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The New Retirement Rules for 2015

A summary of five recent changes to the way individuals will save, transfer, and pass on retirement assets

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Introduction

Proper guidance in the retirement planning process has always been important. In light of the wave of baby boomer retirees and the increased scrutiny of Individual Retirement Arrangement (IRA) transactions by the financial regulatory authorities, it may be more important than ever before. A recent series of IRA and retirement plan rules and regulations will change how individuals save, transfer, and pass on their retirement assets. Some of these new rules provide financial planning opportunities while others create potential pitfalls. In this paper we review these changes and their associated financial planning considerations.

The Transamerica Advanced Markets Group strives to provide individuals with the right information to help them make the right decisions with their retirement, estate, and tax issues. In light of the current regulatory environment and the complexities of retirement planning in general, we hope you find the information in this paper helpful.

Financial Regulatory Agencies: Taking a Closer Look at IRA Transactions

Given the breadth and complexity of IRA rules and regulations one could reasonably argue that it's impossible, if not impractical, for the average individual saving for retirement to effectively manage their retirement assets without a considerable investment of time and research. In fact, one of the primary responsibilities of financial professionals today is to help their clients navigate the "rules of the road" for IRAs and other financial planning areas (e.g., tax planning and estate planning). Because the regulatory authorities recognize the important role financial services firms and intermediaries play in the retirement and financial planning process, we have seen an increasing interest in ensuring that these entities are providing individuals with appropriate guidance related to the products and services they provide.

In March 2013 the Government Accountability Office (GAO) issued a report titled ***Labor and IRS Could Improve the Rollover Process for Participants***.[1] What the GAO found, among other things, is that employer-sponsored plan participants often receive guidance on what to do with their retirement plan savings when they leave their employer. The GAO found that service providers, in general, encouraged rolling retirement plan savings into an IRA, even with only minimal knowledge of an individual's financial situation. The GAO also found that plan participants may find it difficult to understand and compare their distribution options because the information they receive is either too generic or not detailed enough, leaving them without an understanding of the key factors they need to know in order to make an appropriate decision.

The GAO recommended that the Department of Labor (DOL) and the Internal Revenue Service (IRS) should provide oversight and guidance for the IRA rollover process to ensure that it is more efficient, and that it enables participants to make informed decisions based on their personal and financial situations.

FINRA Notice 13-45[2]: Reminder to Firms of Their Responsibility on IRA Rollovers

In December of 2013, FINRA issued Notice 13-45 to remind firms of their responsibilities when (1) recommending a rollover or transfer of assets in an employer-sponsored retirement plan to an IRA or (2) marketing IRA and associated services. In particular, the Notice addresses firms' recommendations to participants in employer-sponsored retirement plans who terminate employment or become eligible to role all or a portion of their plan assets over to an IRA.

FINRA's concern, along with many knowledgeable financial professionals, was that a greater emphasis was traditionally being placed on the benefits of rolling money out of an employer-sponsored retirement plan with little attention being given to some of the disadvantages for certain individuals.
The importance of personal circumstances in the decision making process was generally overlooked.

In response to this Notice, financial services organizations should be making it clearer to individuals that each choice for rolling over their savings offers advantages and disadvantages, depending on the individual's unique financial needs, circumstances, and retirement plans. In particular, the decision to roll over plan assets to an IRA rather than keeping the assets in a previous employer's plan or rolling over to a new employer's plan should be based on a variety of factors, the importance of which will depend on an individual's needs and personal circumstances. Some of these factors include:

- Eligibility for pre-59 ½ withdrawals that are exempt from the 10% additional federal tax.
- The ability to defer required minimum distributions beyond age 70½.
- Protection from creditors and legal judgments.
- Potential favorable tax treatment of employer securities (NUA).
- A loan feature available from an employer-sponsored retirement plan.

Traditionally, many of these factors have been overlooked by individuals who lacked the expertise and/or knowledge about the advantages and disadvantages of the options available to them when faced with a decision about what to do with the money in an employer-sponsored retirement plan. Hopefully, the result of this FINRA Notice will be that more individuals receive the guidance they need from financial services organizations to make the right decisions about their retirement assets and IRA rollovers.

SEC National Exam Program: Examination Priorities for 2014

On January 9, 2014, the National Examination Program (NEP) from the Securities and Exchange Commission (SEC) Office of Compliance and Examinations published its 2014 priorities.[3] This list of priorities identifies areas that the NEP staff perceives to have heightened risk. In particular, the most significant initiatives across the entire NEP included closer examination of retirement plans and IRA rollovers.

