Welcome to InFRE's January, 2018 Issue of Retirement Insight and Trends

www.retirement-insight.com/welcome-infres-january-2018-issue-retirement-insight-trends/

Retirement InSight and Trends is the quarterly newsletter for the International Foundation for Retirement Education's Certified Retirement Counselors® (CRC®s) to help retirement professionals with the practical application of new retirement readiness, counseling, planning and income management concepts for the mid-market. Find out more about the CRC® and InFRE here.

This issue is worth one *free* CRC®, CFP®, ASPPA, and the American College's Professional Recertification Program (CLU®, ChFC®, CASL) CE credit upon reading all the articles and successfully completing the online quiz. An email will be sent to you and InFRE upon successful completion (score of 70% or more) of the CE exam.

Click here for the Continuing Education Exam that corresponds to this issue. Click here to see other free issues that you may read and receive CE for passing the online exam.

To report CE:

- Your score will automatically be sent to InFRE for CRC® credit and the CFP Board CFP® credit.
- You are responsible for reporting your CE hours for ASPPA recertification and the American College's Professional Recertification Program (CLU®, ChFC®, CASL).

Looking for additional CE opportunities? Visit the continuing education section of the Retirement Resource Center store to find hundreds of additional professional development and continuing education options by leading experts, the way you want to learn, at the level that's right for you.

January, 2018 InFRE Update: True Retirement Professionals

www.retirement-insight.com/january-2018-infre-update/

The International Foundation for Retirement Education (InFRE) created the Certified Retirement Counselor® (CRC®) certification in 1997 to raise the retirement readiness of the American worker by advancing recognition among financial professionals of the importance of earning a retirement-specific certification.

To meet the requirements of today's fiduciary environment, we believe it is critical to have an accredited professional credential that signifies achievement of a level of competence and ethical commitment associated with being a retirement professional.

Of over 160 financial designations listed on FINRA's website, the CRC® is one of only eight retirement and financial planning-related certifications independently accredited by the National Commission for Certifying Agencies (NCCA) or the American National Standards Institute. In the future, accredited credentials will be favored as advisors are increasingly expected to abide by a duty of loyalty and a duty of care when serving their clients.

InFRE helps CRC® Registrants prepare for being true retirement professionals capable of guiding clients and plan members in making informed decisions. We help CRC® Certificants stay up-to-date with the latest thinking regarding retirement readiness, risk management and retirement income through this Retirement InSight online newsletter and our monthly professional development webinar partnership with the Int'l Retirement Resource Center.

The Int'l Retirement Resource Center provides retirement-specific training and education programs by leading experts so advisors and middle-income consumers make decisions that fortify their retirement security and peace of mind. They have built relationships with the retirement industry's leading speakers, authors, trainers and professional development experts over almost thirty years in the financial industry. We are pleased to offer you a terrific selection of retirement-specific professional development online courses to help you meeting your CRC® continuing education requirements. New courses are added monthly.

Society rewards professionals for their special expertise. True retirement professionals earn respect and are held in high regard because of the commitment they have made to advance their education and to be held to high ethical standards. Thank you for your commitment to be a true retirement professional by earning the Certified Retirement Counselor® certification!

IRA Beneficiary Designations and Surviving Spouse Strategies

www.retirement-insight.com/ira-beneficiary-designations-surviving-spouse-strategies/

By Rex L. Hogue, Attorney and Partner, Haiman Hogue, PLLC

Rex Hogue, Attorney, Estate Law Expert, Attorney and Partner, Haiman Hogue, PLLC

Editor's note: This article is an adaptation of the live webinar delivered by Rex L. Hogue in 2017. His comments have been edited for clarity and length.

You can read the summary article here as part of the 4th Qtr 2017 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

You may also choose to take the full length course IRA Beneficiary Designations and Surviving Spouse Strategies: Why Many IRA Owners Should Use a Retirement Plan Trust for 1.0 hours continuing education (CE) credit.

Qualified retirement plans (QRPs) create numerous planning problems. I found that most people have no idea how much they complicate estate planning nor do they know how to deal with the complications. Many mistakes can be made that can be devastating, and frequently they are fatal. You cannot reverse them.

There are seven situations for retirement plan trusts that we think are absolutely the best way to deal with beneficiary designations. In this article we are going to talk about basic inherited retirement plan rules, tax problems with QRPs, three tax options with IRAs, what we refer to as the "five blowout" problems, seven problems with individual beneficiaries, and why the retirement plan trust is better than other options.

Using a retirement trust also avoids problems such as the beneficiary deciding to cash out early, or a beneficiary rolling over the client's IRA into the beneficiary's IRA. It also avoids problems with naming individuals as beneficiaries. Retirement trusts can also protect beneficiaries from making bad financial decisions, prevent going through guardianship for a minor child, avoid existing creditors, and why it is a better beneficiary designation than an ordinary living trust.

Clarification on terms I will use in this article:

· By IRA I mean traditional IRAs, Roth IRAs, 401(k)s, 403(b)s—basically, any ERISA-based plan.

·There are two similar terms out there: one is required minimum distributions, and the other is minimum required distributions. I will refer to them as RMDs.

·Custodians or plan administrators or the plan manager will be referred to simply as the "custodian".

Who Should Use a Retirement Plan Trust?

With qualified retirement plans, good planning usually means one plan for everything else and a totally separate plan for qualified retirement plans. They can become the biggest problem asset after death because they have different distribution rules and different tax rules than any other asset. Most people just do not get the significance of that.

Say a client is concerned that the beneficiary would not make good choices regarding distribution. Either the beneficiary is irresponsible, or they are too young to make good decisions. Many times, a 22-year-old kid may be smart. They might have had a 4.0 in college, but they do not yet have any experience in the world and understand the significance of avoiding taxes and enjoying tax-free growth. Alternatively, they are concerned that a beneficiary would lose part of their inherited IRA in a divorce, a bankruptcy, or a lawsuit (a very state-specific issue).

Texas law is one of the most favorable in the nation. Under Texas law, inherited IRAs are protected from bankruptcy and lawsuits. However, they are not protected from divorce. No state protects them from divorce. With most states, inherited IRAs are not asset-protected. There are only seven or eight states in the US that protect qualified retirement plans and IRAs in particular when they are passed on. Inherited IRAs for minor children are particularly problematic. I have seen many people just put a minor's name on a beneficiary designation.

If the plan owner is incapacitated, how do you get a signature to get authorization to do anything? Do not expect a normal power of attorney to work. My experience with financial institutions is, the larger they are, the less likely a normal power of attorney is going to work. Asset or investment changes are times when we might need a signature, such as if we need a change in beneficiary designation, or if they are going to convert the plan to an IRA, particularly a Roth IRA, or if they need to change custodians, especially if a custodian has become uncooperative, or if they need to take RMDs. You usually need a signature for all of that.

The cost of one year's guardianship is way more than the cost of using the retirement plan trust. That is really the cost consideration in a case like that. You may also have a beneficiary who qualifies for a governmental assistance program, and inheriting the IRA would cause them to lose those governmental benefits.

Second marriages really complicate QRP planning because you are bound by certain rules as to who can be named and whether the spouse has to do a waiver. If there are children from before the marriage, and a person wants their spouse to benefit while the spouse is alive, but then they want to go back to their prior marriage children, the only way to do that is through a retirement plan trust. If the spouse does a rollover, those kids are never going to see it. If a family has $200,000 or more in qualified retirement plans and you do a cost-benefit analysis, it is basically a no-brainer. It might worth the cost of the trust with as little as $150,000.

