



Planning for Minimum Distributions from Qualified Plans and IRAs

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Planning for Minimum Distributions from Qualified Plans and IRAs

- **Tax-qualified retirement plans**
 - Main benefit - Tax deferral
 - Roth - Tax-free
- **Required Minimum Distribution (RMD) Rules:**
 - How tax-deferred accumulation ends
 - Rules complex
 - Penalties high (up to 50%)
- **Potential Opportunities**
 - Over \$400 Billion IRA rollover market per year, growing to \$600 Billion by 2016¹
 - Fast growing Beneficiary IRA market

¹Estimates published in “The Retirement Income Reference Book”, 2012 by LL Global/LIMRA.

AGENDA

■ Qualified Plans and Traditional IRAs

- Lifetime Required Minimum Distributions (RMDs)
- Qualified Longevity Annuity Contracts (QLACs)
- Post-Death RMDs

■ Roth IRAs

- Post-Death RMDs
- Roth Conversion Legacy Planning Opportunity

■ Trust Beneficiary

- Advantages/Common Mistakes
- Post-Death RMDs

■ Impact on Practice



Lifetime Required Minimum Distributions (RMDs)

■ Required Beginning Date (RBD)

- April 1st of year after 70 ½ birthday
- Subsequent RMDs due 12/31

■ **RMD =**
$$\frac{\text{Prior 12/31 Value}}{\text{Applicable Distribution Period (Uniform Life Table)}}$$

■ Doesn't apply to Roth IRAs



RMDs – Annuitized Amounts

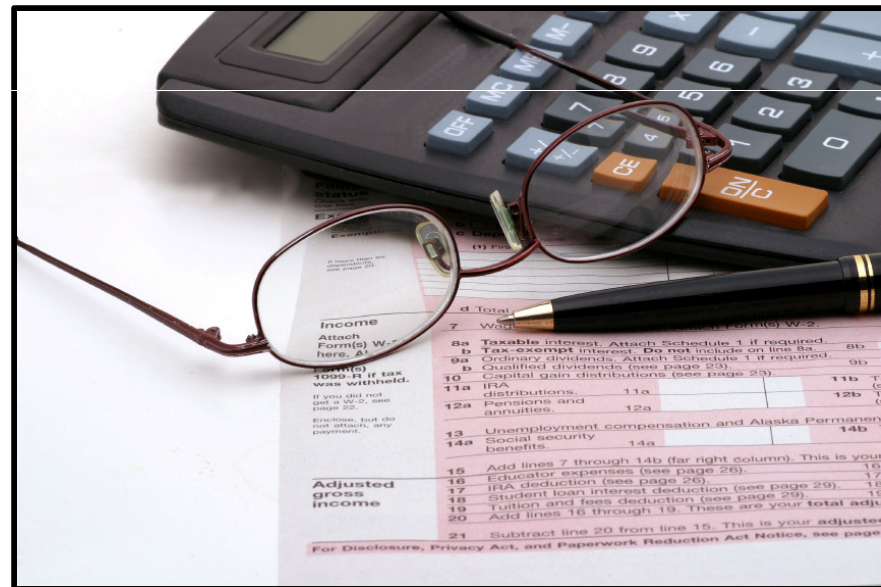
■ Two sets of RMD rules

- Qualified Plans/IRA account balances
- Pension payouts/annuitized amounts
 - Periodic payment for life or period certain that does not exceed life expectancy
- May not apply any portion of annuity income payments received towards RMD determined under account balance method (except in calendar year that immediate annuity is purchased).

Annuitizing a Portion of IRA balance

Clarence, born January 1, 1940 turned age 74 at start of 2014. He had an IRA valued at \$250,000 on 12/31/13.

- 2014 RMD \$10,504
- In July 2014 he transfers \$100,000 to SPIA with monthly payments of \$650 starting 8/1/14. Will receive 5 monthly income payments in 2014 totaling \$3,250.
- Must withdraw at least \$7,254 from IRA account by 12/31/14.
- Will continue to calculate RMD on remaining IRA funds using account balance method 2015 and beyond
- May not apply any portion of annuity payments received in 2015 and beyond towards meeting the RMD on non-annuitized portion of IRA.