This examination priority specifically focuses on individuals who are changing employment or entering retirement and are left with multiple options as to the handling of their retirement plan assets held at their former employer.

The SEC staff was undertaking several initiatives, including:

- Examining the sales practices of investment advisors targeting retirement-age workers to roll over their employer-sponsored retirement plan into higher-cost investments, including whether advisors are misrepresenting their credentials or the benefits and features of IRAs or other alternatives.
- Examining investment advisors for possible improper or misleading marketing and advertising, conflicts, suitability, churning, and the use of potentially misleading professional designations when recommending the movement of assets from a retirement plan to an IRA in connection with a customer's change of employment.

As you can see from this ruling in early 2014, 2013 marked an inflection point with respect to IRA planning. We began to see acknowledgment that the retirement planning process and, in particular, IRA planning issues, are relatively complex and the guidance and advice from financial services organizations are critically important to the financial well-being of today's retirees. As you'll see further on in this paper, 2014 produced some significant changes to retirement and IRA planning that reinforce the importance of working with a knowledgeable financial professional.

In-Plan Roth Conversions

Background

The American Taxpayer Relief Act (ATRA) of 2012 made it easier for employer-sponsored retirement plan participants to convert from their traditional retirement plan (e.g., 401(k)) to a Roth version of their plan (e.g., Roth 401(k)). Most importantly, ATRA allowed plan participants to convert vested non-Roth balances that are not distributable from the plan to Roth balances, provided the plan permits Roth contributions.

Current Guidance

On December 11, 2013, the IRS published Notice 2013-74[4] to provide additional guidance on in-plan Roth conversions that clarified the rules relating to in-plan Roth conversions. This guidance included the following:

- For plans with a designated Roth account, any vested amount held in the plan is eligible for an in-plan Roth rollover to a designated Roth account in the same plan. However, plan sponsors can restrict the type of contributions eligible for, and the frequency of, in-plan Roth conversions.
- Unvested account balances are not eligible to be converted to Roth balances.
- In-plan Roth conversions of otherwise non-distributable amounts, including contributions and earnings, remain subject to the same plan distribution restrictions that applied prior to the conversion.
- In-plan Roth conversions of an otherwise non-distributable amount must be made as an in-plan direct rollover. Unlike an indirect rollover, there is no mandatory withholding requirement. Furthermore, because the amount is non-distributable, no part of the rollover may be withheld for voluntary withholding. Therefore, an employee making an in-plan Roth rollover may need to increase their tax withholding or make estimated tax payments to avoid an underpayment penalty.
- The five-year period of participation that is required for a qualified distribution begins on the earlier of the first day of the first taxable year in which the employee makes an in-plan Roth contribution or an in-plan Roth rollover if the rollover is the first contribution made to an employee's designated Roth account.
- An in-plan Roth rollover is treated as a distribution for purposes of determining eligibility for the special tax rules on Net Unrealized Appreciation (NUA) for employer securities, even if the rollover is made by an in-plan Roth direct rollover.
- There is no 10% additional tax on funds rolled over from a traditional pretax plan account to a designated Roth account prior to 59 ½. However, if a plan participant withdraws all or part of the in-plan rollover from a designated Roth account within five years of the rollover, the participant's withdrawal may be subject to the 10% additional tax on early distributions under IRC Section 72(t).

Distinctions between Designated Roth Accounts and Roth IRAs

There are two separate sets of rules for Designated Roth Accounts and Roth IRAs. The following summarizes some of the key distinctions between the two types of accounts.

- An individual may establish a Roth IRA and roll over an eligible rollover distribution from a designated Roth account to that Roth IRA even if such individual is not eligible to make regular Roth IRA contributions.
- The 5-year period for determining a qualified distribution from a Roth IRA begins with the earlier of the taxable year in which the Roth IRA was established or the taxable year in which a rollover contribution from a designated Roth account is made to the Roth IRA. The 5-year period of participation used to determine qualified distributions from a designated Roth account does not count toward the 5-year period of participation for qualified distributions from a Roth IRA.