For young couples who have children and growing 401(k)s, this is frequently a big problem asset. Minor children also complicate QRPs. If there is any chance that minor children would be the beneficiaries, they really need to think this through.

If the plan owner had yet to take the RMD, the inherited retirement plan beneficiary has until September 30 the year after the owner’s death to decide how to take it. There is no real reason to hurry this decision. They always have from nine to twenty-one months. However, my experience is that many custodians treat this like somebody has pulled a pin on a hand grenade and tossed it in their office.

There are penalties for making wrong choices that cannot be abated. You cannot tell the IRS my accountant or my custodian or my financial planner or my attorney gave me bad advice. The IRS is not going to waive penalties for that. It is always important that the client depend on professionals hired by the family and never depend on the custodian. Sometimes custodians just give bad advice. Clients have no recourse against them. They do have recourse against financial planners, attorneys, and CPAs if they hired them.

A Trust Well Done

A poorly drafted trust or an improperly done beneficiary designation form can be a disaster for any kind of plan that depends on a beneficiary designation form. Trust drafters should be attorneys who are familiar with drafting trusts as beneficiaries for retirement plans. Many attorneys who may be great estate planning folks do not deal with this area. Relatively few estate planners do these types of trusts. Trust drafters should understand the nuances of beneficiary designation forms. I cannot tell you how many times attorneys have had me look at their forms, and I have to tell them that their form actually does not comply with the law.

Attorneys should also be willing to work with the custodian. It is a real problem if the trust drafter and the custodian cannot get along with each other and will not talk to each other.

Typically, custodians give three choices:

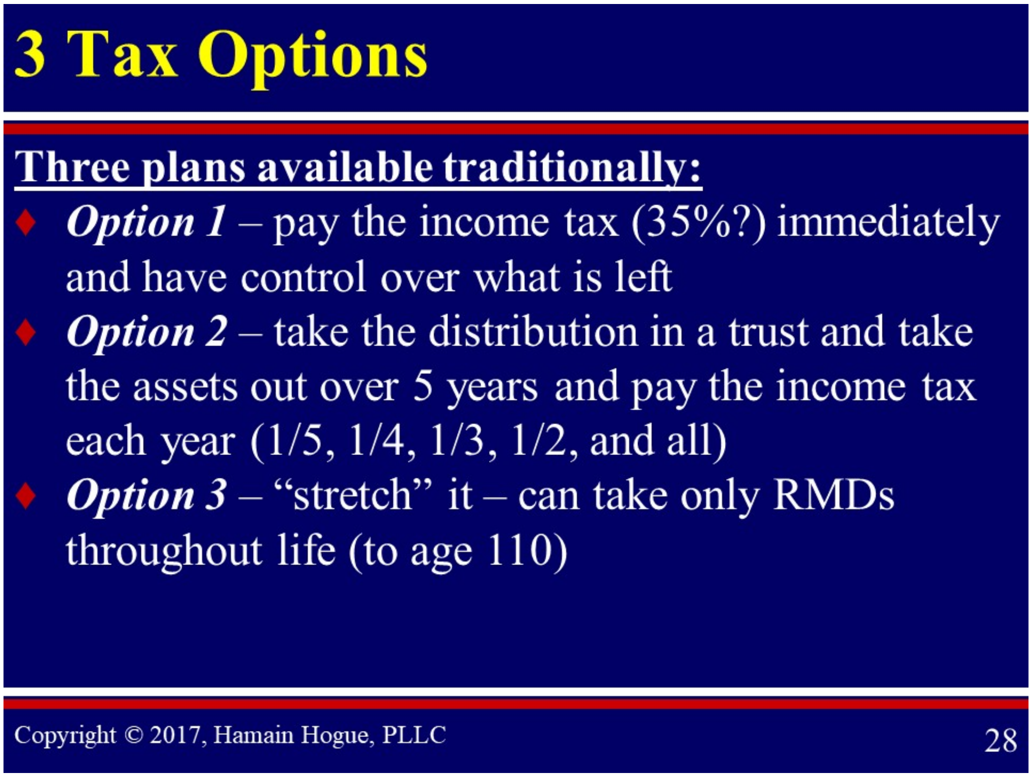
1. They will accept the drafter’s beneficiary designation form, or
2. They will accept a concept that is required on their own forms, or
3. They are not going to allow the concept. The answer here is that you get another custodian.

The mother of a friend of mine died and had a $500,000 IRA. Greg and his sister, Anne, were the recipients. Greg took the IRA because the custodian asked him what he wanted them to do with the account, and he said, “Just send me a check.” Then he wrote his sister a check for half of it. The following April Greg called me, and says, “My CPA is saying I had $500,000 of income last year. He is an idiot. Why would he say that?” I realized that he had taken the check and cashed it, and then written his sister a check. I told him that he had taken a $500,000 distribution and owed income tax on that.

This is a case where the IRA can turn into a large IOU to the IRS without careful planning. Taxes are not the only problem, though they are certainly a big problem.

Tax Options for Beneficiaries to Receive Distributions

In January of 2003, the IRS created new minimum distribution rules that allow for longer tax-free compounding. They also made it easier to calculate RMDs. But what happens on death when there are assets remaining in the plan? There are three options.



With Option No. 1, the beneficiary can pay the income tax, let's call it 35 percent immediately, and have control over what is left. As stupid as that may seem to us as professionals, many people will just go ahead and pay the tax, and do what they want with it. That is a very bad strategy when it comes to IRAs.

Option No. 2 is a trust named as beneficiary. If the trust has language in it, then you can do a five-year payout. That means that you take one-fifth the first year, one-fourth the second year, one-third the third year, half the fourth year, and all of it in the fifth year. For tax purposes, that is how the tax rates calculate it.

Option No. 3 is to stretch it so that the beneficiary can take the RMDs throughout their life, and they can stretch it to age 110. The beneficiary is going to calculate how many years by taking 110 minus their age. For the first beneficiary, that is as long as it can be stretched. That is an important consideration in planning.

Let us look at an example. Harry is married, and he has one child. He has a $250,000 IRA. He turns 70.5, and he must start taking RMDs. With good planning this IRA can become worth over $2.5 million. When I am talking to somebody about that age, and they say, "My IRA is not that big," I tell them, "Well, you might be sitting on a goldmine and not realize it. It could be worth a lot of money if you manage it and plan it correctly."

Let us see how that might happen. The current amount is $250,000. Harry takes distributions from required minimums only to age 86. He takes out $281,000, but that leaves $327,000 in it. Then his wife takes distributions for another four years. She takes almost $89,000. Then on her death, there is $330,000 left. They took out almost $370,000, and there is still $330,000 in it. If they do not do any planning at the wife's death, roughly 35 percent is going to be paid in income tax, or about $115,000. If there is estate tax on top of that, that total is going to be $191,000. There is only $139,000 left for the family. That is pretty sad on a $330,000 IRA. I have seen things like that happen.

Option No. 2 is they name their living trust as beneficiary, and they do a five-year stretch. Let us assume they are going to get a 6 percent return. That generates payouts of about $66,000 the first year, then $70,000, $74,000, $78,000 and finally $83,000. That gets the family about $741,000.

Option No. 3 is good planning. We go back to the same $330,000 IRA, and now they have decided they are going to give half to their son and half to their grandchild. The son takes out required minimum distributions for 27 years on his half. He takes out $521,000. Then the grandchild takes out required minimums of another $1.6 million. We now see that from the $250,000 IRA, the husband and wife took about $370,000. The son and the grandchild took out another $2.1 million, so the total to the family is over $2.5 million. Once I sit down and show people this, they get real excited about maybe doing something for a grandchild.