Qualified Longevity Annuity Contracts (QLACs)

■ **Qualified Deferred Income Annuity**

- Can be purchased with IRA funds as well as 401(k), 403(b) and governmental 457(b) plans that offer option
- QLAC values excluded from RMD account balance calculation
- Delayed Annuity Start Date enhances future lifetime income stream
- Distributions must begin by age 85

Qualified Longevity Annuity Contracts (QLACs)

■ Purchase Limits:

- Percentage –
 - IRAs: 25% limit based on prior year-end value of all non-Roth IRAs
 - 401(k): 25% limit applies to each plan separately. Limit applied to last *Valuation Date* adjusted for contributions/withdrawals
- \$125,000 Overall QLAC limit
 - Cumulative QLAC purchases cannot exceed limit'
 - Indexed for inflation ((\$10,000 increments)

Qualified Longevity Annuity Contracts (QLACs)

- **Contract may offer return of premium (ROP) death benefit before or after distributions begin**
 - Must be distributed by December 31st of year following death
 - Owner dies before or on RBD
 - Spouse may roll to their own IRA
 - Non-spouse may transfer to Beneficiary IRA
 - Owner dies after RBD
 - ROP death benefit (cash refund) treated as RMD
 - Not eligible for rollover
- **Contract may also offer life annuity death benefits**
 - Separate rules for spouse and non-spouse beneficiaries
 - Rules are complex

Post-Death RMDs - Beneficiary Designations

Keep them up to date!!!

- **Typically trumps everything**
- **If no named beneficiary, default usually**
 - Estate
 - Surviving spouse
- **Consequences**
 - Unintended disinheritance
 - May negatively impact stretch opportunity



Post-Death RMDs

Important Distinction

“Designated Beneficiary”

- ***Individual* designated as beneficiary**
- **Only designated beneficiary can “stretch”**
- **Certain trusts (“see through”) treated as Designated Beneficiary**

Post-Death RMDs

RMD Tables

- **RMD** =
$$\frac{\text{Prior year-end account balance}}{\text{Life expectancy factor}}$$

- **Single Life Table**

- **Fixed-term (no recalculation) method**
 - All post-death RMDs, except surviving spouse
 - Divisor determined in first distribution year; reduce by one each subsequent year
 - Account exhausted at end of beneficiary's life expectancy

■ **Recalculation method**

- Lifetime RMDs and post-death RMDs for surviving spouse
- Use attained age each year
- Life expectancy never runs out/account never exhausted

■ **Fixed-term (no recalculation) method**

- All post-death RMDs, except surviving spouse
- Divisor determined in first distribution year; reduce by one each subsequent year
- Account exhausted end of beneficiary's life expectancy

Post-Death RMDs

Timing

- **First order of business – beneficiary withdraws any of deceased’s remaining year of death RMD before 12/31**
 - Must be taken from qualified plan account before transfer to Beneficiary IRA
- **First Beneficiary RMD**
 - Non-spouse: 12/31 of year following year of death
 - Spouse
 - 12/31 of year following death if deceased died after RBD, or
 - Year in which deceased would have attained age 70 ½ if deceased died after RBD

Post-Death RMDs

Spousal Beneficiaries – Special Rules, Choices

- **Spousal rollover: Can be done at any time**
- **Or, remain beneficiary**
 - Delayed RMDs if deceased spouse died before RBD
 - Single Life Table but recalculation method used (use factor from table each year)
- **If not sole beneficiary, split account by 12/31 of year after death**



Post-death RMDs

Spouse as Sole Beneficiary of Traditional IRA

	Account Owner Dies Before RMD	Account Owner Dies On/After RMD
Spousal Rollover Or Treat as Own	First RMD at surviving spouse's RBD. Use Uniform Life Table and look up attained age each year	
Remain as Beneficiary	Use Single Life Table and look up spouse's attained age each year a distribution is required.	Use Single Life Table for the spouse each year or if owner was younger use Single Life Table for owner's life expectancy and reduce by one each year.
	Delay RMD until owner would have been 70½	First RMD by 12/31 of year after owner's death
	Or 5 year rule	

Post-death RMDs Spouse Remains as Beneficiary

Spouse Remains as Beneficiary – May Be Best Choice When...