- Amounts distributed from a Roth IRA may be rolled over or transferred only to another Roth IRA. They are not permitted to be rolled over to a designated Roth account. The same rules apply even if all the amounts in the Roth IRA are attributable to a rollover distribution from a designated Roth account in a plan.
- A designated Roth account is subject to the required minimum distribution (RMD) rules that apply to all employer sponsored retirement plans. However, the RMD rules do not apply to Roth IRAs while the owner is alive.
- Unlike Roth IRAs, in-plan rollovers to a designated Roth account cannot be recharacterized (i.e. undone to reverse the tax liability on conversion).

Planning Considerations

For individuals who have an employer-sponsored retirement plan that includes a designated Roth option, availability of in-plan Roth conversions can serve as an effective tax management feature.

Plan participants typically need to make an election regarding their annual plan contributions near the end of the year prior to the year of their actual contributions. Assuming the plan offers a Roth option, the plan participant typically has to decide if they want their plan contributions to be made on a pretax basis (traditional) or an after-tax basis (Roth). Prior to the new in-plan Roth conversion flexibility, significant limitations existed to later transfer traditional plan contributions and earnings to the designated Roth account. The only recourse plan participants had was to change the destination of future contributions or satisfy strict eligibility requirements for a Roth conversion.

In-plan Roth conversions now provide additional flexibility and planning options to plan participants. Under the new law any plan participant, regardless of age or employment status, can convert all or a portion of their vested traditional plan assets to a Roth version of the same plan as long as the plan allows. Because many individuals may not have a sense of what their tax status may be over the course of the upcoming year, the ability to convert traditional plan assets into the Roth option may be advantageous given the client's tax status at year-end or in subsequent years.

For example, a plan participant could start the year off by making pretax contributions to a traditional 401(k) to reduce their taxable income. Later in the year, when they have a better sense of their tax liability, they can choose to convert all or a portion of the vested balance to the in-plan Roth option and pay taxes on their retirement plan amounts now rather than when they withdraw them in retirement.

Along the same line, individuals who expect to be in a higher tax bracket when they retire or have tax deductions that can be used to offset the tax cost of a conversion, may find an in-plan Roth conversion to be tax efficient. Keep in mind, however, that unlike a Roth IRA, in-plan Roth conversions cannot be undone (aka. recharacterized). Therefore, consideration of the timing or asset allocation of the converted amount may be worthwhile.

Others who may benefit from an in-plan Roth conversion are high net worth individuals who don't need or want all of their money in the retirement plan, but would like it to grow as an income tax-free inheritance for their spouse or children. Once amounts in your employer-sponsored plan are converted to a designated Roth account, future earnings grow tax-free and these tax-free amounts can be passed on to beneficiaries. Unlike Roth IRAs, however, designated Roth accounts are subject to RMDs. Therefore, individuals who would like to take advantage of this strategy should be cognizant of their eligibility to roll over their designated Roth account to a Roth IRA prior to age 70½ and the five-year period for qualified distributions from the Roth IRA.

Tax diversification plays an important role in the retirement planning process. This new flexibility for eligible plan participants to predetermine the tax status of their retirement assets provides an important and beneficial planning opportunity.

New Once-Per-Year Rollover Rules

Background: The Bobrow Decision[5]

In 2008, Alvan and Elisa Bobrow engaged in a series of indirect IRA rollover transactions that drew the attention of the IRS. The Bobrows claimed that all of their IRA distributions were properly rolled over while the IRS claimed that only one of their IRA distributions was rolled over successfully. The U.S. Tax Court agreed with the IRS, contradicting a long-standing IRS position.

Prior to the Bobrow case, many individuals and financial professionals believed that the once-per-year rollover rule that applied to 60-day IRA-to-IRA rollovers was applied on an IRA-by-IRA basis. On March 20, 2014, the IRS released announcement 2014-15[6] that provided new guidance on the once-per-year IRA rollover rule. In light of the Tax Court's decision in the Bobrow case, the IRS has ruled that the once-per-year rollover rule applies to the aggregate of all of an individual's IRAs and not on an IRA-by-IRA basis. This new guidance contradicted what was previously considered an acceptable, and fairly common, IRA transaction. In fact, the authors of IRS Publication 590 (2013) even got it wrong!

When this decision was published many individuals became concerned about the status of IRA transactions they had engaged in prior to the decision. Fortunately, the IRS decided not to enforce the Bobrow decision retroactively and stated in its Announcement that in no event would the new regulation be effective before January 1, 2015. The IRS has also implied that the same rule will apply to rollovers between Roth IRAs.