But it at least makes them consider that as a possibility. Now in 2005, there was a private letter ruling (PLR) that allowed trusts to be the beneficiary and do a stretch out. Up to that time even though the law allowed it, every time we named the trust as a beneficiary, the custodian would tell us the individual can take it out and do a stretch, or we will do a five-year payout. We would point out we have got the language here that allows us to do a lifetime stretch, but the custodian would never allow it. After this case, custodians started allowing it.

I am going to say that our experience over the last two or three years is that 97 or 98 percent of the custodians will now allow a stretch through a trust. Generally, the beneficiary can use their own life expectancy. It does depend on how that trust is drafted. But the way we do them, each individual beneficiary has her own separate trust share. They get to use their own life expectancy. Many people know that PLRs are only valid to the people who applied for it. But the ruling has been affirmed over 500 times since then in other PLRs, and it is not going away.

Even in the new tax proposal, there is something about this in there, but it is not going away. By now, this is well established in our law. But the stretch is not automatic. I have people say so that this just automatically happens. I tell people there is nothing in estate planning that is automatic. Something must happen to trigger it. You have to do something to exercise the options. That means the beneficiary must make the right options, and the beneficiary must handle it the right way.

Qualified Retirement Plans Can Create Estate Problems

Here is a planning opportunity for you: A lot of company-sponsored QRP custodians do not allow stretches beyond five years in those ERISA plans.

They do allow them in IRAs. So why do company-sponsored QRP custodians not allow them? Many times, they do not know the rules. Sometimes they are willing to administer the rules according to the law, especially if it is an employer's plan. They do not want the liability. They feel like somebody pulled the pin on a hand grenade and tossed it in their office. They want to get rid of it. Unfortunately, there is no way to force them to abide by the law. You have to find out in advance whether they are going to accept it. One reason rollovers to an IRA can be so important is because you get to pick the custodian.

If you can pick the custodian, you can pick one who will go along with this. If the client does not do anything, they are not going to know there is a problem while they are alive. Many people do nothing other than sending in a beneficiary designation. If that is all they do, they just have to hope it works when they die. They are not getting any feedback from the custodian. But unfortunately, that can handcuff the beneficiaries upon death. They could be forced into what we call the blowout problem. With any sizable QRP, it does not make sense for a beneficiary to take more than they are required to any sooner than they must. A blowout occurs when the QRP is subject to an unnecessarily high income-tax rate because so much is taken out at one time. Many things can cause it.

Here is an example. Luke's father left Luke a $500,000 IRA. Luke had never had that kind of money, never seen that kind of money, never managed that kind of money. So now he is rich. He increases his lifestyle and buys a lot of new stuff. Now he has $500,000 of income in one year. Unfortunately, he did not realize the tax bill is going to come due the next year, and this, by the way, was a real case in our office. In two years, he went from having a $500,000 IRA to nothing left at all. In fact, he even had some debt to the IRS because he did not have enough cash to pay the tax.

Another thing that can come up is the spouse of the beneficiary or a third party wants to spend the money. There is one question that is always important to ask when you are planning for the parents and they have adult children who are married: is your son's wife a good or a bad influence on him over money, or your son-in-law a bad influence over your daughter? Many times, they will say they are not a good influence.

Another example: Angie's mother died and left her a $400,000 IRA. Jack said to Angie, "Honey, I have always wanted my own business. If you really love me, you'd let me invest this in a business." You cannot legally borrow from the plan, so they take a $400,000 distribution. Now they can "borrow," but they can only do so once every 12 months, and they have to pay the entire amount back within a 60-day period.

Let's say that they "borrow" on April 1 and make the first withdrawal. That means they only have until about June 1 to pay the whole thing off. That catches people by surprise because they do not understand the 60-day rule. In this case, the tax was $107,000. Unfortunately, Jack was a better dreamer than he was a businessman. The business was unable to pay. The business went bankrupt, but they still owed the tax. Angie's mother left her an IRA that could have been a huge benefit to her in retirement. Instead what she got is $107,000 that they owe the IRS.

Custodians often do advise the beneficiary of the rules. The beneficiary rolls the IRA into his own IRA. Once it goes to the beneficiary, it is not the custodian's problem. The beneficiary feels rushed into making a decision. I know that happens. I have been through it personally. They are not aware of the rules and the choices. If someone is getting information only from the custodian, they are not getting good information. They often think it is not subject to estate tax.

But that may not be true. Fred was the son of one of our clients. Fred's dad left him a $600,000 IRA. Fred's dad died in January. Sometime in February, Fred talked to the custodian, and he asked, "Can I roll this into my IRA?" You might be surprised to hear that the answer is yes, you can. That is a technically correct answer, but it is misleading because when you do that, it is a $600,000 distribution. Fred does this, rolls it into his IRA, and the following April, he is doing his tax return. Then a CPA informs him that he has $600,000 more income, and owes an additional $218,000 in tax.

The only place that Fred keeps that kind of money is in his IRA, so he has to withdraw it from his IRA. The problem is he is not 59.5, so he suffers a 10 percent early withdrawal penalty. That is another $21,800. And that means that the total amount of tax that goes to the IRS is about 40 percent.

What Can Go Wrong When an Individual is Named the Beneficiary

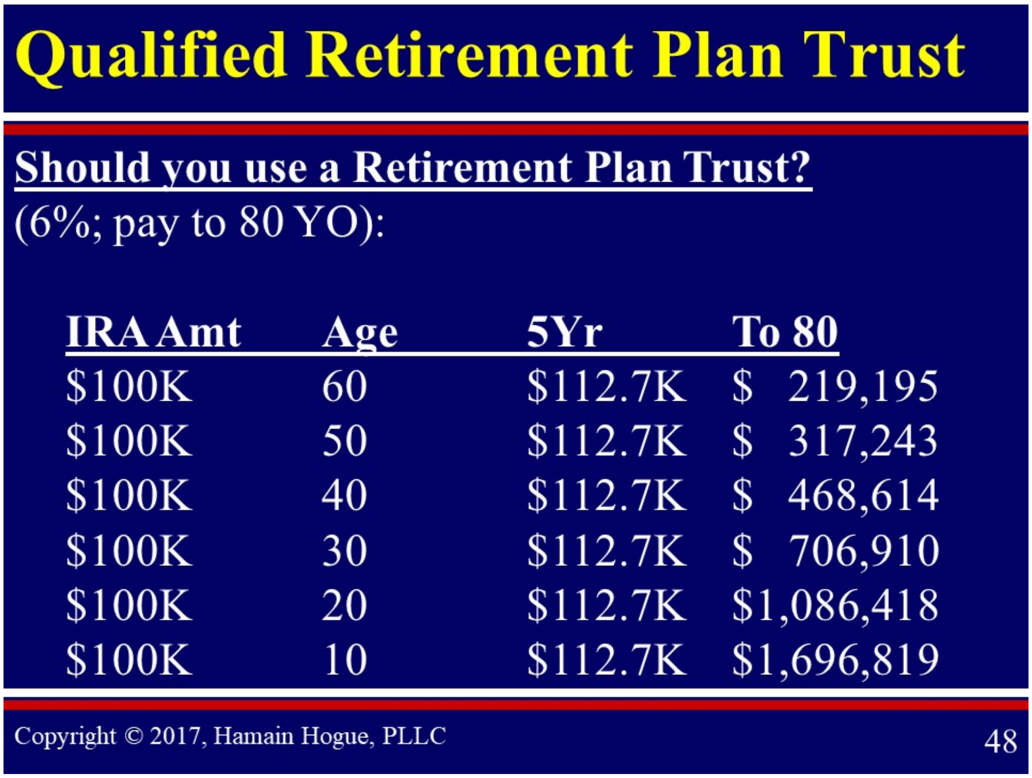
A beneficiary can stretch it out. That is still not perfect. Even if the beneficiary is very responsible, there are still seven things that can go wrong when you name an individual.

