

10 CRITICAL IRA ERRORS ADVISORS MUST AVOID

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MISTAKE #1

Failing to Maximize The Use of QCDs



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Failing to Maximize The Use of QCDs

- IRA owners and IRA beneficiaries who are actually age 70 ½ or older
 - Not available from plans!
- Limited to \$100,000 per person annually
- Can be used to satisfy all or a portion of a client's RMD
- No charitable contribution deduction, but QCD amount is not added to AGI

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Failing to Maximize The Use of QCDs

- Can only be made from the taxable portion of IRAs, Roth IRAs and inactive SEP and SIMPLE IRAs
- Must be sent directly from client's IRA to charity or via check payable to the charity
 - No split gifts
 - No private grant-making foundations
- QCD amount would have to be entirely deductible if it were made with non-IRA funds

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Failing to Maximize The Use of QCDs

- Reporting is done by taxpayer
 - Line 4a: QCD amount
 - Line 4b: \$0, "QCD"
- Help mitigate costs tied to AGI / MAGI
- Of greater importance as of 2018 due to TCJA's increase of standard deduction

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MISTAKE #2

Incorrect Understanding of Creditor/Bankruptcy Protection Rules



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Bankruptcy Protection

- Plans receive protection for an uncapped amount of assets
- IRA contributions and earnings protected up to \$1,362,800*
 - *inflation-adjusted every 3 years (next in 2022)
- SEP and SIMPLE IRAs are "plans"
- Plan funds rolled to IRAs retain their uncapped protection

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Creditor Protection (Non-Bankruptcy)


- ERISA-covered plans are generally fully protected
 - Watch out for solo plans!
 - Exceptions for ex-spouses (via QDRO) and the IRS
- Non-ERISA-covered plans and IRAs receive protection under state law
 - Uncapped protection in many states
 - Limited protection in some states
 - Different protection for traditional IRAs vs. Roth IRAs in some states
- SEP and SIMPLE IRAs are ?????????
 - *Lampkins v. Golden*
- ERISA-covered plan funds rolled to non-ERISA-covered plans or IRAs DO NOT retain their ERISA protection

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MISTAKE #3

Keeping After-Tax Dollars In Employer Plans Too Long



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IRA Pro-Rata Rule

IRA Pro-Rata Rule*

$$\frac{\text{Total After-Tax Amounts in ALL Applicable IRAs}}{\text{Total Balance of ALL Applicable IRAs}} = \% \text{ of Distribution That is Tax-Free}$$

*Exceptions to rule include: QCDs, QHFDs, Rollovers to plans

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Plan Pro-Rata Rule

- Distributions are pro-rata, BUT, the pre-/post-tax portions of the distribution can be "split" and separately allocated
- Any pre-tax portion of a plan distribution must first be allocated to direct rollovers
 - If client has portions of their distribution directly rolled to more than one retirement account (i.e. traditional IRA & Roth IRA), then they can choose how much of the pre-tax funds are allocated to each account
- If total pre-tax portion of a client's distribution is greater than the amount directly rolled over to one or more accounts, any pre-tax amounts are next allocated to 60-day rollovers
- If any pre-tax funds are not rolled over, either via a direct rollover or a 60-day rollover, then those amounts are taxable

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"Mega Back-Door Roth" Strategy

- Plan must allow after-tax contributions
- The after-tax contributions must pass the actual contribution percentage (ACP) test
- Client must be below the "overall limit" (\$58,000 in 2021, not including catch-up contributions)
- Client must have disposable income to make after-tax contributions
- Plan must allow for periodic in-service distributions of after-tax contribution account

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MISTAKE #4

Failing to Understand the "99% Rule"



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Spousal Beneficiary Options*

- 1) Remain as a beneficiary of the inherited account (with special rules)
- 2) Complete a spousal rollover
- 3) Elect to treat the deceased spouse's account as their own

* Spouse must be sole beneficiary

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Remaining A Beneficiary

- No 10% penalty on pre-59 ½ distributions
- Properly titled inherited IRA is established
- Funds must be moved directly
- No RMDs until deceased spouse would have been 72
 - Spouse beneficiaries subject to RMDs can recalculate their life expectancy (but still use the Single Life Expectancy Table)
- Special rule for successor beneficiaries

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Spousal Rollover

- Often makes sense if surviving spouse is $\geq 59 \frac{1}{2}$
- Irrevocable election
- Treated as though money was always in the surviving spouse's IRA
- No deadline to complete

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Choosing the Right Option

The #1 mistake made by spouse beneficiaries is failing to properly choose between:

- Remaining a beneficiary
- Doing a spousal rollover

Hint: Use the "99% Rule"

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The "99% Rule"

"If the surviving spouse is under $59 \frac{1}{2}$, then setting up an inherited IRA is almost always the correct option. Once the spouse turns $59 \frac{1}{2}$, a spousal rollover can be completed."

