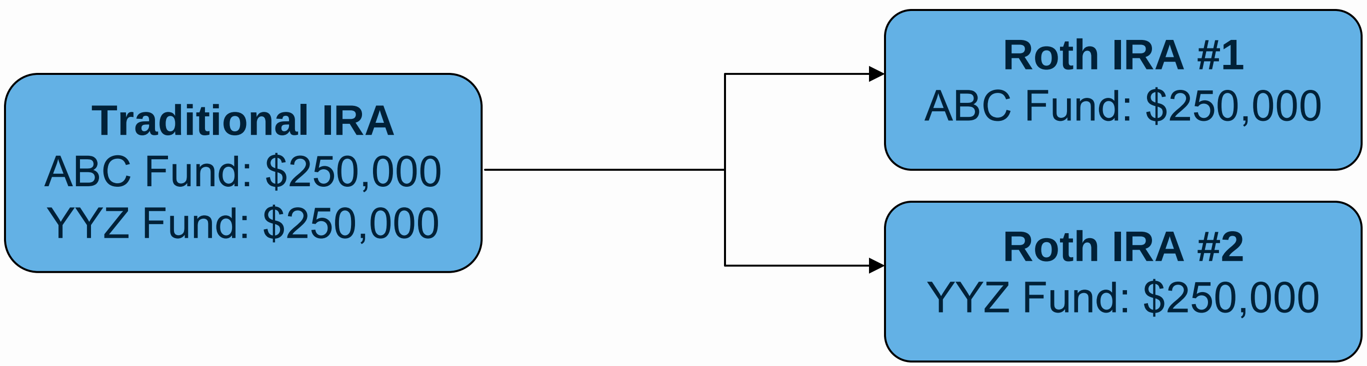
Roth IRA Segregated Conversion Strategy

STEP 1 – Convert Traditional IRA Into Two Separate Roth IRAs



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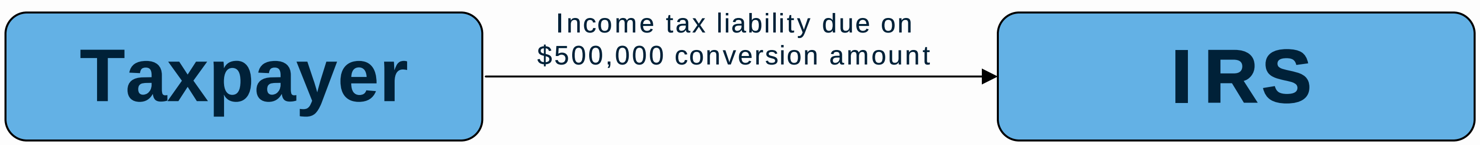
Roth IRA Segregated Conversion Strategy

STEP 2 – Payment of Income Taxes on Roth IRA Conversion

April 15, 2009*



* **NOTE:** Either a tax return or an extension must be filed by this date. Regardless of what is chosen, the tax liability due on the Roth IRA conversion must be remitted by this date in order to avoid late payment penalties and interest.

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Roth IRA Segregated Conversion Strategy

STEP 3 – Recharacterization of Roth IRA Conversion

BAKER TILLY

October 15, 2009*

Traditional IRA #1
ABC Fund: $125,000
(Current Value)

Recharacterization of IRA using the value at the date of conversion (e.g. $250,000)

Roth IRA #1
ABC Fund: $125,000
(Current Value)

Roth IRA #2
YYZ Fund: $275,000
(Current Value)

* **NOTE:** October 15, 2009 is the latest date for which a 2008 recharacterization can take place (either by filing extensions or by filing an amended return).