Let's look at another case. Jake had a couple of grandkids he adored, and he and his wife decided to leave their grandkids $50,000 each from an IRA. One of these kids is five years old.

Unfortunately, Jake's daughter and her husband went through a very bitter divorce. They each convinced the court that the other was a spendthrift. Neither one was appointed the guardian of the estate for the grandchild; a bank got appointed. They had to go through a guardianship of the assets because the 5-year-old cannot legally own money or anything else for that matter. Twelve years later, there was nothing left. This $50,000 that could have been a huge benefit to this grandchild instead just winds up being a financial burden on the family. That is probably not what Jake had in mind.

If instead Jake had done a retirement plan trust, the 5-year-old would have had to start taking required minimum distributions but it would not have been in a guardianship; it would have been in a trust. If he took required minimum distributions only to age 65, he would have been paid almost $700,000. But there would still be $805,000 left in the IRA. That $50,000 could have become over $1.5 million if it had been handled in a trust instead of done directly.

Here is a chart that illustrates two things. Using a 6 percent rate of return, we are going to compare IRA amounts of $100,000 and look at various agents and beneficiaries. Next, we are going to compare a five-year payout at 6 percent to taking required minimum distributions to age 80.



IRA Amt	Age	5Yr	To 80
$100K	60	$112.7K	$ 219,195
$100K	50	$112.7K	$ 317,243
$100K	40	$112.7K	$ 468,614
$100K	30	$112.7K	$ 706,910
$100K	20	$112.7K	$1,086,418
$100K	10	$112.7K	$1,696,819

Let’s say the client is 85 years old. Does a retirement plan trust make sense when they are going to give it to a 60-year-old? Look what happens.

If the 60-year-old gets the $100,000 immediately, they pay income tax immediately. They are going to get a benefit of $65,000 or so. But if they take the stretch over five years because mom and dad used their trust, earning 6 percent, their total benefit is going to be about $112,000. But if they take required minimums only to age 80, between what they will get paid and what is left in it at 80, they get $219,000. You can see that the retirement trust produces a benefit of $100,000 more than if they just took it outright. The lower the beneficiary’s age, the greater the benefit over doing either the five-year payout or the outright distribution.

Look at what happens when a 20-year-old gets it. You are talking about over $1 million in benefits or more than ten times. When it is a 10-year-old, 17 times the benefit. When you are considering planning for retirement plans, look at the age of the beneficiary. If the client has any inkling that they might want to benefit grandchildren, this is a great place to do it because they can control what happens for many years into the future, and it would still be a huge benefit to the grandkids.

Why Do a Retirement Plan Trust versus Name a Beneficiary?

People will ask me why I would do the retirement plan trust instead of just naming a beneficiary. When we ask clients, “Do you want to do the stretch or do you want the asset protection?”, their answer is, “We want both.” The retirement plan trust is a tool that allows them to do both.

1. You can do the stretch out in a trust. And because you can do it in a trust, you can asset protect it. Depending on the state of the beneficiary, if they take it outright not only might that asset not be asset protected but it is a very attractive target to a creditor because it is cash. They can go spend it quickly. If they are involved in a lawsuit, whether it involves their business or a car accident or anything like that, that asset is at risk. If it goes into a trust, they get to protect it. But if they are stuck with a five-year payout, economically that is not as good as being able to do a lifetime stretch.
2. Divorce can be problematic. Parents do not really think about how it may affect their children. If you leave your son or daughter a retirement trust, and they take it individually, one of the things that is happening in a state like Texas is that as those distributions come out, they are community property.
3. Another problem will come up when distributions come out and go into a joint account. That income is community property. The child decides I am going to go put that in with my other separate property because, after all, I inherited it. That inheritance is not normally subject to spousal claims on divorce. But you have now co-mingled it. You have got income, which is community property going into a separate property account. Under Texas law, that is presumed to be community property. Unless you can prove otherwise, it is going to be treated as community property.

Key Takeaways

Let’s talk about some takeaways. Hopefully you see from this that dealing with retirement plans can be very complex. There are many issues involved.

1. Retirement plans pass by a completely different set of rules than other assets. My experience with planners and clients is that that just comes as a surprise. They think it passes by beneficiary designation, the same as life insurance. That is about the only connection between them. They do pass by beneficiary designation.
2. Because of the income tax rules, the fact that you have got to take those RMDs and you have got to make choices about how you are doing it, it is just a totally separate deal than every other asset.
3. Every other asset we can put in a trust. We can asset protect it. It can grow. That growth is not part of the marital income. You can do it in a retirement trust, but you cannot do it with just a retirement plan. The different rules create potential problems, but there are also planning opportunities.

The retirement plan trust is a great option. Because it is so flexible, it fixes a lot of the issues that come up today. Here is something else that I have learned: Many times, when we meet with clients, their planner has done a great job. They have $1 million in their IRA. But the client has never heard about a retirement plan trust.

Whoever teaches your client about this tool is likely to be the person to manage the assets. We are not in the asset management business. We are not going to take over that job from you. But there are some attorneys out there that they will refer to their own group of planners that they work with. We take a very different view of that. We are happy to work with any planners. We are not going to refer your clients to another planner. But it is important that you be the one to bring this to your client's attention because, if they hear it from somebody else, that person gets in the driver's seat to take away the management of their assets.

About Rex L. Hogue

IRA Beneficiary Designations and Surviving Spouse Strategies: Why Many IRA Owners Should Use a Retirement Plan Trust – Rex Hogue

Attorney Rex L. Hogue, has been practicing estate law since 1992. He handles everything from small estates to estates in excess of $300 million, and has earned acclaim for involvement in groundbreaking cases, most notably Estate of Kelley v. Commissioner, TC Memo 2005-235 for which he designed the family limited partnership. He is frequently asked to speak regarding the success of that case, family limited partnership and other complex aspects of estate planning and administration.

In addition to his speaking engagements with bar associations, trade groups, community colleges, and churches. He had a radio show with a CPA for a time and, he has been a guest on several radio shows. He has authored numerous articles on estate law topics, as well as several books, including Practical Estate Planning, an easy-to-understand book for the general public that explains the pros and cons of the basic estate planning tools and the estate planning process.

Are you looking for a retirement speaker for your next conference, consumer event or internal professional development program? Visit the Retirement Speakers Bureau to find leading retirement industry speakers, authors, trainers and professional development experts who can address your audience's needs and budget.

The DOL Fiduciary Rule and Your Duty

By Blaine Aikin, AIFA®, CFA, CFP®, Fi36

There is a famous quote from Supreme Court Justice Benjamin Cardozo where he talks about the difference between fiduciary standards versus rules of the marketplace. He begins with "a trustee" – and whenever he talks about trustee, that is the classic way of thinking about a fiduciary. It is someone who holds assets on behalf of another.

So, "A trustee is held to something stricter than the morals of the marketplace. Uncompromising rigidity has been the attitude of courts of equity whenever they are petitioned to undermine this undivided duty of loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd." By avoiding those exceptions, we can keep the standards for fiduciaries *higher* than the standard or the morals of the marketplace.