- **Surviving Spouse is under 59 ½**
 - Access to penalty-free withdrawals
 - Can always do spousal rollover later
- **Surviving spouse is substantially older than deceased**

IRA Owner Dies Before RBD Surviving Spouse Substantially Older

Example:

Jim, age 58 passed away leaving entire IRA to Spouse, Sue, age 69

■ Choices

- Spousal rollover: RBD – when Sue reaches 70 ½ (Uniform Life Table)
- Remain as beneficiary: RBD – when Jim would have been 70 ½ (Single Life Table)
 - Execute spousal rollover at that time (when Sue is age 81)

Post-death RMDs

Non-Spouse Beneficiaries of Traditional IRAs

Account Owner Dies Before RBD	Account Owner Dies On/After RBD
<p>Beneficiary IRA – RMDs Based on life expectancy of beneficiary. Use Single Life Table and look up age in year after owner's death. Reduce by one in each subsequent year.</p>	<p>Beneficiary IRA – RMDs Based on life expectancy of beneficiary or deceased owner, <u>whichever is younger</u>. If participant is younger, use Single Life Table and look up age in year of owner's death and subtract one. Reduce by one in each subsequent year.</p>
<p>or 5-Year Rule</p>	

Non-Spouse Designated Beneficiary

Post-death RMDs

Non-Spouse Beneficiaries – Death After RBD

Example:



Barbara died in July 2011, shortly before her 72nd birthday, leaving her IRA to her sister Ruth, age 79.

- **She had already taken her RMD for 2011. For her 2012 RMD Ruth uses the life expectancy factor for age 72 (15.5) from the Single Life Table reduced by one (14.5).**
- **She will reduce by one for each subsequent year.**

Post-Death RMDs Successor Beneficiaries

- **Second generation “stretch” of Traditional and Roth Beneficiary IRAs allowed**
- **However, no recalculation of RMDs**
- **RMDs continue to be made over the remaining life expectancy of now-deceased original beneficiary**

Post-death RMDs

No “Designated Beneficiary”

Account Owner Dies Before RBD	Account Owner Dies On/After RBD
5-year rule	Beneficiary IRA – RMDs Based on life expectancy of deceased owner. Use Single Life Table to look up age owner had attained, or would have attained, in year of death. Reduce by one for first post-death RMD and each subsequent year.

No Designated Beneficiary
(Estate or non-qualifying trust)

Post-Death RMDs

5-Year Rule

- **IRA owner dies before their RBD**
- **Distribution deadline: 5 years after IRA owner's death**
- **Annual distributions not required**

Roth IRAs

- **No lifetime required distributions**
- **Post-death RMDs required**
- **Pre – RBD rules used**
 - Spousal rollover
 - Non-spouse “stretch” or 5-year rule
 - Estate, non-qualifying trust, etc. use 5-year rule

Post-Death RMDs

Roth IRAs

- **All distributions tax-free *only* if 5-year period is met *AND* the owner is 59 ½ or disabled within the meaning of section 72(m), or has died**
- **5 year period begins with establishment of deceased's first Roth**
- **Beneficiary holding period also counts in determining whether the 5-year period has been met**

Example:

On January 1, 2011 Mary converts her \$100,000 traditional IRA to a Roth IRA (her first Roth) and designates her daughter Susan as sole beneficiary.

Mary passes away in early 2013.

- Susan decides to withdraw all \$140,000 value of her interest in January 2014.
- Susan will have to include the \$40,000 of earnings on her 2014 tax return since the 5-year requirement has not been met.

Post-Death RMDs

Roth IRAs

Better Solution:

Susan should withdraw no more than \$100,000 of her beneficiary interest before December 31, 2015.