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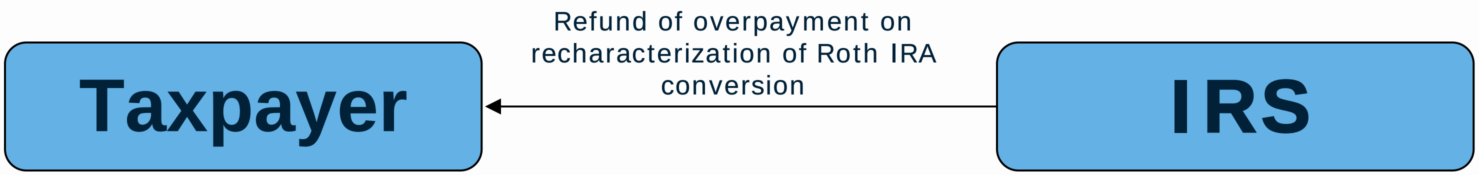
Roth IRA Segregated Conversion Strategy

STEP 4 – Refund of Overpayment of Income Taxes Paid on Roth IRA Conversion

October 15, 2009



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Roth IRA Segregated Conversion Strategy - Example

Using the facts from the earlier Example, instead of converting his entire IRA into a single Roth IRA, John created two separate Roth IRAs, one for each fund. As of April 15th, 2009 the ABC Fund had declined in value to $125,000, while the YYZ Fund had increased in value to $275,000.

As a result of the poor performance of the ABC Fund, John chose to recharacterize the Roth IRA that held the ABC Fund before he filed his income tax return.

The tax savings from John's Roth IRA Segregated Conversion Strategy can be summarized on the following slide:

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Roth IRA Segregated Conversion Strategy

Benefits of Segregating Roth IRA Accounts

	Without Roth IRA Segregation	**With** Roth IRA Segregation	Difference
Value on Date of Conversion	$ 500,000	$ 500,000	$ -
Value of Roth IRA after recharacterization	$ 275,000	$ 275,000	$ -
Value of Traditional IRA after recharacterization	$ 125,000	$ 125,000	$ -
Ordinary Income Recognized	$ 343,750	$ 250,000	$ (93,750)
Ordinary Income Tax @ 28%	$ 96,250	$ 70,000	$ (26,250)

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The Advantages of Stretch Out IRAs

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<u>Objective</u>: Prolong IRA payments over longest possible period of time, thus increasing wealth to future generations

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BAKER TILLY

- An IRA is treated as "inherited" if the individual for whose benefit the IRA is maintained acquired the IRA on account of the death of the original owner.
- Under the tax law the IRA assets can be distributed based upon the life expectancy of the beneficiary.

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- **Two Strategies**
  - Spousal Rollover
  - Inherited IRA
- **Advantages**
  - Rollover delays RMD until spouse’s own RBD
  - Inherited IRA provisions allow beneficiary’s life expectancy to be used for distributions after death of IRA owner

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- **Marital deduction should be available**
- **Typically the default**
- **If no rollover is chosen, then the life expectancy factor of spouse is used by reference to the Single Life Table beginning in the year the IRA owner would have turned age 70½. Each year thereafter the life expectancy divisor is recalculated by referencing the Single Life Table.**

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BAKER TILLY

- Exception to Inherited IRA rules.
- Only available to surviving spouse.
- Allows spouse to roll over assets received as beneficiary to a new IRA in his/her own name.
- Spouse's age used to determine when required minimum distributions must begin.
- Spouse may use the Uniform Lifetime Table to determine distributions.

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- **Utilizes the exemption to the five year rule**
- **Avoids IRA assets being subject to estate tax in spouse's estate**
- **Achieves "Inherited IRA" to the degree that distributions occur over life expectancy of the designated beneficiary**

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- **Beginning in 2007, non-spousal beneficiaries (e.g. children, grandchildren, friends, etc.) are permitted to roll over a qualified retirement plan (e.g. 401(k)), via a trustee-to-trustee transfer, into an “inherited” IRA**
- **“Designated beneficiary” trusts are also permitted to roll over qualified retirement plans to “inherited” IRAs**
- **Notice 2007-7**

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Uses of Life Insurance and ILITs to Maximize IRAs

