The Financial and Estate Planning Council of Metropolitan Detroit, Inc.

October 2014

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President's Message

It is a cliché… but my how time flies. This is my last message to you as President of the FEPCMD . It has been my pleasure to serve and to work with all of you.

I want to thank the Executive Board: Jeff Risius, Benson Barr and Eric Carver, as well as the entire Board of Directors and our Executive Director, Kris Wolfe, for making it easy to serve as President. The support of the Board and the membership is important to all of us who are called to lead.

I want to encourage all of you as members to attend our annual meeting on November 18, 2014 at the Inn of St. John's in Plymouth. At that meeting we will be honoring our 25 year members and you will be able to vote for new members of the Board of Directors and Officers for the upcoming year.

Jeff Risius of Stout Risius Ross is the incoming President. He has been in charge of the Program Committee for 2015, and there is an all-star line-up in place.

Our annual meeting speaker will be Natalie Choate. Her topic for the dinner meeting is entitled "IRA's with Hair". I can't wait to find out exactly what she means! Prior to the annual meeting we will be presenting Natalie Choate in a two-hour CPE event. Please attend either or both programs, and please bring a potential new member with you.

One of the programs we hope to institute, perhaps as early as this fall, is a Young Professionals Outreach program. We would like to attract new and younger members by holding forums for networking and knowledge at breakfast and/or lunch, in addition to our traditional quarterly dinner meetings. If you would like to be a part of this effort, please contact Jeff Hoenle or Brian Simmons. Their information can be found on our website www.metrodetroitfepc.org.

Teresa Schafer Sullivan, President

IRA Strategies for Surviving Spouses

Kimberly Polaski and Richard J. Casmirri, CPA MSTFP

Inherited IRA Strategies for Surviving Spouses

When a spouse inherits an IRA (Traditional or Roth) from his or her deceased husband or wife, there are several planning strategies that the surviving spouse can follow in order to meet his or her specific needs. Spouses who are designated as the sole beneficiary of the IRA have special options available to them compared to the options available for non-spousal beneficiaries. Choosing the correct option for the surviving spouse's circumstances can be a powerful tool for minimizing IRD, preventing IRS penalties, ensuring the preservation of assets and possibly maximizing the special tax attributes of the account. Each strategy has advantages and disadvantages, and with careful tax and financial planning, the surviving spouse can choose the strategy that best meets his or her specific needs.

Traditional IRA

Option 1 - Receive a Distribution for the Amount of the IRA

This option is available to all beneficiaries of IRA's, whether the beneficiary is the spouse of the decedent or not. Distributions made to a beneficiary from the decedent's IRA after the decedent's death are exempt from the Code Sec. 72(t) 10% early withdrawal penalty.

Pros: Receive lump sum of money immediately; avoid 10% early withdrawal penalty. If prior nondeductible contributions were made to the IRA, the beneficiary receives that carryover basis in determining his or her taxable distributions.

Cons: The distribution is taxable, and depending on the size of the distribution, could raise the beneficiary into a higher tax bracket in the year of the distribution.

Option 2 - Elect to treat the IRA as the surviving spouse's own IRA

According to Reg. Sec. 1.408-8, Q&A 5(a), surviving spouses can make an election to treat the decedent's IRA as if it were their own. This election can be made by the spouse retitling the inherited account into his or her own name as the IRA owner, or it will be made automatically if the spouse begins to contribute money into the account, or take other actions that are consistent with being the owner

of the IRA. With this option, the existing monies in the inherited IRA are treated as if the surviving spouse contributed it all themselves.

Pros: The beginning date for required minimum distributions will be deferred until the spouse turns 70 ½ (if the spouse is younger than the decedent, this may be beneficial); the spouse can use the Uniform Lifetime Table to determine the required minimum distributions rather than the less favorable single life expectancy table; the spouse can name his or her own beneficiaries and increase the overall lifespan of the IRA. If prior nondeductible contributions were made to the IRA, the beneficiary receives that carryover basis.

Cons: Unless a 72(t) exception is met, the spouse will be subject to tax and the 10% penalty on all distributions taken before he or she turns 59 ½. Additionally, if the surviving spouse was older than the decedent, the beginning date for required minimum distributions would have been accelerated.

Option 3 - Roll-over funds to an IRA in surviving spouse's name

A surviving spouse can decide to roll-over the funds from the decedent's IRA into his or her own IRA. Similar to the election in Option 2, the funds in the roll-over IRA will be treated as the surviving spouse's own.