After that all earnings can be withdrawn tax-free.

Roth IRA Conversion

Legacy Planning Opportunity

- **Prospect: Traditional IRA owner approaching age 70 1/2**
- **Unlikely they (or spouse, if applicable) will ever need funds from IRA**
- **Non-spouse beneficiaries financially successful and likely to “stretch” at owner’s death**
- **Roth conversion**
 - No RMDs for Roth IRA owner
 - Tax-free “stretch” opportunity for beneficiaries

Roth IRA Conversion Beneficiary Stretch

Meet Tracy

- 67 year old widow
- Significant income
- Substantial investment portfolio
- \$250,000 Traditional IRA
- Does not anticipate needing the income from the IRA
- Goal: Leave a legacy with IRA assets
- Has heard that converting to a Roth IRA removes the RMD requirement



Roth IRA Conversion

Beneficiary Stretch

Meet John

- Tracy's only child, age 38
- Successful business owner
- Currently in the 35% income tax bracket and expects to remain so
- Does not expect to need any assets from his Mother's estate
- Plans on establishing beneficiary IRA at his mother's death and will likely invest the after-tax amounts of the RMDs to increase the legacy he leaves his children

Roth IRA Conversion – Beneficiary Stretch

Does it make sense to convert?

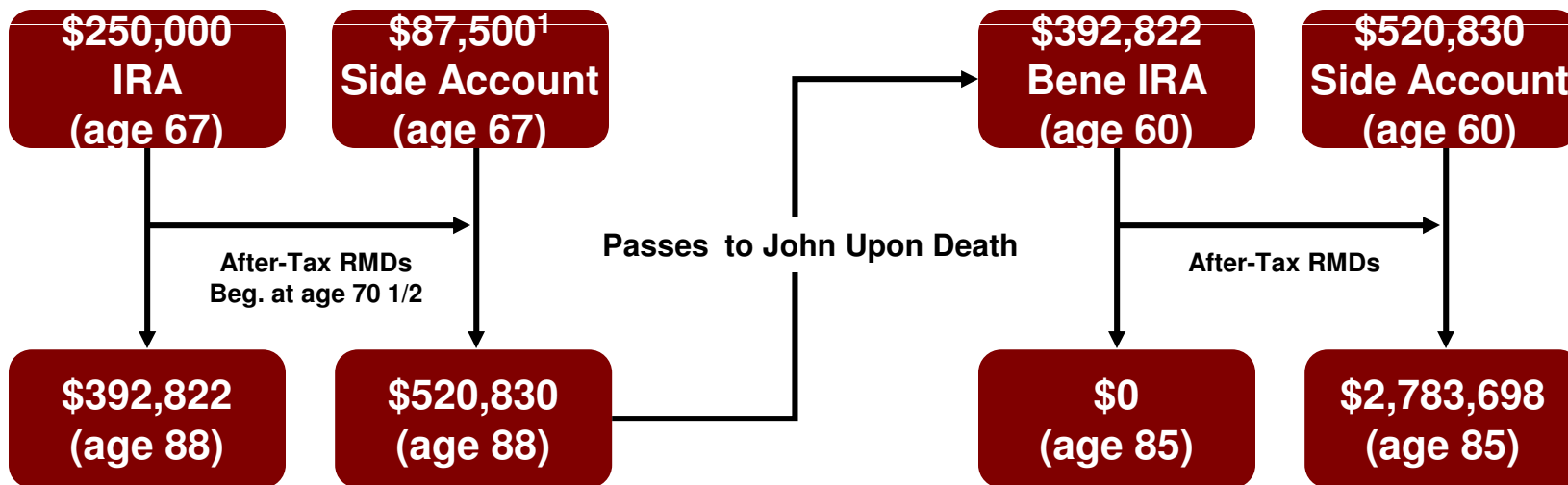
No Conversion

Assumptions: 35% Current Tax Bracket, 35% Tax Bracket in Retirement, Estimated 7% annual investment return. After-tax RMDs reinvested in taxable side account.

