Nine tips lawyers can give clients to make the most of retirement savings

By Jonathan A. Levy

Saving for retirement is the bedrock of estate planning and elder law. Without it, there may be no estate to plan, no cushion for old age, and no money to leave to children or to charities. Sensible tax and beneficiary elections, as much as thrift and investment success, help preserve a comfortable nest egg. Lawyers can use their expertise to guide clients through the maze. Here is a checklist of nine tips for clients, each followed by a brief explanation for lawyers.

1 Make sure your account records are accurate.

Employees do not always receive the correct payments from retirement accounts. Mistakes happen. Records fade into the mists of mergers and mass layoffs. However, one can reduce the risk of being shortchanged. Those still working should review their periodic plan statements to confirm they are receiving full credit for plan contributions and hours of work.

Retirees and those about to retire should obtain from the plan administrator a written statement of assumptions used to calculate benefits, such as years of service, pay history, age, and projected Social Security benefits (if those reduce pension amounts). Employees have a right to this information under the Employee Retirement Income Security Act of 1974 (ERISA). See 29 U.S.C. § 1025(a); Roeder v. General Signal Corp., 901 F. Supp. 124 (W.D.N.Y. 1995). The data provided should match annual pay statements and similar records. Employees should complain in writing to the account administrator if there is a discrepancy.

2 Obtain a copy of the terms of your retirement accounts and then read those terms, or find someone to interpret them for you.

ERISA imposes many rules for retirement plans. However, plan sponsors may set their own, stricter rules, Prop. Reg. § 1.401(a)(9)-1, Q&A A-3(c), and many sponsors have done so. Participants need to know the terms of their particular plan to make sound choices—which may include moving the funds to a more flexible IRA if the plan is too restrictive.

3 Understand the different ways to withdraw retirement benefits.

Deciding how to withdraw retirement benefits can be intimidating. Life savings are at stake. However, the main alternatives can be readily explained. Clients may either: (1) withdraw the account balance in a lump sum; (2) withdraw the balance and roll it over to an IRA; (3) withdraw money in installments; or (4) take the money as an annuity for life. Some plans do not offer all of these choices. Other plans permit a blend, such as taking part as an annuity and the rest in periodic installments. Nevertheless, understanding the basics will prepare clients for most possibilities.

A lump-sum withdrawal can make sense if the employee is comfortable managing his or her own investments or hiring and monitoring a money manager, or if the employer's plan has poor investment choices or inflexible beneficiary designations. However, many company retirement plans are well run and reasonably flexible.

If an employee takes a lump sum without rolling it over to an IRA (or other tax-deferred account), he or she will owe income taxes on much, if not all, of the withdrawal. Certain special rules for lump-sum distributions may ease the tax bite, but most employees are better off moving the funds to an IRA for continued tax deferral. The best way to do this is with a "direct rollover" in which the funds are transferred directly by the plan administrator to the IRA.

If the funds remain in the retirement plan or are rolled over, most employees (or their surviving spouses) eventually choose between installment payments and a lifetime annuity. An advantage of installment payments is that if the owner dies before the money is used up, the balance belongs to the owner's beneficiaries. Also, payments may increase with inflation. The disadvantage is that the owner can outlive the money.

In contrast, an annuity usually ends at the employee's death (or perhaps the death of the survivor of the employee and spouse). The annuity issuer pockets any remaining funds. Because the issuer can predict actuarially how often this will happen, it can afford to pay more while recipients are alive. For those who surpass their life expectancies, payments continue. Plan sponsors can give projections to compare these alternatives. A CPA or actuary can also help review the numbers.

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Withdrawal choices and other retirement-plan elections mentioned in this article are discussed in greater detail in *Estate Planning for Retirement Benefits with Natalie Choate* (OSB CLE 2000); Natalie Choate, *Life and Death Planning for Retirement Benefits* (3d ed. 1999); Louis Mezzullo, *An Estate Planner's Guide to Qualified Retirement Plan Benefits* (2d. ed. 1998).

4 Consider whether your pension should continue if your spouse survives you.

Married employees may have a choice of taking retirement benefits in the form of an annuity that lasts only for the employee's single life, or a joint annuity with smaller monthly payments that continue while either the employee or the spouse is alive. For many couples, it makes sense to elect to continue the pension for the survivor's life. Otherwise, a spouse who outlives the employee could end up destitute. On the other hand, if the spouse has adequate outside resources, or is sickly and unlikely to outlast the employee, then the greater monthly income to the employee favors a single-life annuity.

The spouse may be able to veto an employee's choice of a single-life annuity. The spouse's rights derive from the Retirement Equity Act of 1984 (REA), which amended ERISA. For pension plans and many defined-contribution plans, a surviving spouse is entitled to (1) a pre-retirement survivor's annuity or (2) a joint-and-survivor annuity, depending on whether the employee dies before or after reaching retirement age. The spouse may consent to a waiver of REA benefits, if the plan complies with complex requirements. See IRC §§ 401(a)(11) & 417; Reg. § 1.401(a)-20; Louis Mezzullo, *supra*, 85-100.

There are no REA rights with IRAs. However, the spouse still may be entitled to some portion of the account that was accumulated during the marriage while the couple lived in a community-property state. See Andrew Pharies, "Community Property Aspects of IRAs and Qualified Plans," *Probate & Property*, Sept./Oct. 1999.