Pros: Same as Option 2 – Potentially more favorable rules for Required Minimum Distribution, including beginning date; ability to name own beneficiaries.

Cons: Same as Option 2 – Generally, tax and penalty will be due on any distributions taken before the spouse turns 59 ½.

Option 4 - Leave IRA in decedent's name until surviving spouse reaches 59 ½ years old

As previously stated, a significant 10% penalty is charged by the IRS for any distributions made before the owner of the IRA is 59 ½ years old. So for certain younger spouses, it may be best to not make the election or roll-over the funds until the spouse is old enough to avoid this penalty. According to Reg. Sec. 1.408-8, Q&A 5 (a), the election or roll-over can be made any time after the death of the decedent. As such, distributions from the decedent's IRA to a beneficiary are exempt from the 10% penalty under Code Sec. 72(t) (2) (A) (ii). So in this option, the spouse would be free to take any amount of distributions while the IRA is still in the decedent's name and only have to pay the income tax. The surviving spouse can then make an election or roll-over the funds to his or her own IRA once he or she is old enough to avoid this 10% penalty.

Pros: Avoid 10% penalty on pre- 59 ½ withdrawals; receive benefits of election/roll-over after age 59 ½.

Cons: any lump-sum distributed while the IRA is in the decedent's name is subject to tax in the year of the distribution.

Other Traditional IRA Considerations

It is important to understand that if the surviving spouse chooses to treat the inherited IRA as his or her own or if he or she chooses to rollover the funds into his or her own account, the fair market value and any carryover basis from the inherited IRA will be included with any other traditional IRA he or she owns directly. This is important for future distributions and could have a significant impact on the tax effect of making any future Roth IRA conversions. In particular, the backdoor Roth Contribution strategy could be jeopardized for the surviving spouse.

The backdoor Roth contribution strategy exists for clients who would otherwise be phased out, due to AGI thresholds, from making direct Roth IRA contributions. Instead, these clients typically make nondeductible contributions to a Traditional IRA and then convert the funds almost immediately to a Roth IRA. Since the contributions were nondeductible in the first place to the Traditional IRA, the Roth conversion generally has no tax impact. However, if the surviving spouse treats the inherited traditional IRA as his or her own account or rolls over the funds to his or her own IRA, a pro-rata portion of this Roth conversion may be deemed taxable.

Roth IRA Considerations

Qualified Distributions

Generally a non-spousal beneficiary of an inherited Roth IRA must (1) withdraw the entire balance within 5 years of the original owner's death or (2) begin withdraws, based upon the IRS life expectancy tables, by December 31st of the year after the original owner's death. Similar to Traditional IRAs, if the sole beneficiary of the inherited Roth IRA is the spouse of the decedent, he or she has the additional options to treat the Roth IRA as his or her own account or to rollover the inherited Roth funds into his or her own Roth IRA.

The primary planning attribute for Roth IRAs is that distributions may be tax free to the beneficiary and may also avoid the 10% penalty of Code Sec. 72(t) if they are deemed to be qualified distributions. In order for distributions from a Roth IRA to be considered qualified, they must not be made within the five-year period that starts on the first calendar day of the tax year that the taxpayer made contributions to the Roth account. From there, in order for distributions from a Roth account to be treated as qualified, they must be:

- made after obtaining the age of 59 ½,
- made to a beneficiary (spouse or non-spouse) after the death of the original Roth IRA owner,

- made due to disability, or
- a special purpose distribution specifically exempted in the IRC (such as a distribution for a first-time home purchase).

Given the above, spouses who inherit Roth IRAs can generally receive tax free distributions from those accounts provided that the five-year period is met. If the spousal beneficiary of an inherited Roth IRA is giving consideration to converting or treating that inherited Roth IRA as his or her own (so to avoid the typical distribution requirements of inherited Roth IRAs) he or she should be aware of some other potential issues.

It should be noted that for purposes of determining the five-year period, the beneficiary of the inherited Roth IRA should generally use the decedent's holding period in determining whether that five-year threshold was met for qualifying distributions. This carry-over period is applicable to the inherited Roth IRA only and as such if the beneficiary independently funded a Roth IRA, the accounts may have separate five-year periods for determining qualified distributions. According to Reg. Sec. 1.408A-6, Q&A 7(b), surviving spouses who take advantage of the opportunity to treat the inherited Roth IRA as their own account or choose to rollover the inherited Roth funds into their own account, may use the five-year period that permits the earliest qualified distribution date. That is to say, the surviving spouse can use the earliest beginning date from either his or her separate Roth account or from the decedent's Roth IRA for this five-year period test.