Tracy



John (Age 60)



¹ Available assets not used to pay taxes on Roth IRA conversion

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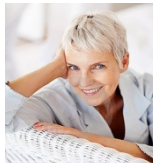
Roth IRA Conversion – Beneficiary Stretch

Does it make sense to convert?

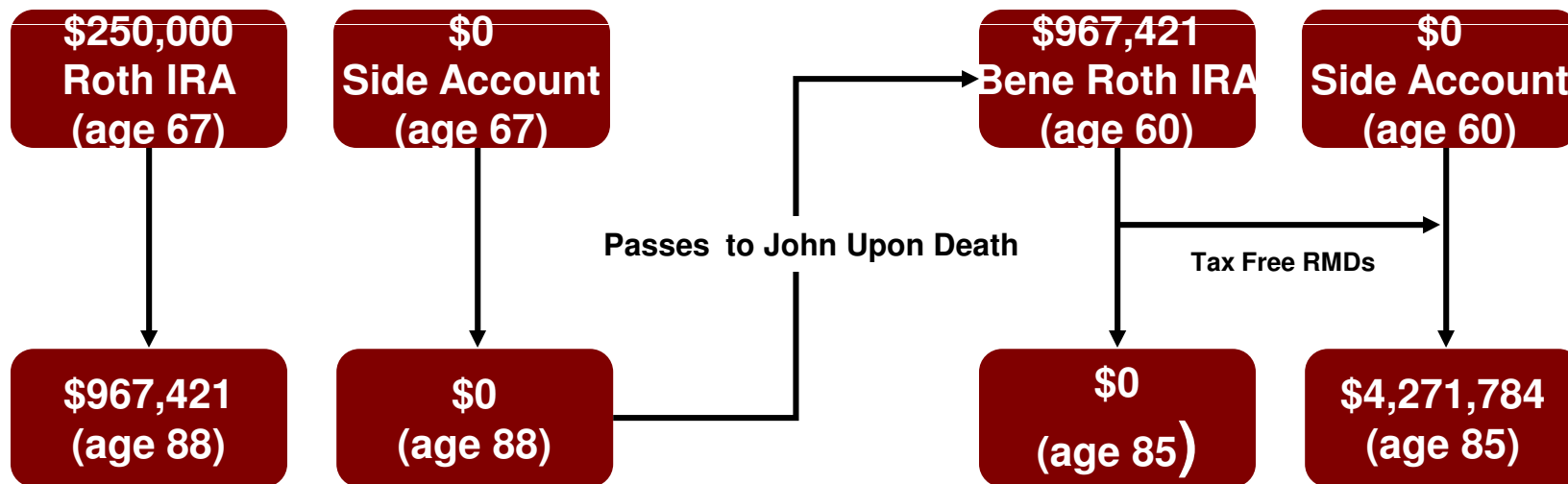
Conversion

Assumptions: 35% Current Tax Bracket, 35% Tax Bracket in Retirement, Estimated 7% annual investment return. After-tax RMDs reinvested in taxable side account, taxes due on the conversion (\$87,500) are paid out of pocket.