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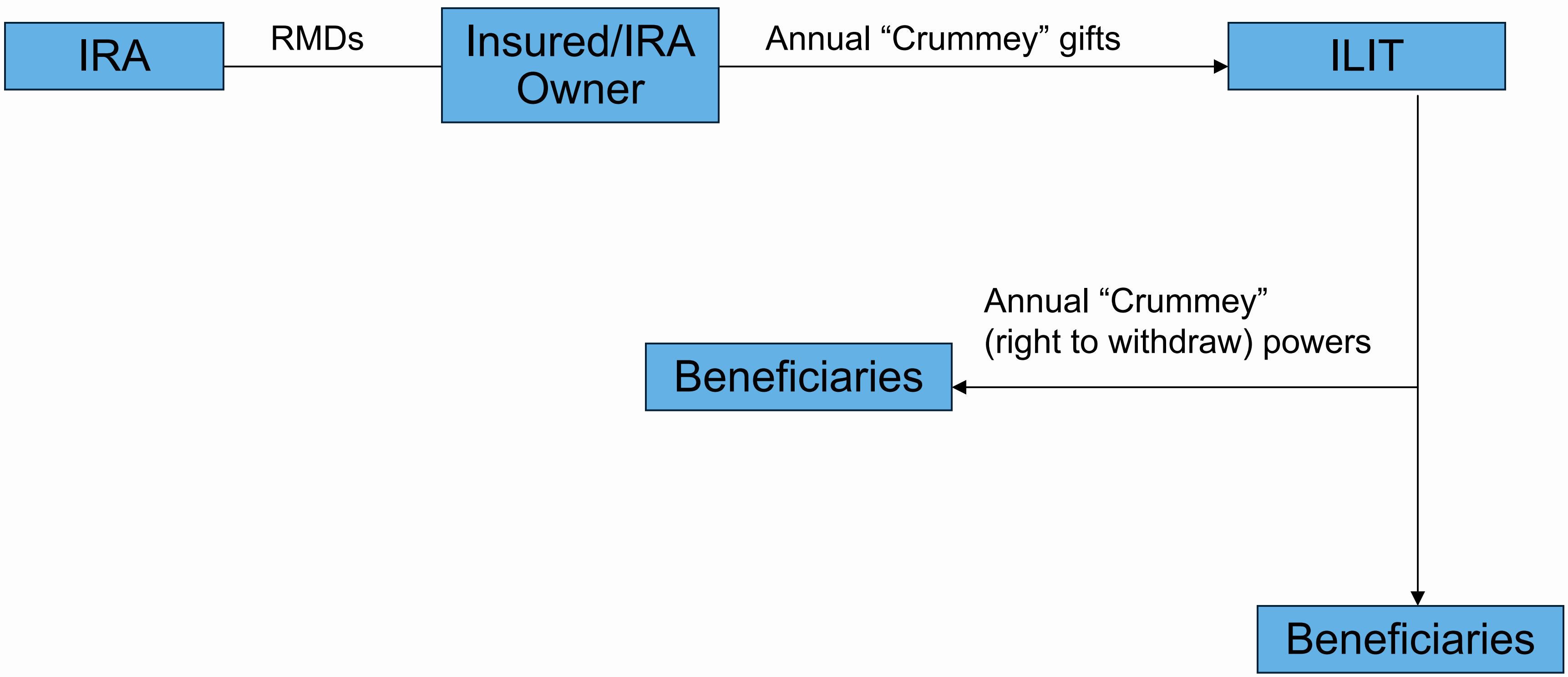
Life Insurance and ILITs

Irrevocable Life Insurance Trusts (ILIT)



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Foundational Concepts

- **Death before age 70½**
  - Five-year rule
  - Exceptions to the five-year rule
  - Delayed distributions – spousal beneficiary
  - Spousal beneficiary – special trust problem
- **Death after age 70½**
  - Life expectancy distributions if you have a designated beneficiary
  - Distributions must begin by December 31st of the year after death
  - Year of death distribution – life expectancy of IRA owner

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Foundational Concepts

BAKER TILLY

	Death Before Required Beginning Date	Death On or After Required Beginning Date
Designated Beneficiary	**Life Expectancy Rule**	**Life Expectancy Rule**
Non-Designated Beneficiary	**Five-Year Rule**	**"Ghost" Life Expectancy Rule**

