Tips to help you minimize the tax bite on your retirement assets

How to assist you in protecting your retirement savings

For many investors, a large percentage of their assets are likely held in tax-advantaged accounts such as 401(k)s and IRAs. While these accounts can be appropriate for sheltering retirement savings from taxes pre- and post-retirement because these assets are included in the account holder’s gross estate, they can be highly exposed to tax issues in an estate if managed improperly. In short, the combined estate and income taxes owed by beneficiaries could potentially erode the lion’s share of the value of these assets and the earnings of these assets while they were held in the 401(k)s and/or IRAs.

Proper naming of beneficiaries

Many problems that arise when transferring retirement plan assets occur around the naming of beneficiaries. Consider these tips to help avoid problems in this area:

• Be sure to have a named beneficiary. Naming the account holder’s estate as the beneficiary will trigger the “five-year rule,” which states that retirement plan assets must be paid out immediately or by the end of the five years following the account holder’s death.

• Review and update beneficiary designations. Life situations change frequently, and those changes can affect your beneficiary designations. For example, many times after a divorce, participants forget to update their beneficiary designations.

• Make sure one or more contingent beneficiaries are named. Without contingent beneficiaries you may face the same consequence as not naming a beneficiary at all—particularly when a primary beneficiary is no longer living.

Spousal vs. non-spousal beneficiaries

Retirement plan assets that pass to a surviving spouse may qualify for the unlimited estate tax marital deduction, whereas retirement plan assets that a non-spouse beneficiary inherits may be subject to estate tax upon the account holder’s death.

In addition, after the account holder’s death, the surviving spouse may roll over retirement plan assets to an IRA in his or her own name or elect to treat the retirement plan as his or her own. If the spouse chooses the latter option, he or she may defer taking required minimum distributions (RMDs) until he or she turns age 70½—a distinct advantage from an asset accumulation and taxation perspective.

A surviving spouse may also “disclaim”—or refuse—his or her interest in an IRA. Once disclaimed, the spouse will not receive any interest in the retirement plan and it will pass to contingent beneficiaries (typically children...
or grandchildren). Distributions to the contingent beneficiaries must then be made under the RMD rules that apply to non-spouse beneficiaries.

**Tips for non-spouse beneficiaries**

- Unlike a surviving spouse rollover, an IRA inherited by a non-spousal beneficiary must remain in the name of the deceased account holder.
- Any distribution to a non-spouse beneficiary is a taxable event. Therefore, any check delivered by the deceased’s retirement plan trustee should be made payable directly to the inherited IRA custodian or trustee.
- A non-spousal beneficiary must begin taking RMDs from the inherited IRA by December 31 of the year following the year of the account holder’s death.

**Other considerations**

Other strategies to help make qualified retirement plan assets more tax efficient include:

- **The stretch IRA**—A distribution strategy that can extend the tax-deferred status of IRA assets across multiple generations. The strategy aims to avoid large distributions and allows only RMDs to occur for as long as possible.

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