Tracy



John

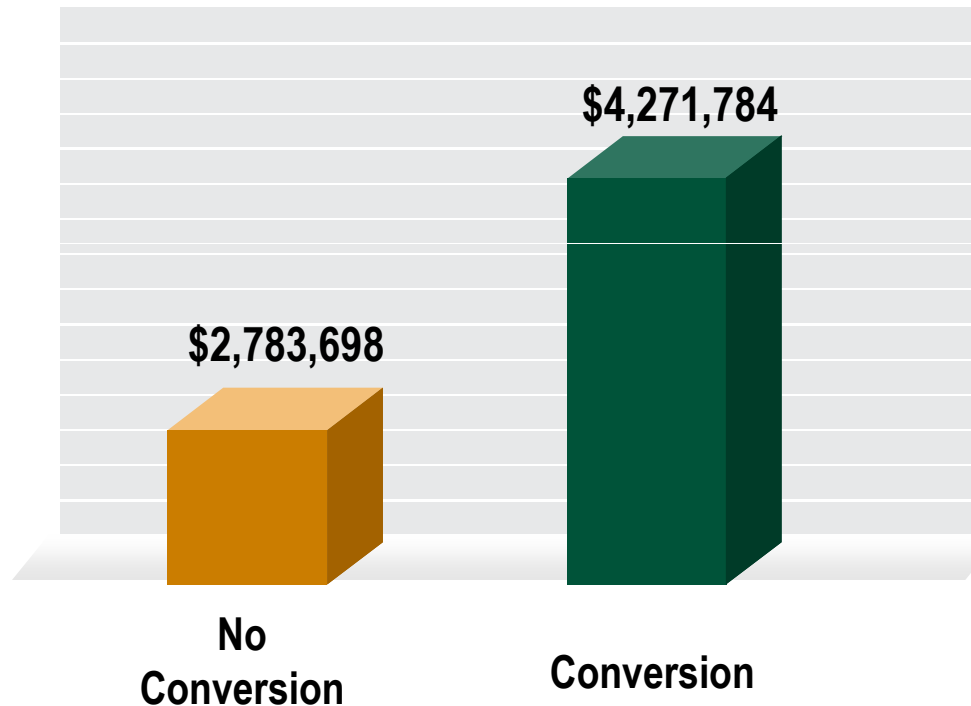


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Roth IRA Conversion – Beneficiary Stretch

Comparing the Options

Account Values at the End of John's Life Expectancy



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Post-Death RMDs Trust Beneficiary

- **No income tax advantage**
- **Many name living trust as beneficiary to avoid probate – not necessary**
- **Generally used for control (non-tax) purposes**
- **Possible estate tax and planning capabilities**
- **Complex RMD rules – consult experts**

Post-Death RMDs Trust Beneficiary

Reason to name trust as beneficiary

- Minor or incompetent
- To guarantee stretch
- To determine successor beneficiary
- Second marriage situations
- Estate tax planning



Post-Death RMDs

Trust Beneficiary

- **“See-Through” trust qualifies as Designated Beneficiary**
- **“See-Through” requirements**
 - Valid under state law
 - Irrevocable
 - Beneficiaries (all individuals) must be identifiable
 - Documentation deadline (Oct. 31)
- **No “Separate Accounts” rule**
 - Life expectancy of oldest trust beneficiary
 - Use sub trusts to separate
 - Numerous Private Letter Rulings approve transfer of Beneficiary IRA to trust beneficiaries at trust termination

Conduit Trust

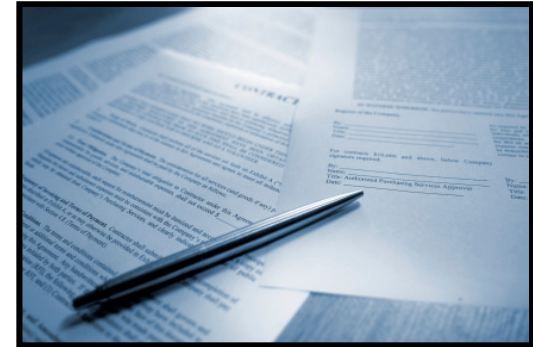
- **Merely passes RMDs to beneficiaries**
- **Life expectancy of oldest**
- **Some spousal benefits if sole trust beneficiary**
 - Delayed RBD (if owner died before RBD)
 - Recalculation (Single Life Table)
 - Generally no spousal rollover

Establishing Beneficiary IRAs (or changing custodians)

Key Rules:

No constructive receipt permitted

- Must be direct rollover for non-spouse beneficiary
- IRA registration must include deceased's name



Grow Practice Through Beneficiary IRAs

- **Master complex distribution rules**
- **Demonstrate knowledge of non-spouse stretch IRAs**
- **Explain multiple generation tax-deferral opportunity**
- **Proper beneficiary designations are critical**
- **Will does not govern retirement assets**
- **Offer to review clients' beneficiary designations**
- **Great opportunity to establish relationship with clients' heirs**

Thank You

Questions & Answers

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