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Critical dates:

- **<u>September 30</u> of the year following the year of death**
  - Date at which the beneficiaries are identified
- **<u>October 31</u> of the year following the year of death**
  - Date at which trust documentation (in the case where as trust is named as a designated beneficiary) must be filed
- **<u>December 31</u> of the year following the year of death**
  - Date at which the first distribution must be made by each IRA beneficiary
  - Date at which separate shares must be created

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Inherited IRA

Inherited IRA Analysis - Case Study

Yr	Immediate Distribution	IRA Payable to Non-Qualified Beneficiary (Five-Year Rule)	IRA Payable to Surviving Spouse (Spousal Rollover)	IRA Payable to Child
5	$ 424,713	$ 734,664	$ 712,898	$ 709,235
10	$ 601,269	$ 624,042	$ 965,679	$ 993,194
15	$ 851,222	$ 883,462	$ 1,296,715	$ 1,384,000
20	$ 1,205,083	$ 1,250,725	$ 1,727,638	$ 1,917,956
25	$ 1,706,047	$ 1,770,662	$ 2,313,679	$ 2,641,305
30	$ 2,415,265	$ 2,506,742	$ 3,210,501	$ 3,611,318
35	$ 3,419,312	$ 3,548,817	$ 4,434,486	$ 4,896,101
40	$ 4,840,750	$ 5,024,091	$ 6,093,099	$ 6,571,657

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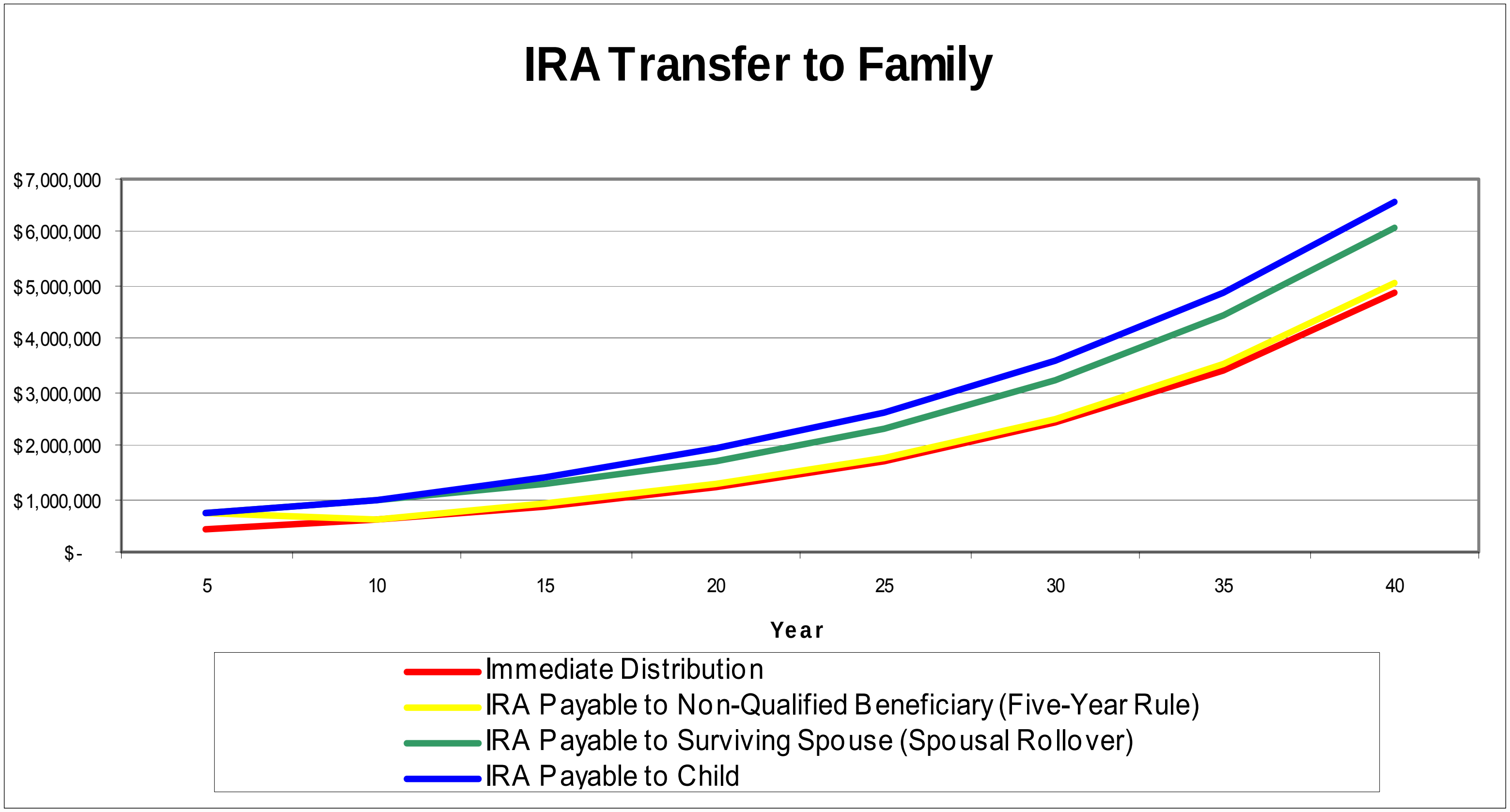
Inherited IRA

