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TWO THINGS CERTAIN®

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PROBATE: A HUGE MISTAKE FOR YOUR IRA

By: Spencer M. Baxter

In the past few decades more and more companies have shifted employee retirement benefits from defined benefit plans (commonly known as pensions) to defined contribution plans (such as a 401k plan). With the shift away from pensions the public has had no choice but to heavily rely on defined contribution retirement plans to fund their "Golden Years." At present time, the U.S. Department of Labor estimates more than 88 million people are participating in a defined contribution retirement plan in the U.S. At the end of 2013, The Federal Reserve Board estimated defined contribution plans to be valued in excess of $4.89 trillion and IRA plans valued in excess of $6.16 trillion. In this article, the term IRA is used to encompass all defined contributions plans and Individual Retirement Accounts such as 401(k), 403(b), and Thrift Savings Plans. Even with such broad use of and high accumulation of wealth in these retirement accounts, most individuals don't give much thought to, let alone seek out advice on, who to name as their retirement plan beneficiary. If no beneficiary is named, an IRA can be subjected to the probate process with disastrous consequences.

The Basics of Retirement Accounts

Upon the death of an IRA owner, the account distribution requirements can be quite complicated and confusing. The main variables affecting distribution are the age of the original account owner at their death and the beneficiary election made for the account. When a living person is named as the beneficiary they are typically considered "designated." Upon the account being converted to an "Inherited IRA" for the beneficiaries, they are required to withdraw a small percentage of the account based on their age (called the Minimum Required Distribution) in the year after the decedent's death. A younger beneficiary's required distributions will be smaller than an older beneficiary's withdrawal requirements. A beneficiary can take full advantage of tax-deferred growth on the bulk of the account, and only pay income taxes on the amount withdrawn each year (commonly known as a Stretch Inherited IRA.) The theory being that smaller annual withdrawals will not trigger higher income tax brackets as much as larger consolidated withdrawal would.

Alternatively, if a named beneficiary is not considered "designated" and the account owner had not reached 70 ½ prior to passing, there are very few efficient outcomes. The most common causes for this situation are: no beneficiary was named, no named beneficiary is living, or the decedent put "my estate" on the retirement account forms. The retirement account will then fall under the purview of probate and be distributed pursuant to the terms of the decedent's Last Will and Testament or the Laws of Intestacy. Retirement accounts subjected to probate must have all account assets distributed no later than December 31 of the 5th year from the decedent's death (Stretch Inherited IRAs are not available). Any tax

advantages gained by small annual withdraws are lost as everything in the account will be taxed as the beneficiary's income over a short timeline.

US Treasury Recommended Treatment of Retirement Accounts

Under current laws the 5 year distribution rule can be avoided with the help of a trusted professional advisor, so long as Congress does not make any changes. With that in mind, the most recent recommendations for potential changes to Federal Tax Law and Regulations by the US Treasury in the 2014 “Greenbook” suggests the eradication of a Stretch Inherited IRA for any non-spouse beneficiary. The specific recommendation would have the same result as subjecting a retirement account to probate, namely the total withdrawal of all account assets within 5 years of the account owner’s death. It’s not surprising that the low-hanging fruit of a combined $11.05 trillion in retirement accounts has baited the US Treasury to recommend changes that would take advantage of the expected transition of wealth in the coming decades. Although the Treasury’s Greenbook only consists of recommendations, it does illustrate the need to evaluate the relevance of one’s current estate plan, and more particularly the beneficiaries of one’s retirement plans.

Conclusion

Talk to your financial advisor to make sure your IRA Beneficiaries are up to date. If you do not have a financial advisor, JGB will be happy to recommend one to you. Be sure to designate a beneficiary consistent with your will or trust and estate planning goals. JGB stands ready to assist you with questions about Probate, your IRA beneficiaries, and your estate plan in general.

Johnson, Gasink, Baxter, LLP.

1138 Professional Drive

Williamsburg, VA 23185

(757) 220-9800

(804) 824-9690

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About the Author:

Spencer Baxter is an experienced problem solver who helps individuals and businesses achieve and protect their goals of prosperity, stability and growth through appropriate planning. Spencer takes great pride in making sure that his work for clients is always reliable, correct, and on time.

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