Other Roth IRA Considerations

If a nonqualified distribution is made from an inherited Roth IRA to a surviving spouse, it is important to understand the make-up of the inherited Roth IRA. Certain ordering rules exist and the applicability of income taxes and/or the 10% penalty on a nonqualified distribution vary if the funds represent normal contributions, Roth conversions, or earnings. Under the IRC, distributions are first ordered against normal contributions to the account, then conversion contributions (first in, first out method), and lastly earnings. As such the tax basis in the inherited Roth account is allowed to be recouped before earnings are treated as being distributed to the surviving spouse. These earnings may be subject to income tax and the Code Sec. 72(t) penalty if the distributions are deemed to be nonqualified.

With respect to the 10% early distribution penalty under Code Sec. 72(t), there is an important planning point to be aware of as it relates to conversion contributions. The issue here is that Roth distributions ordered against conversions (based upon the previously discussed ordering rules) have a separate five-year period test than distributions that represent typical Roth contributions. The five-year period used in determining if a distribution representing a conversion contribution is subject to the 10% penalty, begins on the first day of the tax year in which the conversion took place. As such, this may be later than the five-year period from which the Roth IRA was funded by typical contributions. This effectively prevents a taxpayer from converting traditional IRA funds to an existing Roth IRA and taking penalty free distributions from the converted funds within five years of said conversion.

Conclusion

The rules for inherited traditional and Roth IRAs are complicated and far reaching, especially for a surviving spouse. As such, due considerations should be made by the practitioners advising such clients and they should look to insulate their clients by ensuring that their entire estate and financial planning team, from the attorney, to the accountant, to the IRA custodian understand the client's objectives and the steps for implementation. It is crucial that a surviving spouse also understands the available options and chooses the strategy that best suits his or her needs and circumstances. The potential IRS penalties and income tax imposed on certain withdrawals can be significant, and may be avoided with the right amount of planning between the surviving spouse and his or her team of advisors.

Kimberly Polaski is a Staff II Consultant at Marcum LLP, specializing in Closely Held Businesses, Pass Through Entities and Transaction Planning. Richard J. Casmirri, CPA MSTFP is a Supervisor at Marcum LLP, specializing in High Net Worth Individuals, Trusts, Estates and Wealth Transfer Planning.

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NOTE: Need more information on IRAs?
Please review the upcoming FEPCMD presentations by Natalie B. Choate on Tuesday, November 18, 2014

Afternoon Program (includes CPE) – 3:00 pm

"Roth Immersion" & "When Insurance Products Meet IRAs"

Evening Program – Cocktails at 5:30 pm / Presentation at 6:30 pm / Dinner at 7:30 pm

"IRAs With Hair"

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THE FINANCIAL AND ESTATE PLANNING COUNCIL OF METROPOLITAN DETROIT

presents

NATALIE B. CHOATE

TUESDAY, NOVEMBER 18, 2014

FEPCMD ANNUAL MEETING – ELECTION OF OFFICERS

The Inn at St. John's

44045 5 Mile Rd, Plymouth, MI 48170

Approved for CE and CFP credit for afternoon session: State of Michigan Life and CFP

AFTERNOON PROGRAM / GALILEE ROOM:

Registration: 3:00 p.m.
Presentation: 3:15 p.m. – 5:30 p.m.
Break: 4:15 p.m. – 4:30 p.m. (cookies and beverages)

"Roth Immersion" Course #65278 and
"When Insurance Products Meet IRA's"
Course #65279

COST: $125.00

EVENING PROGRAM / THE ATRIUM:

Complimentary Cocktails: 5:30 p.m. – 6:30 p.m.
Presentation: 6:30 p.m. – 7:30 p.m.
Dinner: 7:30 p.m.

"IRAs With Hair"

COST: $75.00

FULL DAY DISCOUNT: $175.00

Natalie B. Choate practices law in Boston, Massachusetts, with the firm of Nutter McClennen & Fish LLP. Her practice is limited to consulting on estate planning and retirement benefits matters. Her books *Life and Death Planning for Retirement Benefits* and *The QPRT Manual* are leading resources for estate planning professionals. Miss Choate is a former chairman of the Boston Bar Association Estate Planning Committee, which she founded in 1981. She is a former Regent of the American College of Trust and Estate Counsel and former Chairman of its Employee Benefits Committee. She is a member and former officer of the Boston Probate and Estate Planning Forum. She was named "Estate Planner of the Year" by the Boston Estate Planning Council, and was one of the first 10 attorneys to receive the "Distinguished Accredited Estate Planner" award from the National Association of Estate Planners and Councils. She is listed in *The Best Lawyers in America*. From 1990 to 1992, Miss Choate served as Chairman of the Boston Bar Association's ERISA and Employee Benefits Law Committee. A Boston native, she is a graduate of Radcliffe College and Harvard Law School.

