Vol. 12, No. 2 **Choate's Notes** Fall 2010
A free newsletter for estate planners, from Natalie B. Choate

Dear estate planning professional:

Freebies: There are several excellent useful and FREE reports available at MetLife's www.maturemarketinstitute.com, including "The Essentials: Medicare and Medicaid" (40-page plain-language explanation of these programs), a 50-state survey of long-term care costs, and a "Retirement Readiness Workbook." For FREE easy access to current and past IRS § 7520 rates, visit http://www.leimberg.com/freeresources/keyrates.asp. While there subscribe to Steve Leimberg's fantastic email newsletters (not free), including *Estate Planning*, *Asset Protection*, and *Employee Benefits*. It's not too late to listen to the FREE 90-minute "webinar" by Jonathan Blattmachr, Michael Graham, and Mitchell Gans, three absolutely top estate planners, two of whom are the creators of the Interactive Legal Suite estate planning/drafting software system (not free) on "Why 2010 is the Trust & Estate Attorneys' Opportunity of a Decade." Find it at www.interactivelegal.com, click "Register for Webinar," then click "View Event Recordings," then scroll down to this 1/6/2010 recording.

Good idea: Wealthy grandparent has a substantial traditional IRA equal to his GST exemption, and $$ millions in other ("non-IRD") assets. He leaves the IRA to his grandchildren for a stretch payout over their long life expectancies. The rest of the estate he leaves to his children; this residuary share is burdened with the estate taxes on the entire estate. Even though the IRA pays no estate tax, the grandchildren get the "IRD deduction" (§ 691(c)), thus increasing the relative value of what they receive. I thank Earl Johnson for sending me this idea.

My Roth journey: This summer I thought I'd better take my own medicine and do a Roth conversion. But what portion of my traditional retirement plan assets should I convert? $10,000? $100,000? $1 million? $10 million? or the whole shebang? An answer came in an article describing 10 "blue chip" stocks that (the author averred) were beaten down in price, selling for a mere fraction of their true worth, way oversold. Luckily I already owned these 10 paragons, then worth a total of $100,000, having ridden them all the way down. So I moved them from my traditional IRA to a Roth IRA. This is like making the "buy" decision again for stocks you already own. While this has worked well so far, the idea that I'm paying income taxes on $100,000 years before I have to is very hard to get used to. The experience has satisfied my appetite for Roth conversions for the foreseeable future, thank you. The additional outside-the-plan dollars I had previously considered using for additional Roth conversions I have decided to spend, instead, on redoing my kitchen.

Until the next issue,
Natalie B. Choate

Who Makes Retirement Benefit Mistakes?

The IRS. In *Gibbons*, T.C. Summary 2006-106, Mama (who was then under age 59½) withdrew $67,552 from her 403(b) plan, and used $37,112 of it to pay her daughter's college expenses. The IRS went after Mama for the 10% early-distributions penalty (§ 72(t)) on the portion of the distribution ($30,440) not used to pay higher education expenses. By the time the case came to court, the IRS realized it should have applied the penalty to the *entire $67,552*; the education-expense exception is available for IRAs only, not 403(b) plans, so *none* of Mama's distribution actually qualified for the exception! The IRS should have read p. 566 of *Life and Death Planning for Retirement Benefits* (7^{th} ed. 2011). The Service chivalrously allowed Mama to keep the benefit of the IRS's mistake; she had to pay "only" $3,044 of penalty on her withdrawal.

Plan administrators. Employee died in the year he would have reached age 70½, but died before his RBD. The surviving spouse/sole beneficiary of the 401(k) plan requested a direct rollover of the entire balance to her own IRA. The plan said it would roll over everything but the minimum required distribution (MRD)—the amount that the deceased employee *would* have had to take (for his age 70½-year) *if* he had lived until April 1 of the *following* year. That amount, said the plan, had to be distributed to the widow and could not be rolled over. That was Plan Administrator mistake #1: It's true the MRD cannot be rolled over, but there is no MRD for the year of death if the employee dies before his RBD as in this case. See pp. 55–57 of *Life and Death Planning for Retirement Benefits* (7^{th} ed. 2011). Ok, said the widow, just distribute this so-called "MRD" to me and roll the rest directly to my IRA. She didn't want to fight City Hall, and she knew that (since it *wasn't* really an MRD) she could roll over the distribution as soon as she received it. Fine said the Plan Administrator, we'll distribute to you 80% of the MRD; the rest we have to send to the IRS as mandatory withholding of federal income tax! That's Plan Administrator mistake #2: Mandatory 20% withholding applies *only* to eligible rollover distributions. Since an MRD is *not* an eligible rollover distribution, the recipient can ALWAYS opt out of withholding on an MRD! See pp. 160–163 and p. 184 of *Life and Death Planning for Retirement Benefits* (7^{th} ed. 2011), a book this Plan Administrator clearly needs to read.

Financial advisors and institutions. At least half the requests for a hardship waiver of the 60-day rollover deadline are necessitated by the error of a financial institution or advisor—typically, depositing what is supposed to be an IRA rollover contribution into the participant's taxable account by mistake. The "good news" is that the IRS will always grant the hardship waiver in these cases. See p. 194 of *Life and Death Planning for Retirement Benefits* (7^{th} ed. 2011).

Me. Recently I told a still-working 70-something colleague that he was too old to contribute to a traditional IRA (true), but that as long as he had at least $6,000 of compensation income he could contribute $6,000 to a Roth IRA for 2010. Whoops! I forgot to mention there is an income limit on such "regular" Roth IRA contributions; you are NOT permitted to contribute to a Roth IRA if your income exceeds a certain amount. I should have read p. 333 of *Life and Death Planning for Retirement Benefits* (7^{th} ed. 2011). I thought of this omission two days later in the middle of teaching my 4-hour *Roth Immersion* seminar. So my friend had to close the new Roth IRA he had just opened. This goes to show that free tax advice may not be worth much, even from an "expert!"