Inherited IRA Analysis - Case Study



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IRA – ILIT Strategy

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ISSUE: **Perhaps the single biggest issue with an inherited IRA is that the IRA owner’s estate oftentimes needs to utilize the IRA to pay the applicable estate tax liability. The payment of the estate tax using IRA funds, in turn, causes additional income tax to be incurred at higher income tax rates. As a result, between 60% to 80% of IRA could be lost to taxes. (This is known as the “Inherited IRA Tax Spiral”.)**

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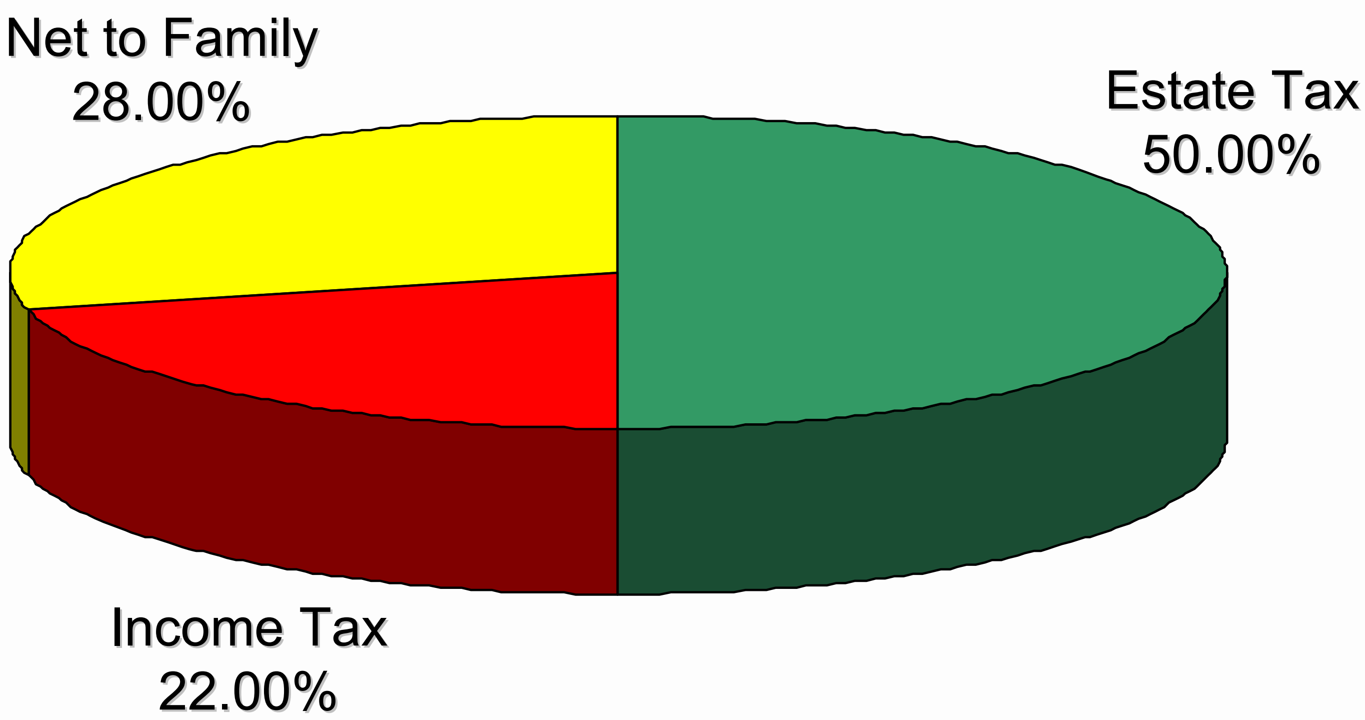
IRA – ILIT Strategy