Transition Rules for 2014 and 2015

On November 10, 2014, the IRS released Announcement 2014-32[7] that confirmed that the IRS will be applying the Bobrow aggregation rule to distributions occurring after January 1, 2015, and provided guidance on how it would apply the rule to any rollover that involves an IRA distribution occurring before January 1, 2015. The Notice also clarified that the aggregation rule applies across all types of IRAs owned by an individual.

IRS Announcement 2014-32 provides a special transition rule for distributions in 2014 and 2015. Under this transition rule, an IRA distribution occurring in 2014 that was rolled over to another IRA can be ignored for purposes of determining whether a 2015 distribution can be indirectly rolled over within 60 days. Consistent with prior rollover rules, this transition rule applies only if the 2014 and 2015 distributions are from different IRAs and neither IRA made nor received the 2014 rollover distribution.

In addition, the new announcement clarifies that the IRS will apply the Bobrow aggregation rule across all types of IRAs owned by an individual. In other words, a rollover between an individual's Roth IRAs would preclude a separate rollover within the one-year period between the individual's traditional IRAs including Simplified Employee Pension (SEP) and Savings Incentive Match Plan for Employees (SIMPLE) IRAs.

"Rollover" Methods Approved by the IRS

While the IRS has tightened the rules on IRA-to-IRA rollovers, it's important to keep in mind that, generally speaking, this decision should have little impact on an individual's ability to move money between retirement accounts of any kind. That's because the IRS provides several options for moving money between retirement accounts that were not impacted by the Bobrow decision (as clarified in Announcement 2014-32). These options include:

- **Trustee-to-trustee transfers–**Funds go directly from one IRA custodian to another without the account owner taking possession of the funds while they are moving between IRAs. Sometimes referred to as a "direct-transfer," this type of IRA-to-IRA transfer can happen at any time and as often as you like. The IRS actually encourages IRA trustees to offer IRA owners this option.
- **Qualified plan-to-IRA rollovers–**The once-per-year rollover rule applies to IRA-to-IRA rollovers only, and does not impact this type of rollover. However, if you want to avoid the potential risk of missing the 60-day deadline, plan participants should request a "direct-rollover," which is similar to a trustee-to-trustee transfer mentioned previously. The plan assets are transferred directly to the IRA custodian without the plan participant taking possession of the funds while they are moved from the qualified retirement plan to the IRA.
- **IRA-to-qualified plan rollovers–**Similar to the qualified plan to IRA rollover transaction mentioned above, this type of transaction would be exempt from the once-per-year rule as well.
- **Roth IRA Conversions–**If assets in a traditional IRA or qualified plan are rolled over to a Roth IRA either directly or indirectly, typically referred to as a conversion, it will not count as a rollover for purposes of the once-per-year rule.

Planning Considerations

In light of the approved "rollover" methods listed above, it seems the intent of the court in the Bobrow case was to dissuade people from taking advantage of the 60-day IRA-to-IRA rollover rule. Therefore, effective January 1, 2015, individuals should plan accordingly as rollovers in violation of this rule may be taxable and subject to the 10% additional federal tax on pre-59½ distributions. Furthermore, if an erroneous rollover is processed it may be treated as an excess IRA contribution subject to an additional 6% federal tax.

While it isn't often that the IRS makes a determination in a court case that is this controversial, the rules can change—even rules that seem like long-standing conventional wisdom.

Federal Bankruptcy Law and Inherited IRAs

Background

This issue of inherited IRAs being treated as "retirement assets" has been debated for years in the federal bankruptcy courts. The debate had primarily focused on the issue of determining whether or not an inherited IRA is considered a retirement account in the hands of the beneficiary.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) afforded bankruptcy protection to retirement funds. BAPCPA provided bankruptcy protection for the cumulative value of IRAs and Roth IRAs up to $1 million, adjusted for inflation (currently $1,245,475). Employer-sponsored plans governed by ERISA were afforded an unlimited exemption. The 2005 changes to the Bankruptcy Code did not explicitly address whether an inherited IRA is entitled to the same exemption that is available to retirement plans and IRAs.

Supreme Court says IRAs are not "Retirement Assets"

On June 12, 2014, the U.S. Supreme Court ruled unanimously in *Clark v. Rameker*[8] that inherited or "beneficiary" IRAs are not protected in bankruptcy under federal law. While the protection of retirement funds has traditionally seemed relatively straightforward, the issue that was brought before the Court focused primarily on the definition of retirement funds with respect to inherited IRAs. One side argued that an inherited IRA was still a retirement account regardless of its present owner or status. The other side argued that inherited IRAs should not be considered retirement funds in the spirit of protection afforded under BAPCPA. According to the Court, whether an account consists of "retirement funds" depends on the objective "legal characteristics" of the account and not on any subjective intent of the account holder.