"If the surviving spouse is $59 \frac{1}{2}$ or older, a spousal rollover is almost always the right move."

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Potential Exceptions to the "99% Rule"


- Scenario #1
 - Much younger spouse (<11 years younger)
 - Deceased spouse would already be 72 or older (as long as they would not have been 70 1/2 prior to January 1, 2020)
 - Surviving spouse does not anticipate needing inherited IRA money until they are at least 59 1/2
- Scenario #2
 - Older spouse
 - Younger spouse would not yet be 72 (as long as they would not have been 70 1/2 prior to January 1, 2020)
 - Spouse beneficiary doesn't need/want to take distributions

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MISTAKE #5

Ignoring The Potential Benefits of QLACs



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Qualifying Longevity Annuity Contracts

- FMV excluded from a retirement account owner's prior year-end balance for RMD calculation purposes
- Distributions must begin in the month after attainment of age 85
- May be purchased with the lesser of 25% of retirement funds or \$135,000
 - 25% limit is applied to each employer plan separately
 - 25% limit is applied in aggregate to IRAs
- Limited death benefit options
 - Return of premium
 - Life annuity

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Qualifying Longevity Annuity Contracts

- Must be fixed annuities
- May not offer any commutation benefit, cash surrender value or similar feature
- Can be purchased with IRA, 401(k), 403(b) and governmental 457(b) plan funds
- QLAC overpayments must be returned by the end of the year following the year the premium payment was made

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Qualifying Longevity Annuity Contracts

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Qualifying Longevity Annuity Contracts

- Offer more liquidity than immediate annuities with similar lifetime guarantees
- Should QLACs "replace" fixed income, or equity positions?
- Mortality credits are key!

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MISTAKE #6

Failing To Review See-Through Trusts post SECURE Act



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See-Through Trusts

- Also known as look-through trusts
- Use oldest applicable trust beneficiary's life expectancy to calculate RMDs
- No separate account treatment
- Must meet certain requirements

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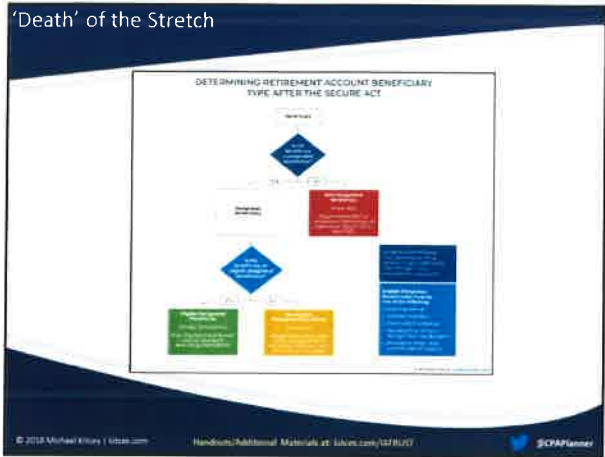
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See-Through Trust Requirements

- Regulation 1.401(a)(9)-4, A-5
 - Valid under state law
 - Irrevocable at death
 - Trust beneficiaries are identifiable
 - Proper documentation is provided to the custodian by October 31st of the year following the year of death

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'Death' of the Stretch

- Impact to trust beneficiaries
 - General rule is still that trusts are Non-Designated Beneficiaries
 - Trusts can still be treated as Designated Beneficiaries if they meet the "See-Through Trust" rules
 - Certain "See-Through Trusts" may be treated as EDBs
- Conduit trusts benefiting a single EDB should be able to receive EDB treatment*

*Treatment is unclear if multiple EDBs

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'Death' of the Stretch

- Discretionary Trusts will generally not qualify for EDB treatment
- Exception: Applicable Multi-Beneficiary Trusts
 - All trust beneficiaries must be designated beneficiaries
 - At least one trust beneficiary must be an EDB because they are either:
 - Disabled
 - Chronically ill

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Not Fixing Mistakes When You Catch Them



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A Problem That Won't Go Away


- Robert K. Paschall et ux. v. Commissioner; 137 T.C. No. 2; Nos. 10478-08, 25825-08, July 5, 2011
- There may be no statute of limitations!