Blaine Aikin, AIFA®, CFA, CFP® – Fiduciary Responsibility Expert
Editor's note: This article is an adaptation of the live webinar delivered by Blaine Aikin, AIFA®, CFA, CFP® in 2017. His comments have been edited for clarity and length.
You can read the summary article here as part of the 4th Qtr 2017 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.
You may also choose to take the full length course The DOL Fiduciary Rule and Your Duty of Care for 1.0 hour continuing education (CE) credit.

What are the Morals of the Marketplace Versus the Fiduciary Standard?

When we are talking about the rules of the marketplace, we are talking about*counterparty* transactions; the relationship involved is one that we classically think about in a transaction, where it is very much arms-length. If you are going into a transaction with someone else, you typically know that there are conflicts involved. Both parties are trying to serve their self-interests. Moreover, usually, the sophistication gap is relatively narrow.

The buyer can beware here. Imagine shopping for a car; it is not that complicated to research cars, and whenever you go into the showroom, you know that there's somebody on the other side of the transaction that you are dealing with. The standard of care is the rules of the marketplace. It is suitability-based. It is quite a product-protection type of regulation as opposed to something more significant. It is often very rules-based, where it is highly specific: "thou shalt do this, or thou shall not do that."

Fi360 **Counterparty vs. fiduciary adviser**

Attributes	Counterparty Transactions	Personalized Advice
Relationship involved	"Arms-length"	"Trustee/trustor"
Conflicts	Conflicts acknowledged; Parties serve self-interests	Conflicts must be resolved to serve the client's interest
Information balance	"Sophistication gap" is narrow; buyer beware	Relationship of control vs. reliance; high vulnerability
Standard of care	Rules of the marketplace; suitability	Fiduciary; suitability plus the Prudent Person Rule
Regulatory regime	Rules-based	Principles-based

6

When we are talking about personalized advice in that column on the right-hand side, this is the fiduciary relationship that Cardozo was talking about. We have a trustee: someone who is responsible for taking effective control of the assets of an individual, who in this case would be the trustor, the one who is giving up some measure of control to the trusted advisor. In that circumstance, conflicts must be resolved in the client's interest because of the sophistication gap—the information balance—is very disproportionate. You have a relationship of control and reliance with high vulnerability on the part of the client, as opposed to a regular counterparty transaction.

That is why we have a fiduciary requirement. It is not only suitability; it also requires the Prudent Person Rule to come into play. It is not just duty of loyalty, it is also the duty of care, and the Prudent Person Rule is something we are going to be talking a good bit about. The Rule is highly principles-based. It encompasses the idea that you are held to two core standards: the duty of loyalty, and the duty of care.

Three Levels of Regulation

What are the duties of loyalty and care? They are straightforward, and from these, many other duties flow.

For the duty of loyalty, the obligation is to serve the best interests of the client and avoid conflicts of interest. I like this definition: a conflict of interest is best thought of as a circumstance that makes fulfillment of the duty of loyalty less reliable. Essentially, we have temptation involved, if you will.

The duty of care, which is going to primarily be the focus of this article, is to act with the skill, the diligence, and the sound judgment that is reasonably expected of someone serving in a similar capacity. The obligation is to be able to produce the state-of-the-art. The proof is in the *process* applied, rather than the *outcome*. You can almost think of this like "despite the doctor's best efforts, the patient died." That is the sort of standard applied here.

If you do all the right things, there could still be a crash in the stock market or something where, at least on an interim basis, things did not go as planned, but you did everything right in the process as an advisor. That is what the obligation of a fiduciary is.

Now this provides an interesting basis for thinking about regulation as well. When you think about who the ideal advisor for most clients would be, most investors would say it is someone who is both trustworthy and competent, and those characteristics directly relate to the duty of loyalty and the duty of care.

In the current financial services environment, we have three levels of regulation. There is a non-fiduciary standard that's at the Exchange Act level. This is for broker-dealers; this is for the counterparty transaction. There is no fiduciary obligation. It is order-taking; it is highly transactional.

When we move into the realm of advice, it is like going to an attorney or a doctor. When you go to your financial advisor, you expect that they are going to act in your best interest because of that information gap mentioned earlier. The Investment Advisers Act of 1940 is very much a fiduciary act that requires investment advisers to act in the best interest of clients.

However, because you are dealing with a client, that act is not quite as high a standard as what you find in the retirement marketplace. In the retirement marketplace, the adviser is acting once removed from the end-investor (participant). There are other fiduciaries – for example, the plan sponsor in a retirement plan – who need to select their fiduciaries – those that they are sharing fiduciary obligations with, like an adviser or an investment manager. All fiduciaries need to choose very wisely because they are one step removed from the investor.

The highest standard is really under the ERISA fiduciary standard, and that is what the DOL Fiduciary Rule is all about because it is obviously in the retirement space.

Why then, did the DOL act? What they said right at the beginning of the rule-making was that they observed that instead of ensuring that trusted advisers were giving prudent and unbiased advice (due care type) and adhering to that duty of loyalty in accordance with fiduciary norms, there were a multi-part series of technical impediments to fiduciary responsibility in the Rule. In much simpler terms, there were loopholes within the definition of who a fiduciary was.

What the DOL Rule does is change the definition to make it apply more broadly. The DOL felt that contrary to legislative intent under ERISA, advice was being given without fiduciary accountability. The solution that they determined was important was to tighten the definition of fiduciary conduct. Now whenever you provide investment advice that is personalized, you will be held to a fiduciary standard as an investment adviser.

However, they also did one other thing: they made specific refinements to the rules. They added some exceptions and exemptions to accommodate the business practices of broker-dealers. This is somewhat controversial because ERISA is the highest fiduciary standard, and the rule has been that you cannot have a conflict of interest unless there is a specific, prohibited transaction exemption that allows that conflict to exist. That is an important thing to keep in mind as we talk further about the DOL Rule.

How Does the DOL Fiduciary Rule Work?

It all starts with answering the question, “Are you, in fact, a fiduciary?” The original definition out of ERISA had a five-part test to it. Two of the parts said you had to be giving advice on a regular basis, and that advice had to be the primary source for decision-making. It was based on that advice being used by an investor to make a decision.

Under the new definition, you are a fiduciary under the Rule if you render investment advice either directly or indirectly. In other words, an affiliate of yours could be giving the advice as well. You are doing it for compensation, so this rules out those cocktail conversations. However, then if you are giving virtually any type of investment advice, you will be held to the fiduciary standard under the revised definition, as shown next.

> You are a fiduciary under the rule if you render investment advice either directly or indirectly (e.g. through or together with an affiliate) for compensation and do any of the following:
>
> 1. Represent or acknowledge that you are acting as a fiduciary; or
> 2. Render the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient (i.e. it is individualized); or
> 3. Direct the advice to a specific advice recipient or recipients regarding the advisability of particular investment or management decisions with respect to securities or other investment property of the plan or IRA.

Now, this is a significant change. The loopholes have been closed. As you may be aware, the DOL Rule that came out was accompanied by a great deal of explanatory information, so much explanatory information that it spans about 1,000 pages. It starts with the definition of fiduciary, so you want to remember, “You are an investment fiduciary if you provide advice.”

The DOL could have just said that and moved on to describing the Rule, but it went a step further. It did elaborate in the Rule about certain things that are *not* fiduciary communications that you can provide – for example, education that is not accompanied by personalized, specific advice. That is not a fiduciary communication. Alternatively, when someone explains how a retirement plan works or generally how asset allocation works, that is not considered a fiduciary activity. Rather, that is education, a non-fiduciary form of communication.