Here the Court examined three legal characteristics of inherited IRAs.

1. The holder cannot make additional contributions to the account.
2. The holder is required to withdraw money from the account no matter how close the holder is to retirement.
3. The holder may withdraw the entire balance of the account at any time without imposition of the 10% additional federal tax under IRC Section 72(t).

These three characteristics led the Court to conclude that inherited IRAs are not "retirement funds" objectively set aside for one's retirement. In summation, the Supreme Court was swayed by the argument that when IRA funds pass from the original owner to the beneficiary, the character of the funds change from retirement assets to non-retirement assets, and therefore they are not exempt under the applicable federal bankruptcy code provision.

Uncertainty for Spouse Beneficiaries of IRAs

This decision by the Court has resulted in some uncertainty regarding the status of IRAs that are inherited by a spouse. Keep in mind that a spouse can treat the deceased spouse's IRA as an inherited IRA or transfer the assets into their own IRA. The Supreme Court's decision did not explicitly address this issue or make a determination between a spouse who elects to treat the IRA as an inherited IRA versus a spouse who elects a spousal rollover into their own IRA. However, the Internal Revenue Code (IRC) does distinguish between spousal beneficiaries and non-spousal beneficiaries on a variety of issues. This may imply that the federal bankruptcy court would view assets inherited by a spouse more favorably. A view held by some is that a retirement asset of one spouse would be viewed as a retirement asset of both spouses. To date however, there is no certainty on this issue. Therefore, it may be wise to consider alternatives when bankruptcy may be an issue for spousal IRA beneficiaries.

Planning Considerations

Although the Supreme Court's decision concluded that inherited IRAs are not protected from bankruptcy under federal bankruptcy statutes, state bankruptcy statutes may provide bankruptcy protection or creditor protection in non-bankruptcy situations for inherited IRAs. In fact, these seven states currently have laws expressly exempting inherited IRAs under state bankruptcy statutes: Alaska, Arizona, Florida, Missouri, North Carolina, Ohio, and Texas. Certain other states may offer similar protections via court decisions. If you have questions regarding exemptions provided by your state of residence, you may want to consult with a bankruptcy attorney for additional information regarding what assets may or may not be protected.

If an individual does not reside in a state that affords bankruptcy or creditor protection to inherited IRAs, another alternative may be to establish a trust as the beneficiary for IRA assets. A properly drafted trust that includes spendthrift and "look-through" provisions can help shield inherited IRA assets from the claims of creditors while still allowing the trust to "stretch" distributions over the life expectancy of the trust's oldest beneficiary. Keep in mind, however, that trusts could result in additional fees and expenses, and may incur higher taxes.

Individuals should periodically review beneficiary designations to ensure they reflect their current intentions and any changes in their personal life or family structure. In light of this new ruling, it's also important to consider the personal and financial situations of the beneficiaries themselves. There are many considerations to take into account when naming an individual, entity, or a trust as the beneficiary of inherited assets. Consultation with a knowledgeable financial professional can help individuals obtain the right information to make the right decisions for their personal planning needs and circumstances.

Tax-Free Roth Conversions of After-Tax Plan Funds

Background

For many years, interpretations varied within the financial services industry regarding the distribution and rollover rules applicable to distributions from qualified plans that contained both pretax and after-tax amounts. As a result, plan providers were inconsistent in their interpretation of distributions to separate destinations. In addition, the safe harbor interpretations in IRS Notice 2009-68, treating distributions to different destinations as separate distributions, could be avoided through a series of steps involving an indirect 60-day IRA rollover. (*See IRC Section 402(c), 402(A), and IRS Notice 2009-68)*

New Guidance: Multiple destinations are treated as single distributions

On September 18, 2014, the IRS released Notice 2014-54[9] Guidance on Allocation of After-Tax Amounts to Rollovers, which provides guidance on the taxation of various transactions when assets withdrawn from an employer-sponsored retirement plan contain both pretax and after-tax funds. One of the most important financial planning features of this new guidance is that it allows plan participants who have pretax money and after-tax money in their qualified plan to allocate the pretax amount and the after-tax amount to separate traditional IRA and Roth IRA accounts. The new guidance is effective for distributions made on or after January 1, 2015; however, it may be relied upon as of the date of the Notice and relief is provided for individuals who may have engaged in the referenced transactions prior to the Notice.