Inherited IRA "Tax Spiral"



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<u>*SOLUTION*</u>: Establish an Irrevocable Life Insurance Trust (ILIT) to hold a life insurance policy whereby the death benefit proceeds can be used to provide liquidity to the IRA owner's estate, thereby preserving the inherited IRA.

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IRA – ILIT Strategy

Irrevocable Life Insurance Trust (ILIT)

- A type of dynasty trust which holds a life insurance policy on the grantor's life so as to benefit the grantor's beneficiaries without the imposition of future estate, gift and/or GST tax.
- To the extent that the grantor's estate has insufficient liquid assets cover the estate tax liability, trust assets can be lent to the estate or used to purchase assets from the estate.
- To the extent that the grantor does not hold any "incidents of ownership", none of the trust assets will be included in his/her taxable estate.

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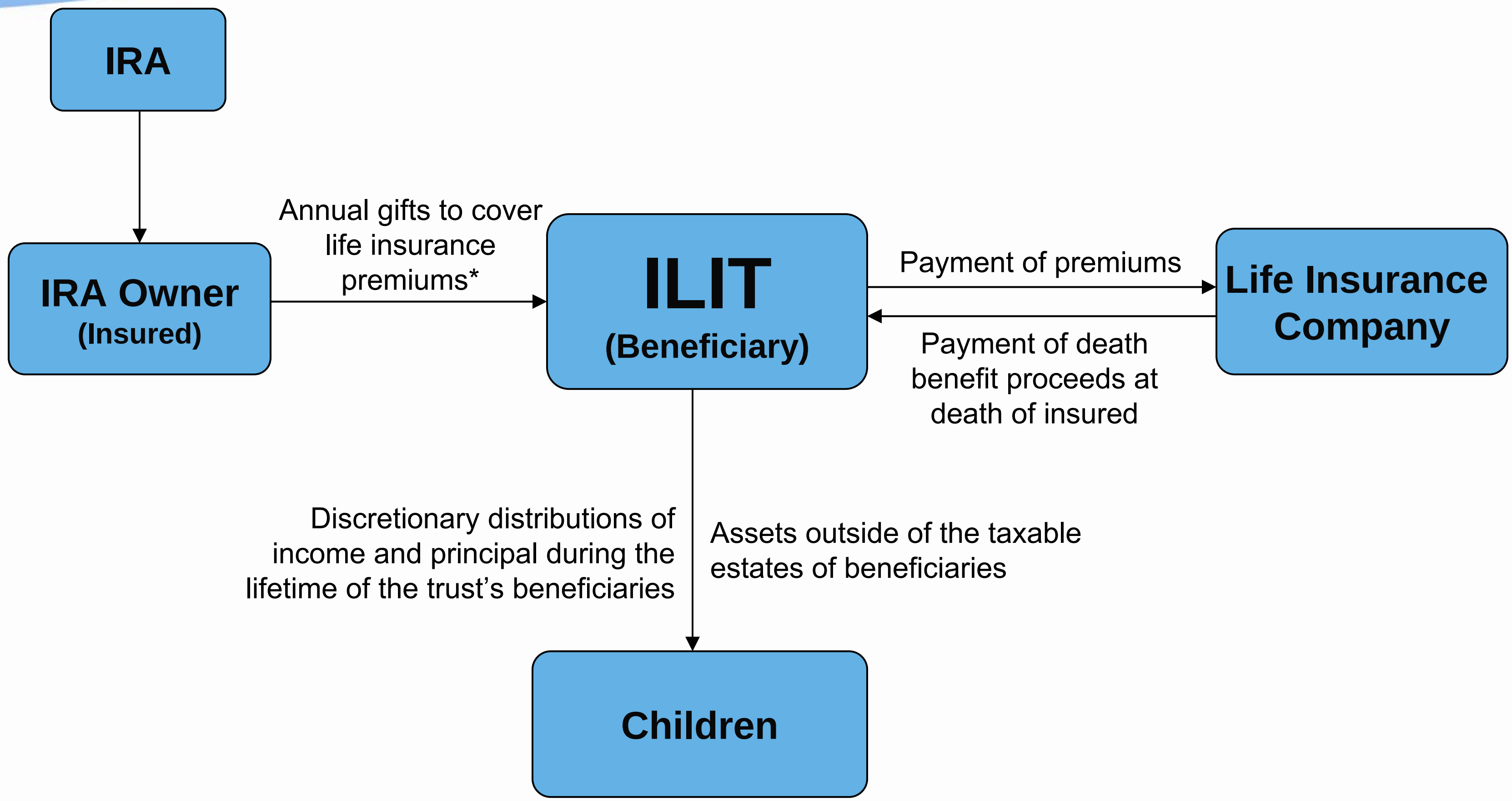
IRA – ILIT Strategy