However, you have to be careful that you do not slide from one activity to the next. For example, you might be giving a presentation as an investment person in the front of a room to a group of employees. You are providing education, and then somebody walks up to you afterward, a plan participant, and says, “Yeah, I think I get what you are saying from what you described so far, but let me tell you about me, and what should I then do?” As soon as you answer that question—what the individual should do—you’re giving personalized advice, and you have slipped into that definition of fiduciary.

Another exception to the Rule is if you are only placing an order; that is similar to a counterparty transaction and not a fiduciary activity. Similarly, there’s a platform providers exception. For example, assume a retirement plan puts out a request for proposals and says, “We want to implement a retirement plan. Here are the specific types of requirements we have for a platform provider.” A provider comes in that offers retirement plans and says, “I have such a plan. Here’s how it matches up against what you need. Would you like me to do this for you?” This example is tantamount to a counterparty transaction, where you are order-taking regarding what they are looking for.

There is a critical exception to the definition to be aware of: support services provided by plan sponsor employees. If a plan employee provides basic support to the participants, they are not considered a fiduciary if they are not registered investment advisers who may have another job on the side.

There are exceptions for general communications, such as someone who is a radio talk show host generally talking about financial topics. They are not an adviser if they are not giving personalized investment advice. Those are all called the “non-fiduciary communications.”

What was the DOL Trying to Address?

A fiduciary investment adviser is someone who meets the definition that we just covered. For ERISA, then, the definition applies. The fiduciary duties of loyalty and care apply, and all the subsidiary type duties that are associated with those standards.

An essential concept under the DOL Rule is that impartial conduct standards must be followed. These standards are how someone goes about giving advice in a way that protects the duty of loyalty and makes sure that duty of care and subsequent competence standards are being followed.

There are other aspects of the Rule that are important. How the adviser is compensated comes into play, and this goes back to those “disintegrating exceptions” that Judge Cardozo talked about. Someone who has non-level compensation can still be a fiduciary if they do certain things under this Rule. This is a lightening up of the Rule to accommodate commission-type income on the part of someone providing advice. Moreover, here there is a prohibited transaction exemption known as BICE – it is the Best Interest Contract Exemption – that would be required under most circumstances for non-level compensation.

That exemption adds a few more hoops for an adviser to jump through to make sure that those fiduciary duties are protected. If the adviser is a level-fee adviser – where someone does not have the conflict associated with what can be paid varying by what the advisor recommends – then he or she avoids a conflict of interest situation and have no conflict associated with variability in compensation. Either they do not need a prohibited transaction exemption, or there's a streamlined version that could come into play, such as with an IRA rollover.

Assume a plan participant goes to an adviser and says, "Hey, I'm thinking about retiring. Should I take a rollover or not?" Well, there's an inherent conflict there, even for a level-fee adviser. If they were not doing business with the individual before, but they would be afterward if they accept this IRA rollover, then the adviser is going to make more money. Now they are conflicted if they give advice such as "Oh yes, you should roll that IRA over." In that circumstance, they do need to make sure that they have disclosed that conflict, they have applied impartial conduct standards, and they have gone through the steps necessary to make sure that the duties of loyalty and care are preserved.

Where Does the DOL Rule Stand Now?

The DOL Rule has been on has been on a long and arduous road. The DOL first came up with the original fiduciary definition starting in 1975 and all the way through 1978. It was not until 2010 that the DOL proposed to tighten the definition in the way that I have described. Since then, there has been a whole lot of back and forth.

As of June 9th of this year (2017), the main Rule provisions became applicable. Some people do talk about the Rule not being implemented or delayed, and that there are specific provisions of it that are delayed that haven't yet taken effect. However, the primary requirements of the Rule, including the definition and the obligation to conduct these impartial conduct standards, are in effect now. The time between June 9th and January 1st, 2018 is known as the "transition period." Some of the more onerous provisions of those prohibited transaction exemptions were to come into play by that January 1, 2018, date.

Now there is a proposal by the new administration to push that final applicability date out 18 more months until July 1st of 2019. That delay has not been made final yet, but it looks like that is about to happen. There is the possibility of a lawsuit by consumer groups to try and roll back that delay, but it is vital that you understand where we are. So essentially, we are in the ninth inning and headed for extra innings, I guess you could say, under the Rule. The most important thing is to recognize that the fundamental Rule is in effect now.

During the transition period, there are certain things that don't apply, and these are what are considered to be the more controversial and more onerous elements of the Rule. Under the prohibited transaction exemption known as BICE – or the Best Interest Contract Exemption –

by the time that the Rule is to be finally implemented, there would need to be a designated compliance person in the financial services firm who's providing the advice, and there would have to be a written acknowledgment of fiduciary status by those who are providing advice. Material conflicts of interest would have to be disclosed, and any limitations of what products they could offer would also have to be disclosed.

Due diligence would have to be documented. In other words, that duty of care – those impartial conduct standards – would have to be documented so that there would be a record of how prudence was applied and demonstrated. Certain other records would also have to be maintained.

There are a couple of other prohibited transaction exemptions that are also impacted during this transition period. These relate to such things as annuities and principal transactions. The delay does address these most controversial elements of the Rule, but it also protects investors' interests. Because the main body of the Rule went into effect, it preserves the fiduciary principles while making certain practical concessions to make sure that advice is more broadly available.

During the transition period, some people have mistakenly latched onto the idea that this transition period is one of nonenforcement. They may have good reason to believe that because the DOL said that they would be lax in enforcement and heavy on education and assistance during the transition period. However, that is conditioned upon the adviser and the adviser's firm working diligently and in good faith to comply. Accordingly, the DOL issued a field assistance bulletin that makes it quite clear that you have to diligently and in good faith seek to comply.

Also note that there is already a private right of action under ERISA, so assets that are held directly in ERISA plans are already subject to lawsuits for breaches of fiduciary responsibility, for example. Also, the DOL has direct regulatory oversight and can have regulatory actions taken against those who violate the fiduciary obligation. Concerning individual retirement accounts, which are also covered under the Rule, the avenues for investors to have recourse are much more limited because they are not ERISA accounts.

FINRA, however, does oversee brokerage accounts, including IRAs, and the Number 1 complaint in a FINRA arbitration case is a breach of fiduciary responsibility, even though broker-dealers do not traditionally have that fiduciary obligation. A plaintiff will typically argue that "Advice was being given. This was not a counterparty transaction," and they will seek to hold the adviser accountable as a result of that.

Now that we have a Rule in effect that describes precisely what an adviser is, I think those FINRA arbitration cases will probably step up for those who to try to argue that they were not acting in a fiduciary capacity.

What Do You Need to Do to Comply?

If you are investment advisor or a plan sponsor, this will give you some idea of what the obligations under the Rule are and what to look for with respect to the advisers that are working with you to help you comply with the Rule, with your obligations.

“Impartial Conduct Standards” are the key to compliance with the Rule. Under the DOL Rule, the DOL said that impartial conduct standards under this Best Interest Contract Exemption require financial institutions and their advisers to do three things.

1. The first is to comply with the Best Interest standard. As you look at the three components of this, you must act with prudence. That then points directly to the fiduciary duty of care, and the duty of care is right there next to loyalty regarding the core obligation that every fiduciary has.

2. The advice must be individualized; in other words, you must know what it is that the end-investors are seeking to accomplish. The conduct must conform with the fiduciary duty of loyalty; in other words, conflicts must be managed. The next one is to charge only reasonable compensation. Your compensation as an adviser must not be excessive – some might even say unconscionable. That is why you get to a reasonable concept in the standard; if the compensation is too unreasonable, it is pretty apparent that this was not serving the client’s best interest.