The new guidance treats plan distributions that are transferred to multiple destinations as a single distribution for applying the pretax first rule. In particular, Notice 2014-54 states that "all disbursements of benefits from the plan to the recipient that are scheduled to be made at the same time are treated as a single distribution without regard to whether the distributions are made to a single destination or multiple destinations. In effect, this guidance permits an individual to direct the pretax portion of a distribution to one destination (e.g., traditional IRA) and the after-tax portion to a different destination (e.g., Roth IRA).

It's worth noting that distributions from employer-sponsored plans are still made on a pro-rata basis, so adherence to the distribution and ordering rules of Notice 2014-54 is important. For example, an individual cannot "cherry pick" just the after-tax portion of their plan assets and have them directly rolled over to a Roth IRA. Each distribution from the plan will still be made on a pro-rata basis and will consist of a proportionate amount of pretax and after-tax amounts, as was the case prior to Notice 2014-54. Instead, Notice 2014-54 provides guidance on how the plan can split a pro-rata distribution and direct it to separate accounts.

For example, assume an individual has $10,000 in their employer's 401(k) plan; $8,000 of pretax contributions and earnings and $2,000 of after-tax contributions, and that the entire amount is eligible to be distributed and rolled over to the individuals traditional and Roth IRAs. This individual cannot request that just the $2,000 after-tax amount be distributed and rolled over to their Roth IRA. In fact, a $2,000 distribution would consist of a pro-rata amount of pretax and after-tax amounts (i.e., $1,600 pretax and $400 after-tax). The individual could, however, request that the $1,600 pretax amount be rolled over to their traditional IRA and the $400 after-tax amount be rolled over to their Roth IRA.

Ordering Rules for Multiple Transactions

Notice 2014-54 goes a step further by also designating a specific set of ordering rules for a series of transactions. In summation, pretax portions of a plan distribution are allocated first to direct rollovers, then to indirect, 60-day rollovers, and finally to amounts paid directly to the recipient.

For example, a plan may only permit one direct rollover per distribution. In this case, the individual may be required to request a direct rollover of their pretax funds to a traditional IRA and an indirect rollover of their after-tax funds to a Roth IRA. As mentioned previously, all disbursements of benefits from the plan to the recipient that are scheduled to be made at the same time are treated as a single distribution without regard to whether the distributions are made to a single destination or multiple destinations. Although the plan participant may be limited to the number of direct rollovers that may be made in a given time period, as long as the distributions occur at the same time they can elect multiple distribution transactions (i.e., a direct rollover of pretax amounts to a traditional IRA and an indirect rollover of the after-tax amounts to a Roth IRA). This guidance applies only to distributions from employer-sponsored retirement plans. It does not apply to distributions from traditional IRAs.

Planning Considerations

Individuals should check with their retirement plan providers to see if they have any after-tax amounts in their retirement plans. They should also check to see if there are any plan limits on the number of direct rollovers the plan will accommodate within a specific time period. If an individual has after-tax amounts in their retirement plan, they should meet with their financial professional to ensure that any rollover transaction be carefully reviewed in light of the recent guidance issued in Notice 2014-54.

In addition, individuals may want to check to see if their retirement plans permit after-tax contributions. If an individual is in a position to save additional after-tax dollars, and is ineligible or has already contributed the maximum amount to a Roth IRA, after-tax contributions to an employer-sponsored retirement plan may be an alternative. When the participant becomes eligible for distribution from the retirement plan, they may be able to roll over the after-tax amount to a Roth IRA.

A word of caution: Retirement plan contribution and distribution rules vary and can be somewhat complex, so individuals should review this transaction carefully with their plan provider.

The guidance provided in Notice 2014-54 may seem like common sense but existing IRS regulations on distributions from employer-sponsored plans may create some uncertainty regarding this transaction. Also, IRS rules regarding distributions still make this transaction somewhat complex. Individuals may want to consult with a knowledgeable financial professional before engaging in this transaction.