5 Ask the right questions when you hire and monitor your money manager.

An employee who takes a lump sum—whether or not rolled over to an IRA—will likely need to hire and monitor money managers. Possibilities include mutual funds, stockbrokers, bank trust departments, registered investment advisors, and financial planners. Although lawyers cannot give investment advice, they should be familiar enough with investment markets to help clients ask the right questions of potential managers. This calls for a working knowledge of stocks and bonds, mutual funds, portfolio diversification, cash-value life insurance, tax-deferred annuities, and how money managers are paid and regulated.

6 Determine if you qualify for a tax break for lump-sum distributions.

If a client takes a taxable lump-sum distribution from a qualified retirement plan (but not an IRA), special rules may reduce the income taxes due. With ten-year averaging, a qualifying lump sum is taxed separately from other income, and likely at much lower effective rates. Capital-gains treatment offers a lower tax rate on the part of the plan balance attributable to pre-1974 employment. See IRS Form 4972 instructions. Both of these rules are available only to individuals born before 1936.

A third special rule, available to departing employees of any age, involves net unrealized appreciation on an employer's stocks that have been contributed to a retirement account. See IRC § 402(e)(4); Reg. § 1.402(a)-1(b). If the stocks are withdrawn in kind, rather than in cash, as part of a lump-sum distribution, the employee owes income taxes only on the shares' value as of the date of contribution to the account, and not on the (likely greater) value on the date of distribution. The remaining tax is due when the stock is later sold, at favorable capital-gain rates. This tax deferral can be invaluable for low-basis shares.

7 Pick the right IRA beneficiary to stretch out tax deferral.

For a married client, the spouse is normally the best person to name as IRA beneficiary. At the owner's death, the spouse can either (1) keep the money in the IRA and withdraw it, even before age 59, without paying the usual 10% early-withdrawal penalty tax; or (2) convert the account to his or her own IRA, and name new designated beneficiaries. If the new beneficiaries are younger, this can slow down the pace of required distributions, perhaps extending tax deferral by decades.

If the IRA beneficiary is not the owner's spouse, the beneficiary cannot name new beneficiaries at the owner's death. However, if the owner timely complied with the "designated beneficiary" rules of

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Proposed Regulation § 1.401(a)(9)-1, the beneficiary may withdraw the account balance in installments, again with the potential for substantial further tax deferral. If the spouse is already amply provided for, naming children or grandchildren as beneficiaries is often a good choice.

Designating no beneficiary or naming the owner's estate as beneficiary is usually the worst alternative. Depending on the facts, the entire account balance may have to be withdrawn and exposed to income taxes within as little as one year after the owner's death.

Some clients, for estate-planning reasons, wish to name a trust as the retirement plan beneficiary. This brings additional complex rules into play. See Jonathan Levy, "Making Retirement Benefits Payable to Trusts," *OR Estate Planning & Administration Section Newsletter*, June 2000.

8 Don't miss the required beginning date.

The required beginning date (RBD) is a crucial deadline. For most participants the RBD is April 1 of the year after the calendar year in which the participant turns 70. Generally, the RBD is the deadline for retirement plan participants to: (1) start taking minimum required distributions, discussed in the next paragraph; (2) designate a beneficiary, or irrevocably be treated as having no designated beneficiary; and (3) elect whether to "recalculate" their life expectancies for measuring required distributions. Recalculation can have a major impact on tax deferral and the risk of outliving one's retirement benefits. See Natalie Choate, *supra*, at 33-35; Louis Mezzullo, *supra*, at 28.

9 Be sure to withdraw the required minimum distribution each year.

The IRS regulations require that payees of retirement plans, including most IRAs, withdraw a varying percentage of the account balance each year, starting at the required beginning date. Each year's mandatory withdrawal is known as a minimum required distribution (MRD). The account owner is free to take out money faster than the MRD rate. If the actual withdrawal during the year is less than the MRD, the taxpayer owes a 50% excise tax on the shortfall. IRC § 4974(a). Roth IRAs are a major exception, since no distributions are required during the life of the original owner.

Some retirement plans leave it to payees to calculate their MRDs. If so, your clients may need help with the calculation.

Conclusion

Much of the discipline of "retirement planning" involves what lawyers have always done: apply legal and tax rules to clients' individual needs. Familiarity with retirement benefits should be part of the tool kit of those who advise retirees, present and future. This checklist does not attempt to cover every issue, but perhaps it will be a useful starting point.

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Jonathan Levy's article consists of some highlights from his chapter on "Legal Issues in Retirement Planning and Investing" in the pending OSB publication *Elder Law Handbook*.

Chapter topics include predicting clients' needs and resources; working with IRAs and other retirement plans; an overview of investment strategy; cash-value life insurance and tax-deferred annuities; and legal issues in the selection and monitoring of money managers.

Social Security earnings limit repealed

On April 7, 2000, President Clinton signed into law a bill that removes the Social Security retirement earnings limit. Seniors aged 65 to 69 will no longer lose $1 of Social Security benefits for every $3 they earn above the earnings limit, which is $17,000 per person for the year 2000. Earnings limit for persons age 62 to 64 will remain in effect.