AFTERNOON PRESENTATION: Everything you need to know about Roth retirement plans, to help your clients decide on, implement, or undo a Roth conversion. Roth IRAs, offering tax-free distributions and no required distributions during the participant's life, are now available to high-income clients. To help you advise your clients regarding this significant planning opportunity, Natalie Choate explains the rules and shares expert tips. The second session will focus on the special tax rules that apply when a life insurance or annuity contract is held inside a retirement plan to include: tax treatment of plan-owned life insurance during employment and at employee's death, how to "roll out" an insurance policy at retirement, the three different valuation rules for plan-owned annuities, minimum distributions and "annuitized" IRAs, positive planning uses for life insurance and annuities in connection with retirement benefits, and more.

EVENING PRESENTATION: The world of IRA mistakes is like the children's game "Chutes and Ladders." Your client falls down the "chute" by making an IRA mistake. What IRS horrors await him? Before the IRS destroys your client's retirement security, you need to find a "ladder" to bring the client's IRA back up to the sunny skies of retirement heaven! The Problems: Sooner or later you will have a client with a missed minimum distribution, excess contribution, bungled Roth conversion, rollover snafu, or other IRA misstep. The Punishments: Know whether your client faces a 6%, 10%, or 50% penalty, a deemed distribution, or complete disqualification of his IRA. The Remedies: Learn when and how to use corrective distribution, absorption, recharacterization, hardship waiver of a deadline or a penalty, or a rollover to solve your client's problem.

Log onto our website by November 10 to make your reservation and pay with VISA or Master Card.
www.metrodetroitfepc.org

OR PLEASE MAIL YOUR RESERVATION AND CHECK BY NOVEMBER 10 TO:
FEPCMD ● 30600 Northwestern Hwy-#208 ● Farmington Hills, MI 48334
Phone: (248) 538-7654 ● Fax: (248) 671-0165

Member Name:_______________________ Phone Number:_______________________

Guest Name:_______________________ Phone Number:_______________________

Full Day_____________ Afternoon Program Only_____________ Evening Program Only_____________

Amount Enclosed_______________________ Dietary Restriction Request_______________________

Did You KNOW?

Accredited Estate Planner® Designation

Professional estate planners can now achieve an accreditation that acknowledges their experience and specialization in estate planning.

The Accredited Estate Planner® designation is available to attorneys, Chartered Life Underwriters, Certified Public Accountants, Certified Trust and Financial Advisors, Chartered Financial Consultants, and Certified Financial Planners®.

The AEP® designation is awarded by the National Association of Estate Planners & Councils to recognized estate planning professionals who meet special requirements of education, experience, knowledge, professional reputation, and character.

Should you have any questions or need additional information, please call (866) 226-2224 or the local Council office at (248) 538-7654.

NAEPC Member Benefits

NAEPC Journal of Estate & Tax Planning

The *NAEPC Journal of Estate & Tax Planning* is a web-based library of best-in-class thought leadership appropriate for every member of every estate planning council. Visit www.NAEPCJournal.org today to view current and past issues of the publication.

Published quarterly and available at no-charge to all estate planning council members and Accredited Estate Planner designees, *The Journal* is considered to be one of the top benefits of membership in NAEPC.

Ideas for future content may be submitted to editor@naepcjournal.org.

Robert G. Alexander Webinar Series

Introduced in 2013 in memory of NAEPC board member Robert G. Alexander, online programs are offered monthly on the 2nd Wednesday at 3:00 pm ET (with the exception of November of each year). The special programs are available to affiliated local estate planning councils, Accredited Estate Planner® designees, members of affiliated local estate planning councils, and non-members.

Program content complements the core value of NAEPC, **the multi-disciplinary concept of estate planning**.

Continuing education credit will be available at each webinar for Accredited Estate Planner® designees. In addition, a certificate of completion will be made available for those professionals that feel the program satisfies their continuing education requirements and are able to self-file. Councils may also file the program in their home state for programs offered in a group setting.

Registration Fees

- $40 / Accredited Estate Planner® designee (dues must be current at the time of registration)
- $60 / member of an affiliated local estate planning council or at-large member of NAEPC
- $100 / individual non-member

Please visit http://www.naepc.org/events/webinar for more information.