

Life Planning Newsletter
The Law Offices of James A. Busse Jr.
Long Beach CA, Carson City NV.
September 2009

In this issue: **Your 401(k) & IRA: Notes for Owners and Beneficiaries.**



1st August Sunday Mass Cartago, C.R.



Rio Piris near the source Copey, C.R.

Our law firm focuses on Estate and Life Planning for those who wish to preserve their assets for their family. By doing Probate work for our clients we have established Estate Planning methods that are court tested. Because the goal of every person is to have peace of mind their wishes will be carried out, our integrated approach constantly tests the effectiveness of your Estate Plan with actual California and Nevada Cases. We are particularly involved in Medicaid and Medi-Cal Estate planning.

We create Special Needs Trusts and Estate Plans to ensure our clients meet the eligibility requirements, lower their share the cost expense, and reduce or eliminate the potential recovery by the State.

Our law firm integrates Probate with coordinated Estate Planning documents to significantly reduce the impact of the State claim for nursing home care.

Your Retirement arrangement IRA or 401(k)

One of the most complex and penalizing part of your estate may very well be your 401(k) or IRA. This article is not meant to be a complete review of all aspects of your personal retirement plan nor will it cover the many uses you may foresee for your retirement

dollar. What I will do is review a number of DISTRIBUTION traps and propose some solutions that may save you or your beneficiaries a substantial amount of money. I strongly suggest that you not rely solely on this article but that you consult with a competent retirement planner. Notice I did not say a financial planner but a COMPETENT RETIREMENT PLANNER who not only considers income but is knowledgeable and carefully considers our worst enemy, the IRS.

(1) Money kept in the plan is tax deferred. So what if you could name an infant your beneficiary a few days before your death? If you had a 401(k) or 403(b) plan the administrator of that plan might allow your beneficiary to take the distributions over 80+ years but more than likely the administrator would REQUIRE your beneficiary take the distribution over 5 years or less. An IRA on the other hand MUST allow a designated beneficiary (a live person with a name) to take distributions over their expected life. The difference may be huge. Consider a \$500,000 401(k) distributed over 5 years (\$100,000 / year) puts you in the 60% tax bracket (state fed, SSI, etc) and unless you are the spouse you can't simply roll it into your IRA. So the total amount you end up with after 5 years is about \$200,000. IRS WINS! You must take the distributions and pay the tax as ordinary income on top of your regular income. With an IRA however, the beneficiary would only have

to take out 500,000/80 or \$6,250 per year and can leave the remainder to grow tax deferred. If the 500K was invested at 5% in 30 years the beneficiary could purchase a pretty nice house, even in California. (about \$2,000,000) or in 80 years the account would be worth around \$24,000,000, which could be used to fund a nice legacy at a university. The lesson here is that if you want to use your retirement savings as a long term legacy, convert the 401(k) to an IRA and pray the laws don't change.

If your 401(k) has company stock you can take advantage of a little used tax break called the Net Unrealized Appreciation (NUA) on that stock. The stock must be stock in the company you work for. You must also take a total lump sum distribution of all the 401(k) balance. You can roll over the other funds and distribute the stock to yourself. If the stock is distributed to you (NOT CASHED IN) in certificates, you can put them into a regular brokerage account and pay the regular income tax on the basis or purchase price of the stock, NOT THE FULLY APPRECIATED VALUE. So if you worked for Coke and bought their stock in your 401(k) at \$50 per share and after 30 years it was worth \$300 per share you pay income tax on the \$50 per share value of your stock not the \$300 value. Now you keep it for a year with the broker and sell it. You now pay capital gains tax on the \$300 per share which now is 15% or only 5% if you are a low income person. Better hurry on this on though because the tax dogs in Washington in keeping with their desire to make all of us dependant on government, want to increase the capital gains tax to 35% as a disincentive to savings and business. (However, 35% is better than the 60% income tax bracket now proposed so this still may be a good idea. Most plan administrators know nothing about NUA so you really need to find out who the person is in your company that can set this up for you. Start about one year before retirement.

You just inherited an IRA. Great. Now what? Do you simply transfer it to yours? NO! NO! NO! Do you rename it to your name NO! NO! NO! If you do either of these things, the IRS considers the IRA distributed and you pay the tax on the full amount. What you do is to retitle the IRA as follows: **Deceased person's name IRA (deceased ...date...) F/B/O Your Name, Beneficiary**, and you change the Social Security number to yours for tax purposes. There are books written about how to distribute an IRA so I'll not even attempt to delve into this too much. But you should know

some basic terms regarding naming Beneficiaries. Designated Beneficiary means a live person. The Designated Beneficiary has many options regarding distribution up to distributing the IRA over the Designated Beneficiary's lifetime. Beneficiary means an entity such as a Trust or Estate or Charity. In this case the maximum time over which the IRA may be distributed is 5 years or the remaining expected life of the owner (if the deceased died after starting mandatory distributions). By the way, if the mandatory distributions are not taken the IRS has the authority to assess a 50% penalty on the ENTIRE IRA amount. Not just the amount that was not withdrawn. And finally, if there is no beneficiary the IRA will pass to the Estate and the 401(k) or 403(b) will pass according to the plan rules. You do know your plan's rules...don't you? Under recent rulings, it is possible to write a trust or will in such a manner as to create designated beneficiaries for one's IRA. However, it is often easier to take the time to name a beneficiary on the plan's paperwork. I recommend that a person verify the beneficiaries every two years or on every life event (marriage, new child, death of family, new job, etc.) Leaving an ex spouse or deceased person (their estate gets it and who knows who that is) on your IRA is not something pleasant to contemplate. On that subject, when your spouse files for divorce, there is this thing called an Automatic Temporary Restraining Order (ATRO) that prevents you from changing the beneficiaries of your accounts without approval from the court. However, the ATRO does not prevent one from creating a new will. So one way around that might be to create a will that uses the correct wording to designate beneficiaries and create an associated Trust to dump the IRA to the beneficiaries of the Estate and leave the IRA to the trust & designated beneficiaries named by the Trust. Once you get the ATRO it is too late to change the beneficiary on your IRA.

Finally, I'd like to recommend a good book on Retirement Tax Planning. The traps are many and the penalties severe. But reading "The Retirement Savings Time Bomb...and how to defuse it" by Ed Slott IBSN 0 14 20.0377 8 is a good reference and will prepare you to discuss your retirement options with your advisors.

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