



# The Wealth Counselor

A monthly newsletter for wealth planning professionals

From [Henry Weatherby](#)

Volume 2, Issue 11



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Our firm focuses our practice on Estate Planning, Probate and Trust Administration, Business Planning and Elder Law. We help families and businesses preserve and protect assets and values.

## New Planning Opportunities with Non-Spouse Rollovers

Before 2007, a non-spouse beneficiary of a qualified plan was stuck taking distributions under the terms of the plan, which typically required full distribution within five or fewer years of the participant's death. The Pension Protection Act of 2006 (PPA 2006) authorized non-spouse beneficiaries (before it was only surviving spouses) to roll over to an Inherited IRA.

This issue of The Wealth Counselor looks at a very recent pronouncement from the IRS that finally makes this PPA 2006 provision useable and, therefore, is very beneficial to clients and all wealth planning professionals who understand its implications.

### Apparent Good News in PPA 2006

PPA 2006 provides that, effective January 1, 2007, a non-spouse qualified plan beneficiary may be permitted to roll over to an Inherited IRA after the plan participant's death.

### The January 2007 IRS Roadblock

Unfortunately, the IRS focused on the "may" and quickly issued guidance that virtually eliminated the planning opportunity that PPA 2006 seemed to provide. In its January 29, 2007 Notice 2007-7, the IRS declared that a plan was not required to offer non-spouse rollovers, saying it was optional with the plan provider whether to adopt a plan amendment permitting non-spouse rollovers. Therefore, absent a voluntary plan amendment, a non-spouse was stuck using the plan's payout period. And major plan providers did not offer such amendments to their prototype plans.

### The October 2007 IRS Roadblock Removal

In late October the IRS issued its 2007 Interim and Discretionary Amendments, as follows:

"Section 402(c)(11) [Discretionary]:  
PPA '06 . . . added Section 402(c)(11) to allow nonspouse beneficiaries to roll over distributions from a qualified plan to an individual retirement plan. Nonspouse beneficiary rollovers are an optional plan provision for 2007. See, Notice 2007-7. Pursuant to an impending technical correction, nonspouse beneficiary rollovers will be required for plan years beginning on or after January 1,

2008." (Emphasis added.)

This amendment appears to be in anticipation of a Congressional change to PPA 2006 to make it mandatory that qualified plans permit non-spouse rollovers. The full text of the IRS document is at [www.irs.gov/retirement/article/0,,id=173372,00.html](http://www.irs.gov/retirement/article/0,,id=173372,00.html).

#### **What Does All This Mean for Your Clients?**

Beginning January 1, 2008, non-spouse beneficiaries finally will be able to take advantage of the PPA 2006 provisions and roll over from a qualified plan into an Inherited IRA. In the Inherited IRA, the non-spouse beneficiary can use his or her own life expectancy to determine annual required minimum distributions (RMDs). This can significantly reduce the amount that the beneficiary must withdraw each year, thereby deferring income tax and allowing the account balance to continue to grow income tax free.

Implementation of a non-spouse rollover raises numerous pitfalls for the unwary. These pitfalls are identified in the Planning Tips that follow.

**Planning Tip:** The transfer must be DIRECTLY from the plan Trustee to the Inherited IRA's Custodian or Trustee.

**Planning Tip:** Any distribution to a non-spouse beneficiary is a taxable distribution, subject to income tax. Therefore any check delivered by the plan Trustee MUST be made payable directly to the Inherited IRA Custodian or Trustee.

**Planning Tip:** Unlike with a surviving spouse rollover, the Inherited IRA must remain in the name of the deceased participant. The Inherited IRA should be titled like this: Account Holder, deceased, IRA f/b/o Beneficiary.

**Planning Tip:** DO NOT re-title the qualified plan in the name of the non-spouse beneficiary. That will be treated as a taxable distribution.

**Planning Tip:** DO NOT transfer from the qualified plan to an existing IRA in the non-spouse beneficiary's name. That, too, constitutes a taxable distribution of the entire account.

**Planning Tip:** A non-spouse beneficiary must begin taking required minimum distributions from the Inherited IRA by December 31 of the year following the year of the participant's death. Note: This is different

from a spouse rollover, where the surviving spouse can defer required minimum distributions until attaining age 70 1/2.

### **Planning Opportunities**

The IRS's change of position means that additional planning options are now available for non-spouse beneficiaries of qualified plans. These options include those listed below, which were outlined in greater detail in a prior issue of *The Wealth Counselor*:

- | Name a Retirement Trust as beneficiary to ensure the longest term payout possible, while also ensuring consistent account management - in the manner desired by the client using the client's advisors - oftentimes over generations.
- | Give the accounts to charity at death and replace with insurance owned by a Wealth Replacement Trust.
- | Take the money out during lifetime and buy an immediate annuity to provide a guaranteed annual income, to pay the income tax, and to pay for Insurance owned by a Wealth Replacement Trust.
- | Take the money out during lifetime and pay the income tax, then gift the remaining cash through an Irrevocable Life Insurance Trust or other Irrevocable Trust.
- | Name a Charitable Remainder Trust as beneficiary with a lifetime payout to a surviving spouse; the remaining assets passing to charity at the death of the spouse.
- | Give up to \$100,000 from IRAs directly to charity before December 31, 2007.

### **Asset Management Opportunities**

Experience teaches that beneficiaries often frustrate the stretch-out plans of the decedent and squander their opportunity for tax-free growth by withdrawing far more than the required minimum distributions. However, if the participant names a trust as beneficiary of the qualified plan, PPA 2006 provides that the trustee of that trust may roll over from the qualified plan into an Inherited IRA for the benefit of the trust beneficiary. Clients who name a trust as beneficiary of their qualified plan account can thereby protect the assets from creditors (including loss in a beneficiary's divorce) and the beneficiary from the temptation to be a spendthrift.

**Planning Tip:** Naming a trust as beneficiary also allows the participant's trusted financial advisor to continue to manage assets as the participant desired.

### **Conclusion**

The IRS now requires that all qualified plans permit non-spouse rollovers for plan years beginning on or after January 1, 2008. This "about face" means that all non-spouse beneficiaries will be able to roll over from qualified plans to Inherited IRAs rather than be stuck with shorter payout under the plan provisions. This will permit the planning team to implement the right strategy to meet the client's unique planning objectives.

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You have received this newsletter because I believe you will find its content valuable, and I hope that it will help you to provide better service to your clients. Please feel free to [contact me](#) if you have any questions about this or any matters relating to estate planning.

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