Qualified Longevity Annuity Contracts (QLACs)

Background

In 2010 the U.S. Treasury Department requested ideas from the insurance industry on how to facilitate greater availability of lifetime income options in retirement plans and IRAs. Respondents urged the government to amend Internal Revenue Code (IRC) section 401(a)(9) regulations to remove the impediments of required minimum distributions (RMDs) to offering deferred income annuities (DIAs) in those markets. In general, the final regulations adopted this recommendation and exclude DIAs from the account balance used to determine RMDs as long as the DIA contract meets the definition of a Qualified Longevity Annuity Contract.

The QLAC

On July 1, 2014, the Treasury Department issued final regulations for Qualified Longevity Annuity Contracts (QLACs) in Internal Revenue Bulletin 2014-30.[10] These new DIAs provide a unique retirement planning option for assets held in certain qualified plans and IRAs.

The key provisions of QLACs are as follows:

- The amount used to purchase a QLAC is limited to the lessor of 25% of the individual's account balance or $125,000.
- The value of the QLAC will be exempt from RMDs.
- QLAC distributions must begin by age 85; distributions at an earlier age are permitted.
- QLACs may offer a return of premium death benefit, payable in a lump sum.
- QLACs may offer life annuity death benefits for spouse and non-spouse beneficiaries.
- To date, QLACs must be fixed annuities.
- QLACs may not offer a commuted benefit or cash surrender value.

Planning Considerations

QLACs were essentially created to provide longevity insurance in retirement. By placing up to $125,000 into a deferred annuity until age 85, an individual can plan on a lifetime stream of income later in life. However, keep in mind that the decision to purchase a QLAC may be a permanent decision that cannot be undone. In other words, an individual may not have access to these funds in the interim.

Some individuals may see a benefit in using a QLAC to avoid RMDs on the amount they allocate to it. While this is true, the avoidance of RMDs through the use of a QLAC should be weighed against other planning opportunities that may be available. For example, a Roth conversion, while taxable, will allow assets to grow tax deferred and avoid RMDs. A Roth IRA may also provide greater asset allocation options than a QLAC. An individual may also consider reinvesting the RMDs from their IRA or qualified plan. By accumulating assets in a nonqualified account, an individual could maintain access to the funds and purchase a single premium immediate annuity (SPIA) at a later age.

QLACs are relatively new and we may see them evolve as time goes on. If an individual feels this type of product may be right for them, they may want to consult with a financial professional to see if a QLAC meets their needs in retirement, and to explore other options that may be better suited to their specific financial needs and circumstances.

Conclusion

The rules and regulations for retirement plans and IRAs are complex and subject to change. For individuals contemplating retirement it can be overwhelming. For many, unfamiliarity with the rules has derailed their retirement plans and resulted in costly and unfortunate mistakes.

The financial services industry has, for many years, tried to help individuals navigate the challenges of saving and retirement. An abundance of general guidance and information is available to point people in the right direction and to help them make the right decisions. However, a significant limitation exists. General guidance and information, by nature, cannot address the importance of individual circumstances in the retirement planning process.

For individuals who plan to navigate the challenges of retirement planning on their own, a word of caution: even experienced professionals find retirement planning to be a significant challenge. The depth and breadth of the issues to be considered are not only extensive but vary based on individual circumstances. The financial regulatory authorities have also found that general information and “rules of thumb” are insufficient in helping individuals understand basic transactions and the importance of personal circumstances in the decision-making process.

Considering the complexity of the rules and regulations and the challenges people face in simply navigating retirement, proper guidance and advice has never been more important, or needed, than it is today. Individuals have a choice about where to get the information they need to make decisions that are right for them. One of the most important things a person can do, as they contemplate retirement, may be to find a knowledgeable financial professional who can provide the proper guidance and advice that is right for them.

Sources

[1]Government Accountability Office (GAO), ***Labor and IRS Could Improve the Rollover Process for Participants***, March 2013

[2]FINRA Notice 13-45, December 2013

[3]National Examination Program (NEP) from the Securities and Exchange Commission (SEC) Office of Compliance and Examinations, January 9, 2014

[4]IRS Notice 2013-74, December 11, 2013

[5]*Alan L. Bobrow v. Commissioner*, TC memo 2014-21, Docket No. 7022-11, January 28, 2014

[6]IRS 2014-15, March 20, 2014

[7]IRS Announcement 2014-32, November 10, 2014

[8]*Clark v. Rameker*, Trustee, et al., Supreme Court of the United States, No. 13-299, June 12, 2014

[9]IRS Notice 2014-54, September 18, 2014

[10]Internal Revenue Bulletin 2014-30, July 1, 2014

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