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MISTAKE #8

RMD Aggregation Errors



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RMD Aggregation Rules

- **Widely misunderstood**
 - CPAs and advisors alike
- **Horseshmouth, LLC survey**
 - 18% of those initially surveyed answered correctly
 - Multiple choice questions with only four choices!

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Let's See How You Do!

- **Client's goals**
 - Avoid potential penalties
 - Take distributions from as few accounts as possible
- **Client has 6 total retirement accounts**
 - 2 IRAs
 - 2 401(k)s
 - 2 403(b)s

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RMD Aggregation Rules

- **IRAs**
 - Calculate RMD on each account individually
 - IRA RMDs can be added together and taken from any one or combination of IRA accounts (this includes SEP and SIMPLE IRAs)
 - Special rules generally apply to annuitized IRA annuities

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RMD Aggregation Rules

- **Employer Plans**
 - Calculate RMD for each plan individually
 - RMDs must be taken from each plan
 - Employer plan RMDs **cannot** be aggregated
403(b) exception

Under no circumstances can an RMD from one type of retirement account be taken from a different type of retirement account

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RMD Aggregation Rules

- **Annuities**
 - Pre-annuitization - IRA or 403(b) annuities can be aggregated
 - Post-lifetime annuitization – The annuity payment IS the RMD
Possible exception in year of annuitization
 - Grey area – Period-certain (only) annuitization

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Additional RMD Aggregation Rules

- No aggregating between spouses
- No aggregating between RMDs for a client's own account(s) and an inherited account
- No aggregating inherited RMDs for accounts of different decedents

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MISTAKE #9

Roth IRA 5-Year Rule Confusion



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Roth IRA Distributions

- There are two kinds of Roth IRA distributions
 - Non-Qualified distributions
 - Qualified distributions
- Non-qualified Roth IRA distributions follow ordering rules
- All Roth IRAs are considered one giant Roth IRA

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Non-Qualified Roth IRA Distributions

- Tax impact is determined by two factors
 - What "type" of Roth IRA money is distributed
 - How that "type" of Roth IRA money is taxed
- Ordering rules dictate what "type" of Roth IRA money is being distributed
 - Roth IRA contributions are the first money out
 - Roth IRA conversions are the next money out
 - Earnings are the last money out of the Roth IRA

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Tax Impact of Non-Qualified Roth IRA Distributions

- Contributions
 - Always tax free
 - Always penalty free
- Conversions
 - Always tax free
 - *With a 5-year waiting period starting from the date of the first 5-year anniversary*
- Earnings
 - Always taxable
 - *They are subject to the 10% penalty*

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There are two 5-Year Rules!

"Please explain *the* Roth IRA 5-year rule to me?"

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Roth IRA 5-Year Rule
Distributions of Converted Funds

- Used, in part, to determine if 10% penalty applies to distribution
 - Only applies to clients under 59 1/2, AND
 - Only applies when a distribution of converted funds is made within five years of the conversion
- Separate 5-year rule clock applies to each conversion
 - Roth IRA ordering rules apply

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Qualified Roth IRA Contributions

- Qualified distributions
 - Occur after client has held any Roth IRA for 5+ years
 - AND** after
 - One of the following:
 - Age 59 1/2
 - Disability
 - Death
 - 1st-time homebuyer (up to \$10,000)

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MISTAKE #10

Beneficiary Form Errors



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Where there's a will...

- Generally overridden by beneficiary form
- Estate beneficiaries can receive IRA proceeds, but can't "stretch" distributions
 - An inherited IRA FBO an estate may be retitled to inherited IRA FBO estate beneficiary, but the distribution schedule remains
 - You may encounter difficulties with the custodian

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Select Beneficiary Form Cases

- Kennedy v. Plan Administrator for DuPont Savings and Investment Plan
 - U.S Supreme Court, No. 07-636, January 26, 2009
- Cajun Industries, LLC vs. Robert Kidder et al.
 - U.S. District Court; Middle District of Louisiana, No. 09-267-BAJ-SCR – April 26, 2011
- Greenebaum Doll & McDonald PLLC v. Sandler
 - U.S. Court of Appeals for 6th Circuit, No. 06-6496, December 3, 2007

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Select Beneficiary Form Cases

- Charles Schwab & Company v. Chandler
 - U.S. Court of Appeals for 9th Circuit, No. 07-15261, January 22, 2010
- The Pension Pickle
 - New York Post, January 31, 2005

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Questions?

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