IRA – ILIT Strategy - Overview



*** <u>NOTE</u>: Gifts to the ILIT will use IRA owner's annual gift exclusion and/or lifetime gift exemption.**

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IRA – Annuity Strategy

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IRA – Annuity Strategy

- IRA assets are used to purchase lifetime annuity contract
- Every year as annuity payments are credited to the IRA and then distributed to the account owner, the IRA distributions are used to pay premiums on a life insurance policy held in an Irrevocable Life Insurance Trust (ILIT)
- At the account owner's death, neither the IRA (due to the cancellation-at-death feature of the annuity) nor the ILIT will be included in the account owner's taxable estate

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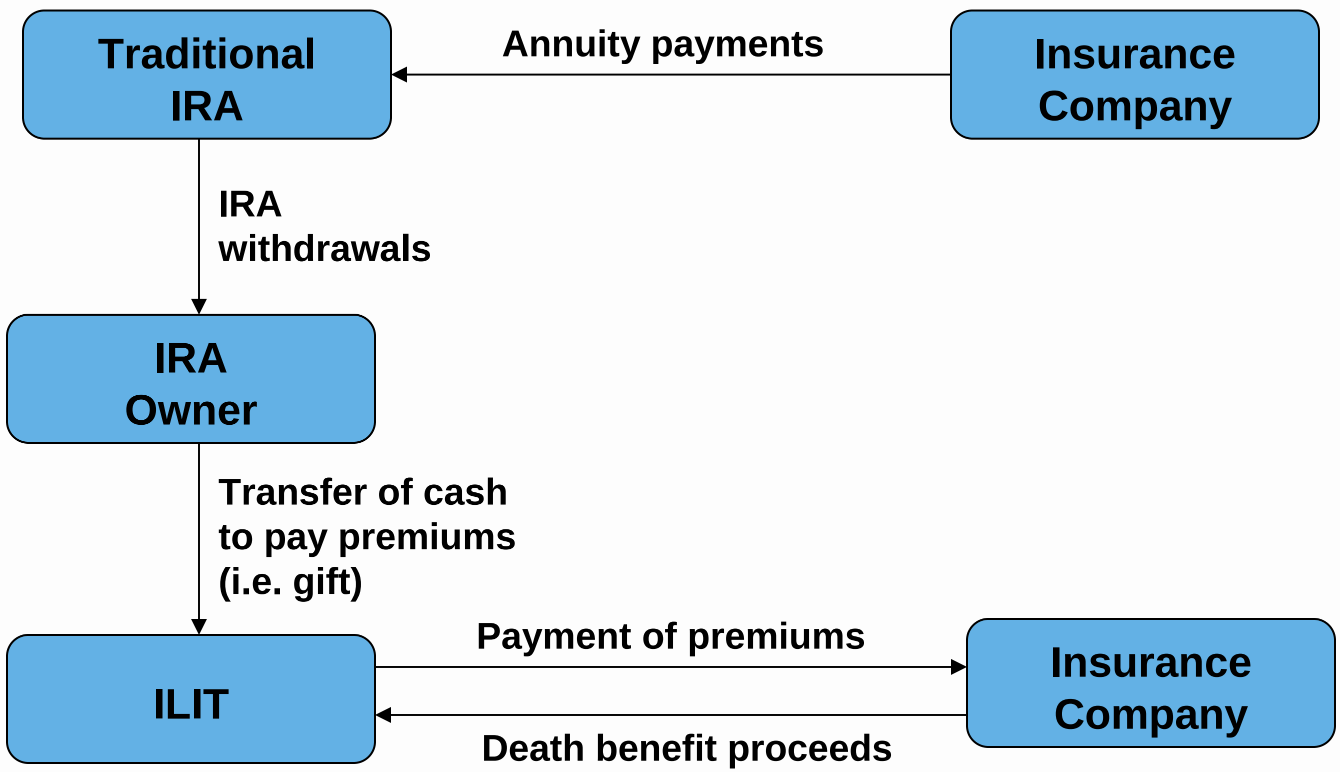
IRA – Annuity Strategy

Overview



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IRA – Annuity Strategy
Overview

Inside taxable estate

Traditional IRA
$0

Because the annuity cancels at death, the IRA does not have any value for estate tax purposes

Outside taxable estate

ILIT
$2,000,000

Because the trust is irrevocable and the gifts are "completed gifts" for gift tax purposes, none of the policy proceeds will be included in the taxable estate (provided the transferor has no "incidents of ownership" over the policy)

