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IRA, RMD, SNT – OMG!

Special Considerations When Retirement Benefits Pass to Minors, Disabled Persons, and Individuals Who May Lose Capacity

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INTRODUCTION

If the thoughts that went through a practitioner's head upon realization that a client's estate plan required retirement benefits planning could be expressed in "text format," what would that look like?

WTH - IDKWTD![1]

OTL[2]

😠 😬 😫 😱 😱 😱

Planning with retirement benefits is daunting. Not only are the Internal Revenue Code sections dealing with retirement benefits impossibly complex, but each administrator/custodian also has their own internal rules and requirements. Not to mention the fact that the IRS is unforgiving when it comes to missing certain deadlines for these assets. Notwithstanding these obstacles, the tax benefits provided by these plans as well as the fact that a significant number of Americans, regardless of age, have some sort of retirement benefits, make it necessary that practitioners incorporate retirement benefit planning into their practices.

But before reaching the stage at which required minimum distributions are calculated and rollover decisions are made, benefits actually need to be transferred from the deceased participant[3] to the beneficiary. And the means by which this transfer occurs can make a significant difference to the beneficiary in terms of the amounts ultimately received and the headaches involved, especially when the desired beneficiary is a minor, a person with a disability, or an individual who may likely have some degree of physical or mental incapacity in the relatively near future. This article examines specific considerations that practitioners should recognize and discuss with clients when any of the afore-described persons are potential beneficiaries of a retirement plan.

IRA, 401(K), SEP, 401(B) – HELP!

There are a multitude of different retirement plans, each governed by a different section of the Internal Revenue Code. The "fun" is multiplied by the fact that it is not uncommon for an individual to have more than one different type of plan, especially if he has changed employment multiple times during his career. However, a common thread among all retirement plans discussed in this article is that they are all structured to allow the money and property invested therein to grow tax-deferred (no taxes are charged to income or gains, such as interest, dividends, or capital gains) until such money or property is withdrawn.

Taking a 10,000-foot view, it may easiest to initially break them into the two most commonly seen categories of plans: qualified plans and individual retirement plans.

I. Qualified Plans.

A "qualified plan," as used herein, is a defined benefits plan[4] or a defined contribution plan[5] established by an employer that satisfies the requirements of the Internal Revenue Code of 1986, as amended (the ***"Code"***) and the Employee Retirement Income Security Act of

[1] What the Heck - I Don't Know What To Do!
[2] Letters form a man kneeling on the floor. Used to show desperation.
[3] Generally, the terms "participant" and "administrators" refers to qualified plans, such as 401(k)s, and the terms "owner" and "custodians" refer to Individual Retirement Accounts (IRAs). In the context of this article however they may be used interchangeably.

[4] A defined benefit plan is a type of qualified plan established and funded by an employer that promises to pay each participant a specific benefit at retirement.
[5] A defined contribution plan is a type of qualified plan in which the participant's benefits are determined by the contributions made to an individual account established for the participant, either by the participant himself or the participant's employer, and the subsequent investment performance of such contributed assets.

1974 (***"ERISA"***).[6] Participation in a qualified plan is an appealing benefit for employers to offer employees because it provides certain tax advantages to both parties.

An employer may deduct contributions made to an employee's qualified plan on the company's income tax return, and employees[7] recognize no current income on pre-tax contributions made to the plan. Moreover, once in the plan, earnings on contributions are tax exempt, meaning that such amounts are only subject to tax upon distribution. Roth qualified plans (discussed further below with regard to a 401(k)) are the exception to this general rule as they allow participants to make non-deductible contributions (or to do taxable rollovers from traditional plans) but earn tax free as opposed to tax deferred. Thus, subject to certain conditions, distributions from these plans are tax free.

The most common qualified plan is the 401(k) plan. A 401(k) plan is a defined contribution plan that allows a participant to invest a portion of his pre-tax salary in investments (stocks, bonds, mutual funds, etc.) offered by the plan administrator. The maximum amount that a participant can contribute to a 401(k) in 2018 is $18,500, although individuals who are or who will turn 50 in 2018 may contribute an additional $6,000 (referred to as a catch-up contribution).

However, these limits are simply the maximum that a *participant* can contribute to his 401(k); employers may make additional contributions to employees' 401(k)s as well. In 2018, an employer may contribute up to $36,500 to each employee's 401(k) so that the maximum total amount that can be contributed to a 401(k) in 2018 by both an employee and his employer is the lesser of: (i) $55,000 (or $61,000 for participants 50 and older) or (ii) 100% of the employee's salary. While an employee's contributions vest immediately, in most cases the employer's contributions do not vest until the employee has worked for the company for a certain amount of time.

A 401(k) can be structured as a traditional 401(k) or a Roth 401(k). Moreover, the participant in a traditional 401(k) plan may convert the plan to a Roth 401(k) at any time so long as the plan offers this conversion option.[8]

A Roth 401(k) generally operates like a traditional 401(k) (and has the same contribution limits); however, after-tax dollars rather than pre-tax dollars are contributed to the account. Since the amounts contributed to a Roth 401(k) are subject to tax before contribution, they are not taxed again when withdrawn so long as the withdrawal meets certain requirements.[9] There are no income limitations to participate in a Roth 401(k), however, distributions must begin to be made to the participant no later than age 70 ½.[10]

II. Individual Retirement Plans

An individual retirement plan is a retirement plan that allows earnings therein to grow tax-deferred until the money is withdrawn.[11] However unlike a qualified plan, it is not subject to ERISA and it is generally not provided by an employer. An Individual Retirement Account (***"IRA"***) is the most common individual retirement plan.

This benefits plan is usually opened by an individual rather than an employer (although

[6] A non-qualified plan is an employer-sponsored plan that does not qualify as a pension plan under section 3 of ERISA. These plans are often used as forms of additional compensation for key employees or as a way to keep talent at a firm. They are not as common and beyond the scope of this article. usually offered as forms of additional compensation to key employees

[7] Employee and participant are used interchangeably in this article in the context of qualified plans.

[8] American Taxpayer Relief Act of 2012 (Pub.L. 112–240, H.R. 8, 126 Stat. 2313, enacted January 2, 2013).

[9] Treas. Reg. § 1.401(k)-1(f), -2 and -6.

[10] Exceptions available if participant is still works and not a 5% owner of the employer.

[11] *See generally* I.R.C. §§ 408, 219.

Title search: IRA, UTMA, SNT, RMD… OMG! Special Considerations When Planning With Retirement Benefits For Minors and Incapacitated Individuals.

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