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"Choate's Notes"

"Choate's Notes" is a newsletter with interesting tidbits for professionals, mainly on the subject of estate planning for retirement benefits. It is sent by first class mail only, and as of now is free. (Advertisements are enclosed with the newsletter, so that's why it's free.) The publication schedule is extremely irregular. Back issues will be published at this website; the current issue becomes a "back issue" when a new issue is published.

If you would like to be on the mailing list, please email your name and (regular postal) mailing address to me at this website. You MUST include your professional title and/or the name of your firm. Choate's Notes is only for professionals in the estate planning, retirement plan or money management business, including lawyers, paralegals, accountants and other tax professionals, money managers, financial planners, life insurance and annuity sellers, plan administrators, IRA providers, mutual fund companies, trust officers, and actuaries.

Choate's Notes **Vol. 1, No. 2** **November 1, 1999**

A free newsletter for estate planners///*From Natalie B. Choate*

Dear estate planning professional:

Bruce Temkin's book **The Terrible Truth About Investing** has finally been published, to critical acclaim. My blurb for the back cover was almost rejected by the publisher because I just said it was a terrific book about the principles of investing, whereas all the other (more prestigious) reviewers outdid each other comparing the book to Shakespeare, the Bible, etc. Everyone who advises retirees should read this book. Some very prominent financial planners have already changed their investment approach based on this book. It can be purchased by calling Fairfield Press, 1-888-820-5958. The original cover price was $29.95; mention **Choate's Notes** and get it for $24.95.

If you have been looking for a good book for *non*-professionals on retirement distribution planning, you've found it: **IRAs, 401(k)s & Other Retirement Plan: Taking Your Money Out**, by Twila Slesnick, PhD, Enrolled Agent, and Attorney John C. Suttle, CPA (Nolo Press, $21.95), available through Amazon.com. The authors not only know their stuff, they put great thought and care into producing a user-friendly book. Example: each chapter begins with "who should read this chapter," and contains its own mini-glossary. Plus it has a beautiful yellow and red cover—your clients will love it. I wish I had written it.

I get almost as many questions about self-publishing as I do about retirement plan distributions. If you are an author or would like to be, be sure to read **The Self Publishing Manual** by Dan Poynter, available in the writer's reference section of any bookstore or through the website www.parapublishing.com. I followed Dan's instructions to the letter in publishing *Life and Death Planning for Retirement Benefits*. I thank my lucky stars *Life and Death* was rejected by the only "real" publisher I submitted it to, so I can keep all the profits on the 7,000-plus copies I've sold.

Already I'm getting questions on the new edition of *Life and Death*. On page 291 I say that, it *might* be advantageous to leave retirement benefits to a charitable lead trust (CLT), "if the distributions from the retirement plan can be matched to the lead-interest distributions to the charity." I've been asked, how could the distributions be so matched, since a CLT cannot be a "designated beneficiary" (DB)? The answer is, such matching could occur only in very particular circumstances. To wit: if the participant (P) dies before his required beginning date (RBD), distributions could be spread out over five or six taxable years. If P dies on or after his RBD, and was taking distributions over his single life expectancy unrecalculated; or over the joint life expectancy (unrecalculated) of himself and a DB who was living on P's RBD but then predeceased P; the distributions can continue, after P's death, over the remaining single or joint life expectancy period. These are the payouts that conceivably could be arranged to match the lead payout to a charity under a CLT.

My speaking schedule, and list of available seminar topics, are posted at my website, **www.ataxplan.com**. If your group or company invites me to speak when I'm already in the neighborhood anyway, you can save on travel expenses. Until the next issue,

--Natalie B. Choate

Keogh Kapers

A "Keogh plan" (or "H.R. 10 Plan") is a qualified retirement plan that covers one or more self-employed individuals. The Tax Reform Acts of 1984 and 1986, and the Unemployment Compensation Amendments of 1992, eliminated almost all of the distinctions that once existed between these plans and the plans of *corporate* employers regarding contributions, rollovers and distributions. For a collection of the old differences, see Treas. Reg. § 1.401(e)). There are still some differences of interest to planners, however. This one-page summary gives an overview; for the nuances and exceptions, see the cited Code sections.

Definitions: A "*Self-employed person*" is an individual who has self-employment income. § 401(c)(1). A Self-employed person is the opposite of a "common law employee" (or, as the Code calls it, "an individual who is an employee without regard to§ 401(c)(1)"), who is an employee of someone else (not himself).

"*Owner-employee*" is a subcategory of Self-employed person. An "Owner-employee" is the sole proprietor of an unincorporated business, or a partner "who owns more than 10 percent of either the capital interest or the profits interest" in the partnership. § 401(c)(3). This author has not found a clear rule as to *when* this 10% test is applied; do we test only at the end of the plan year? Or must we determine whether the individual owned more than 10% of the capital *at any time during* the year? And is the test applied yearly? Or is the individual considered *forever* an Owner-employee if he was *ever* an Owner-employee? Compare Regs. §§ 1.401-11(e) and 1.401(e).

Lump sum distributions: A lump sum distribution (LSD) may qualify for special tax treatment under Code § 402(d)/(e); see Chapter 2 of *Life and Death Planning for Retirement Benefits*. A LSD is a distribution of the participant's entire account balance within one calendar year following the most recent "triggering event." "Triggering events" are: for EVERYBODY, turning age 59½ or dying; for Self-employed persons ONLY, becoming disabled; and for common law employees ONLY, separation from service. § 402(d)(4)(A).