That presents a problem under ERISA generally because there is a requirement under impartial conduct standards to ensure that only reasonable compensation is being taken for the services that are being rendered. The judgment of reasonableness is a matter of facts and circumstances.

3. Finally, the obligation is not to make misleading statements about the investment transactions or your compensation or the existence of *material* conflicts of interest or any other matters that are relevant to decision-making. Notice the word “material” in here. Material is information that someone would want to know before deciding as to whether to accept that advice. They would want to know, “What are the compensation ramifications of the advice that’s being rendered? What conflicts might exist? What are other matters that could influence whether I’m going to take your advice or not?” Those are the significant three requirements of impartial conduct standards.

Note that while this is specifically talking about prohibited transaction exemption requirements, and this phrase, “Impartial Conduct Standards,” was mainly assigned as it relates to that, Impartial Conduct Standards are virtually always required under a fiduciary standard. It really is the processes that need to be in place to protect the duties of loyalty and care.

Whenever we talk about that first obligation under the impartial conduct standards, that is merely the obligation to conform to the Best Interests standard. Moreover, here we have three parts involved in this as well.

1. The advice has to be prudent, it has to be individualized, and it must adhere to the duty of loyalty. How do we demonstrate this prudence or duty of care? It should signify the application of generally accepted investment theories and practices.

Just like when you go to the doctor, you would expect that they would be up-to-date on the state-of-the-art in medicine, that is what's required here for an investment advisor. They need to be current on what is considered state-of-the-art.That begins with due diligence. This is the obligation to research the alternatives that are available to the decision-maker, whether that is a plan sponsor or the plan participant. Add to that the assurance of reasonable cost and compensation. That is a standard fiduciary obligation, to match up compensation for the services that are rendered.

2. Next, advice must be individualized. It is the obligation to consider the client's objectives, risk-capacity, tolerance, and their needs in retirement. One also needs to consider the prevailing circumstances, such as the plan and account options. How much money should be deposited into the account over the course of time, and what would be prudent under those conditions? Market and economic conditions can influence the composition of the available investment options as well and specifically to the individual plan or the individual participant.
3. Lastly, there is adherence to the duty of loyalty. We have talked a good bit about that. Avoid conflicts of interest when possible. We mitigate those conflicts that might not be avoidable by using something like the prohibited transaction exemptions. You must disclose costs, conflicts, and any other material information, and there is a monitoring obligation that it must be consistent with the law and governing documents. Monitoring is typically expected of a fiduciary unless it is specifically excluded with the client's understanding. There is an obligation to document all of this so that if you are ever called into question, you would be able to establish your record of procedural prudence as an investment adviser.

True Retirement Professionals are Trustworthy and Competent

The two key attributes that professional advisers must have are to be trustworthy and competent, adhering to the duties of loyalty and care. When it comes to financial advice, all clients expect that the advice will be objective and competent. This is where I think we are looking to place our focus here – in that service component of all true professions.

The DOL Fiduciary Rule is in effect right now. While there is a part that is delayed, this is not something that can be set aside – that is, there are obligations that I described earlier that are important for you to follow now if you are an investment advisor. For those who are plan sponsors, be aware that these obligations are now in effect and that you can have a reasonable expectation to believe that they will be fulfilled.

Many people think the transition to a broader application of the fiduciary duty as something that is burdensome and something that means just more work. The reality is that whenever someone is seeking a doctor or an attorney, they look for those who are most expert in the area of need. To the extent that an adviser can model these fiduciary principles in processes – for example, with particular expertise in the retirement space – that can be very differentiating in the marketplace. It also starts to put the onus on those that are in the field of investment advice to elevate their game, if you will. When the bar has been leveled to where fiduciary obligations are required widely, think about which credentials might differentiate you in the marketplace that signify levels of competence and ethical obligations associated with being a professional adviser.

About Blaine Aikin, AIFA®, CFA, CFP® – Fiduciary Responsibility Expert:

The DOL Fiduciary Rule and Your Duty – Blaine Aikin

Blaine Aikin, AIFA®, CFA, CFP® is the Chief Executive Officer of fi360. Fi360 is a national and international leader in the field of investment fiduciary responsibility, providing training, Web-based analytical tools, and resources for those who manage money on behalf of others.

Blaine's specialties include fiduciary responsibility, investment management, financial planning, public policy and management. His goal as Executive Chairman of fi360 is to assure that fi360 provides exceptional professional development programs, investment and business management tools, and business and industry thought leadership to improve the decision making of those who manage money on behalf of others. fi360 seeks to promote a culture of fiduciary responsibility to align the interests of investors and investment professionals.

Blaine is the author of numerous articles on the subjects of fiduciary responsibility and investment management, and the author of the monthly Fiduciary Corner column in InvestmentNews magazine.

Are you looking for a retirement speaker for your next conference, consumer event or internal professional development program? Visit the Retirement Speakers Bureau to find leading retirement industry speakers, authors, trainers and professional development experts who can address your audience's needs and budget.

Retirement Speakers Bureau

Essential IRA Tips for Helping Clients Save Taxes and Avoid Penalties

www.retirement-insight.com/10-essential-ira-tips-helping-clients-save-taxes-avoid-penalties/

By Denise Appleby, CISP, CRC®, CRPS, CRSP, APA,
President of **Appleby Retirement Consulting, Inc.**
There is so much that we need to be paying attention to today to protect our clients. By the end of this article, I hope you learn how to prevent rollover and RMD mistakes that can cost your clients their IRAs, and help ensure that the right person inherits IRAs. The cost of making errors includes loss of tax-deferred status, premature taxation, early distribution penalty, excess accumulation, excise taxes … I could go on and on.

Denise Appleby, APA, CISP, CRPS, CRC®, CRSP – IRA Strategies for Mistakes Prevention Expert
Editor's note: This article is an adaptation of the live webinar delivered by Denise Appleby in 2017. Her comments have been edited for clarity and length.
You can read the summary article here as part of the 4th Qtr 2017 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)
You may also choose to take the full length course 10 Essential IRA Tips for Helping Clients Save Taxes and Avoid Penalties for 1.0 hours continuing education (CE) credit.

Abide by the One-per-year Rollover Rule

This rule applies to rollovers that occur between IRAs. I get asked this question a lot: "I am rolling over from my 401(k). Am I subject to the one-per-year rollover rule?" The answer is no. However, if someone breaks this rule, there is loss of tax-deferred status, excess IRA contributions from ineligible rollovers, and 6 percent excise tax if the ineligible rollover is not corrected properly and corrected by the deadline. So, what is this rule?

There are two ways you can move money between IRAs:

1. Transfers are nonreportable, and they are nontaxable. Usually, for a transfer to occur, you go to the receiving financial institution and say, "I have an IRA at another custodian. Please send them a request to send my money to the new IRA I have with you", and they will send it directly to the IRA. That is a trustee-to-trustee transfer. The IRS is never told about those

transactions because it is never reported on the tax return.

2. There are several reasons why someone might want to do a rollover. They may be impatient; they cannot wait on the transfer process, so they want to run over to Bank A, grab a check, bring it over to you, and it is done, possibly within a day. Alternatively, someone might say, “I am hard up on cash. I am going to take some money from my IRA and put it back within 60 days.” That is referred to as a rollover transaction.

The key to remember is that your clients can do only one IRA-to-IRA rollover during a 12-month period. Now, here is what is very important: This applies on an aggregate basis. So, if someone took a distribution from a Roth IRA and rolled it over within 60 days, they are locked up for the next 12 months. They cannot do another IRA-to-IRA rollover with their traditional SEP IRA or Simple IRA.

