

Sample Client Letter on Rolling Over Nonspouse Qualified Plan Benefits

February 2007

To our Clients and Friends:

A recent law change made an important improvement for certain beneficiaries of a company's defined contribution retirement plan, such as a 401(k) plan. For the first time, heirs of a plan participant will potentially be able to rollover the participant's account to an IRA even though they're not the plan participant's spouse. (Surviving spouses were able to do this even under the prior law.)

The ability to roll over the funds to an IRA offers the opportunity to defer the tax that would otherwise be due if the entire inherited amount was distributed in a lump-sum. For example, suppose that Sarah inherits her uncle's \$100,000 401(k) account at this death. Under pre-2007 law, she would likely have received the full \$100,000 in a single distribution and be taxed in the year of receipt.

Under the newly revised law, if the company's plan allows it, Sarah can instruct the 401(k) plan sponsor/administrator to do a trustee-to-trustee transfer of the \$100,000 to an IRA that she sets up just for receiving the distribution. She can then spread out the distributions over a period of years—thereby allowing the funds to build up tax deferred. (If she chooses this approach, she will always have the option to accelerate the distributions if she needs the cash.) The difference between taking the money now in a lump sum versus leaving it in an IRA as long as possible can be in the tens of thousands of dollars (or more), depending on the size of the inherited account. The timing of the transfer may be critical as well.

There is really no downside to rolling over the inherited retirement account to an inherited IRA, as you can always take the money out if desired or needed. However, for a rollover to be tax free, you must arrange for a trustee-to-trustee rollover from the plan directly to a new IRA established for this purpose. Do not take the cash and plan on rolling it over later, as this will not work. Also, the funds should not be transferred to an existing IRA, nor should any additional contributions be made to this new IRA. Furthermore, the IRA must be titled as an inherited IRA, e.g., Sarah Stephens as beneficiary of Sam Adams' IRA. Finally, in certain circumstances, the rollover will need to be completed no later than the year after the account owner's death.

If you'd like to find out more about this new rollover option please call us.

Best regards,