Premature distributions: A distribution from an employer plan made to an employee "after separation from service after attainment of age 55" is exempt from the 10% "premature distributions" penalty (see Chapter 9 of *Life and Death Planning for Retirement Benefits*). § 72(t)(2)(A)(v). Although § 72(t) does not specifically exclude the Self-employed from using this exception, it is not clear what would constitute "separation from service" for a sole proprietor.

Premature distributions, continued: In years after 1996, a person who has "received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law" can take penalty-free distributions from his IRA to pay health insurance premiums. § 72(t)(2)(D). The IRS, in regulations, can permit Self-employed persons to use this exception, but no such regulations have yet been issued.

Life insurance: Generally, if a qualified plan maintains a life insurance policy on the life of a participant, the participant must include the "P.S. 58 cost" of the insurance in his income each year; see Chapter 10 of *Life and Death Planning for Retirement Benefits*. Unlike all other participants, however, an Owner-employee does not get to treat the accumulated P.S. 58 cost (that he has paid tax on) as an "investment in the contract" (basis) for income tax purposes. Reg. § 1.72-16(b)(4).

Choate's Notes **Vol. 1, No. 1a** **June 1, 1999**

A free newsletter for estate planners///From Natalie B. Choate

Dear estate planning professional:

Finally, an easy, **free** and timely way to get the IRS's monthly "Section 7520 rate" (needed for computing gift and estate tax values for annuities, life estates, remainders, CRTs, QPRTs, etc.): the rates are posted at Larry Katzenstein's Tiger Tables software website, **www.tigertables.com**. The new edition of Tiger Tables, due out soon, will incorporate the new IRS actuarial tables.

Every adult should read and complete the booklet "**Let The Choice Be Mine: A Personal Guide to Planning Your Own Funeral**." Estate planners should buy them by the dozen to hand out to clients. This tasteful, careful, informative and thoughtful guide to the more than 50 decisions involved in planning a funeral and burial is written by Cathy Robertson, who learned from her family's background in the funeral business and from her personal experience in planning family funerals. Why didn't someone think of this before? To order, send check payable to MCR, PO Box 1922, Sandpoint, ID 83864, or call (208) 263-8960; email cathy@televar.com. Specify traditional, Catholic or Hispanic. Price is, for one copy $6, plus $2 shipping and handling; 10 copies, $40 plus $5 shipping and handling; call for prices for larger quantities and for personalization details.

My "trust drafting checklist" (to test whether a trust complies with the IRS's proposed regulationsregarding retirement benefits payable to trusts) is now posted at my website, **www.ataxplan.com**.

Until the next issue, --Natalie B. Choate

The Limbo Period

The "limbo period"for minimum required distributions (MRD) begins on January 1 of the year the participant reaches age 70½ and ends on April 1 of the following year (the required beginning date, or RBD).[1] What makes this interim time odd is that, technically, there *is* a minimum distribution required for the year in which the participant reaches age 70½. The IRS calls this "the first distribution calendar year," even though the law allows the participant to postpone that first MRD until April 1 of the year following the year he reaches age 70½. Prop. reg. § 1.401(a)(9)-1, F-1(b). But, if the person *dies* during this time, he has died *before* his RBD.

Here are the special rules that apply during the limbo period:

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[1] The RBD is later for certain individuals in certain plans. § 401(a)(9)(C).

1. In the year a person reaches age 70½, he cannot do a rollover to an IRA from a plan (or another IRA) until *after* he has taken the MRD from such plan (or other IRA). Similarly, he cannot convert a traditional IRA to a Roth IRA until he has taken the MRD from the traditional IRA; and if this MRD pushes him over the $100,000 income limit, too bad—he is ineligible to convert to a Roth. This is true even though, if it weren't for converting to a Roth (or doing some other form of rollover), the participant wouldn't actually be required to take any minimum distribution until April 1 of the *following* year. Treas. Reg. §§ 1.402(c)(2), A-, 1.408A-4 (Q & A 6).

2. There is an obscure rule for determining the amount of the first MRD. MRDs after the RBD are based on the choice of designated beneficiary as in effect *on* the RBD[2]. However, for the *first* MRD (the one that must be made on or before the RBD) "designated beneficiary" has a special definition: It can mean any person who was named as the designated beneficiary at any time from January 1 to April 1 of the year of the RBD. Prop. reg. § 1.401(a)(9)-1, D-3(b). So, if you have a client who has changed his designated beneficiary between December 31 of the year he turned 70½ and the RBD, his first MRD can be based on whichever beneficiary named during that period produces the most favorable MRD.

3. The final question is, which set of distribution rules governs when a person dies during the limbo period? Here the rule is crystal clear. If the participant dies before the actual required beginning date, the distribution of benefits is governed by § 401(A)(9)(B)(ii), (iii) and (iv)—*i.e.*, the five year rule and its exceptions—even though the participant may have already started taking MRDs. Prop. reg. § 1.401(a)(9)-1, B-5. (The only exception would be certain irrevocable annuity elections.) So if a person dies the day before his RBD, without having taken any minimum distributions, those distributions are simply cancelled—nobody has to take them. The first required post-death distribution will be the *following* calendar year (assuming there is a designated beneficiary who elects to use the life expectancy method).

[2] Assuming you don't change your beneficiary *after* the RBD; such changes could further shorten the required minimum distribution payout period.