# New estate planning opportunities available

## Recent tax law changes may require a review of your estate plan

Last year, the Pension Protection Act of 2006 (PPA) and the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) became law. Both of the acts' provisions provide estate planning opportunities related to your retirement accounts.

### Nonspouse 401(k) rollovers to IRAs

Before PPA, a nonspouse beneficiary of an inherited 401(k) plan wasn't permitted to roll it into an IRA. He or she was subject to the employer's rules regarding future distributions, and companies typically require the beneficiary to pull the money out sooner rather than later. Thus, there was no ability for a nonspouse beneficiary to defer tax on an inherited 401(k) the way he or she could with an inherited IRA.

PPA changed all of that. As of Jan. 1, 2007, a nonspouse beneficiary can roll an inherited 401(k) directly into his or her inherited IRA. The beneficiary can then take distributions from the IRA over his or her life expectancy. Keep in mind that the beneficiary must roll the 401(k) assets directly from the 401(k) to an IRA.

By rolling over a 401(k) to an IRA, a 50-year-old beneficiary of a $500,000 inherited 401(k) will be able to take as little as if he or she had inherited a $500,000 IRA. The required minimum distribution (RMD) is less than $15,000 — saving thousands of dollars in tax liability compared to what would have been required before the new law. Plus, the nonspouse beneficiary can enjoy tax-deferred growth on the assets remaining in the account for the rest of his or her life.

### Permanent higher contribution limits and Roth 401(k)s

PPA eliminates the 2010 sunset provisions related to higher contribution limits to IRAs and various defined contribution plans, such as 401(k)s, and it permanently extends the availability of the Roth 401(k). The extension of the increased contribution limits, including the "catch-up" amounts for those 50 and older, allows you to boost tax-deferred retirement savings, which in turn expands your estate planning opportunities.

The Roth 401(k) provides an even brighter opportunity. Because Roth 401(k)s have been made permanent, it's likely more employers will offer these plans. Roth accounts can be especially good estate planning tools because they not only grow tax-free, but also allow tax-free distributions to both you and your beneficiaries.

### Charitable distributions from IRAs

Another significant, though short lived, planning opportunity afforded by PPA lets you make a charitable distribution of up to $100,000 directly from your IRA — but only if you're age 70½ or older, and only for years 2006 and 2007.

Here's how it works: You arrange with a qualified charity to make a contribution directly from your IRA. You don't receive a tax deduction for the contribution, but the distribution is excluded from your income for the year. The contribution will reduce or eliminate your RMD. If your RMD exceeds $100,000, your first $100,000 would be treated as made via the charitable contribution and the balance would still be required — and included in your income for the year.

An added benefit for the charitably inclined is that, because you're not receiving a charitable deduction, the AGI limits on charitable deductions don't apply.

### Expanded Roth IRA conversions

Perhaps one of the biggest changes — and most significant planning opportunities — is one that was created not by PPA but by TIPRA and which won't go into effect until 2010: the elimination of the adjusted gross income (AGI) limit for converting traditional IRAs to Roth IRAs. Currently, you can't make such a conversion if your AGI (not including the converted amount) exceeds $100,000. Beginning in 2010, you can convert your traditional IRA to a Roth IRA regardless of your income.

Of course, by converting, you're obligated to report and pay tax on the taxable amount of the conversion. TIPRA has sweetened the deal considerably if you convert your IRA in 2010: You have the option of reporting all of the income in 2010, or deferring half of it to 2011 and the other half to 2012.

If you can afford to pay the income tax up front, this can be a significant benefit. From an income tax standpoint, it may keep you out of a higher tax bracket in future years because you must take RMDs from a traditional IRA after age 70½. From an estate planning standpoint, it allows you to pass on an asset that your heirs will never have to pay income tax on.

Plus, by paying the income tax you're reducing your estate, meaning that, if you are subject to estate tax at the top rate of 45%, every income tax dollar you pay will reduce your estate tax liability by $.45 — even more if you're in a state that assesses an estate tax. (See the sidebar "How to avoid state estate tax surprises" for more on state estate tax issues.) Of course, the federal estate tax is scheduled to be repealed in 2010, but without Congress-ional action it will return in 2011.

Further, Roth IRAs have no RMDs, so you can continue to accumulate funds without having to withdraw anything. And, because Roth IRAs allow you to contribute past age 70½ (provided you have earned income and your AGI doesn't exceed the limits), you may be able to continue to add dollars to the account.

**Review and update your plan**

The PPA (along with TIPRA) strengthens traditional pension plans, which may strengthen your estate if you have such a plan. In addition, the act enhances the estate planning opportunities other retirement plans offer. Now is a good time to have your estate planning professional review your plan and determine if any revisions are needed.

**The enhanced estate planning benefits of nondeductible IRA contributions**

If you're otherwise ineligible to make either a Roth IRA contribution or a deductible traditional IRA contribution, consider making nondeductible IRA contributions starting with your 2006 contribution. With the Pension Protection Act of 2006's (PPA's) permanent extension of the increased contribution limits and the Tax Increase Prevention and Reconciliation Act of 2005's (TIPRA's) expanded eligibility for higher income taxpayers to convert to Roth IRAs, this strategy just got more attractive, especially if you don't currently have an IRA. And you can make 2006 contributions until April 16, 2007.

For example, by making nondeductible contributions from 2006 through 2010, Jim and Jill, a married couple in their 50s, could contribute (assuming no inflation adjustments to the amounts as currently scheduled) $56,000 into nondeductible IRAs. (They can each contribute $5,000 in 2006 and 2007, and $6,000 from 2008 through 2010.)

In 2010, the couple could convert the IRAs to Roth IRAs, and they would be liable for tax on only the appreciation the accounts enjoyed — the $56,000 in contributions wouldn't be subject to tax. Taking advantage of the ability to defer the income recognition into 2011 and 2012, Jim and Jill — and more dramatically, their heirs — could reap significant benefit down the road.

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