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IRA – Annuity Strategy

Example

IRA Only

Yr	IRA	Estate Tax	Trust (Brokerage Account)	Net Wealth to Family
1	$ 970,000	$ (485,000)	$ -	**$ 485,000**
5	$ 827,478	$ (413,739)	$ 305,431	**$ 719,170**
10	$ 585,507	$ (292,753)	$ 699,910	**$ 992,663**
15	$ 246,129	$ (123,065)	$ 1,209,399	**$ 1,332,463**
20	$ -	$ -	$ 1,731,151	**$ 1,731,151**
25	$ -	$ -	$ 2,235,864	**$ 2,235,864**
30	$ -	$ -	$ 2,887,726	**$ 2,887,726**

IRA-Annuity Strategy

Yr	IRA	Estate Tax	Trust (Life Insurance)	Net Wealth to Family
1	$ -	$ -	$ 2,000,000	**$ 2,000,000**
5	$ -	$ -	$ 2,000,000	**$ 2,000,000**
10	$ -	$ -	$ 2,000,000	**$ 2,000,000**
15	$ -	$ -	$ 2,000,000	**$ 2,000,000**
20	$ -	$ -	$ 2,000,000	**$ 2,000,000**
25	$ -	$ -	$ 2,000,000	**$ 2,000,000**
30	$ -	$ -	$ 2,000,000	**$ 2,000,000**

ASSUMPTIONS:
Pre-Tax Growth Rate on IRA = 7.00%
After-Tax Growth Rate on Brokerage Account = 5.25%
Combined Income Tax Rate = 45.00%
Beginning IRA balance = $1,000,000
Annual Pre-Tax Withdrawal From IRA = $100,000
Annual Life Insurance Premium = $55,000

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Conclusion

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