What I am encouraging you to do here is to tell your clients to use a trustee-to-trustee transfer method when they want to move their assets between IRAs unless they have no other choice. For those who want to use the rollover method, remind them that they can only do that once during a 12-month period because if they break that rule, any rollover that exceeds the first rollover becomes ineligible and is no longer eligible to be held in their IRA.

Obey the 60-day Rollover Rule

Someone who takes a distribution and puts it back must do so within 60 days, and if the rollover is proper – if it meets a 60-day deadline and the amount is eligible to be rolled over – then it is reportable, but not taxable. You will find that many clients do intend to complete this rollover within 60 days, but you make plans and life happens, right?

There are a prevalent number of rulings that the IRS has issued about these 60-day deadlines. People are saying to the IRS, “Please, I made a mistake; I was sick; I was in jail; my mom was sick; I could not completely roll over,” then you get an idea of how many people are missing this deadline for one or more reasons.

What happens if someone misses the deadline? The first thing is that the amount is no longer eligible to be rolled over unless they qualify for an exception. Then, you also have the loss of tax-deferred status and the 6 percent excise tax that accrues for every year that an ineligible rollover remains in the IRA until it is corrected.

The 60-day rollover rules can be used for IRA-to-IRA rollover; that is where the once-per-year rollover rule applies. You can also apply to moving assets between IRAs and employer-sponsored retirement plans. In that case, there is no one-per-year rollover rule.

Believe it or not, it also applies to Roth IRA conversion. Many people believe that the only way you do a Roth conversion is by a direct transfer, where you move the money directly from one account to another. However, you can also do a Roth conversion using the indirect Roth conversion method. Someone takes a distribution from a traditional IRA to the Roth IRA custodian and says, “Deposit this to my Roth IRA as the Roth conversion, and in that case, the Roth conversion must be completed within 60 days of receipt.

There are some cases where the 60-day deadline can be waived. The first is the automatic waiver. The way that applies is let is say an IRA custodian has a set of procedures that someone must follow to complete a 60-day rollover and the IRA owner did everything he or she was required to do. There have been cases where an assistant got a check, and it got stuck somewhere in a drawer and never got deposited to a client is IRA, or a client might have a regular checking account and an IRA, and somehow, the rollover check got deposited to the regular checking account. In a case like that, if the rollover is completed within a year – as opposed to the 60-day – then there is an automatic waiver.

There is a self-certification method that is pretty new where if your client meets a certain requirement, they can certify to the IRA custodian that they meet those requirements, and therefore, the custodian would complete the rollover within the allowed timeframe. If your client is not eligible for the automatic waiver or the self-certification, that is when they have to go to the IRS and say, “Please help me.” This service is not free. It is going to cost them $10,000, and there is no guarantee that the IRS is going to say yes. This process is called a private-letter ruling. Typically, they get an attorney involved who is familiar with the process, so you are not just talking about the IRS is $10,000 fee, but the attorney fee as well. As you can see, this is one of those cases where the prevention is better than the cure.

Spouse Beneficiary Assets Owned versus Inherited

This tip is very important for young spouses. I have seen many cases where a spouse beneficiary inherited an IRA, took a distribution later, and was subject to a 10 percent early distribution penalty when that could have been avoided. Why? Distributions from inherited accounts are automatically exempted from the 10 percent early distribution penalty.

A spouse beneficiary has two options: they can put it in their own IRA or keep the assets in an inherited IRA. The question for a financial advisor is, “What should I tell my client who is a spouse that just inherited an IRA from his or her deceased spouse?”

You are going to ask your client a couple of questions. One of them is, “How old are you?” If your client is a spouse beneficiary under age 59½, your follow-up question must be, “Do you plan to take the distribution from these assets before you reach age 59½?” If the answer is yes, then you want to keep those assets in an inherited IRA because distributions from the inherited IRA are exempted from the 10 percent early distribution penalty.

I am a big believer in checklists. I recommend you create a checklist especially for inherited accounts. Be sure to include if your client is a surviving spouse of the IRA owner, whether the client is under age 59½, and if so, whether or not you need to have that client keep those assets in an inherited IRA to avoid the 10 percent early distribution penalty.

Check Exceptions Before a Rollover

Money is always moving to and from retirement accounts. That includes moving between an IRA and an employer-sponsored retirement plan. You know that distributions taken before the retirement account owner reaches age 59½ are subject to a 10 percent early distribution penalty, but you also know that there are some exceptions to that 10 percent early distribution penalty.

Here is a tip: When your client comes to you to say, "I want to move money from my 401(k) to an IRA with you," ask the age question again, and if your client is under age 59½. Check to see if your client is losing an exception by rolling over those assets to you. Some of the exceptions to the 10 percent early distribution penalty apply to IRAs, some apply to employer-sponsored retirement plans, and some apply to both.

For example, a man qualified for what is referred to as the "age 55 exception." With the age 55 exception, if you separate from service with the employer that sponsors the retirement plan in the year you reach age 55 or later, any distribution that you take after you separate from services is exempted from the 10 percent early distribution penalty.

He knew that much, but what he did not know is that if he rolled over the amount to his IRA, then he would lose that exception, and that is exactly what he did. He took the distribution, rolled it over to his IRA, then took the distribution from his IRA. The custodian reported the distribution with a Code 1 in Box 7 of Form 1099-R to the IRS that the amount was subject to the penalty. The IRS came asking for the $20,000, he said, "I do not owe you," he took the IRS to court, and he lost. The tax court rightly said, "The minute you rolled over those assets to your IRA, then you lost that exception."

It works the other way, too. There are some exceptions that apply to IRAs that do not apply to employer-sponsored retirement plans, which is the first-time homebuyer exception. So, check with your clients who are doing rollovers to see whether or not they are going to lose an exception as a result of the rollover, and if that is the case, then any amount that they need to distribute immediately should be paid to them and not rolled over to the receiving account.

Meet the RMD Deadline

Individuals who are at least age 70½ need to take a required minimum distribution. Those who reach age 70½ this year and it is their first RMD can defer taking their RMD as late as April 1 of next year. What is the big deal? What if someone does not take their RMD? Well, the big deal is that they are going to owe the IRS a 50 percent excess accumulation penalty.

I recommend creating a list of clients who are supposed to take RMDs for the year. Some custodians will even go as far to send their advisors a report that says, "These are the clients that are supposed to take an RMD this year, and this is the amount the clients have taken in RMDs so far," so that you will know to which clients to reach out.

RMDs do not apply to Roth IRA owners, but they do apply to Roth IRA beneficiaries, and they apply to traditional SEP and Simple IRAs and employer-sponsored retirement plan accounts, including Roth 401(k)s, Roth 403(b)s, and Roth 457(b) accounts. We want to check to make sure that they do take RMDs from the accounts they are required.

Here is the one that people often forget: RMDs for inherited accounts. Custodians are required to monitor RMDs for IRAs or send out an offer to calculate the RMD upon request. They are not required to do any RMD reporting for inherited IRAs. So many inherited IRA owners forget or are unaware of the fact that they need to take RMDs from inherited accounts. When you are doing your RMD process for clients, just remember to include your clients with inherited accounts because they too are supposed to take RMDs. If they are supposed to take an RMD this year will depend on several factors, including whether or not the retirement account owner died before the required beginning date and the beneficiary options that are available to those beneficiaries.

What happens if you find out that your client missed the RMD deadline? Do not be too alarmed because the IRS says if the failure is due to reasonable cause, then they will waive the penalty. There has been only one instance in my experience where the IRS denied the waiver request, and that is because the CPA filled out the form incorrectly, and once we fixed that, then everything was fine.

If your client comes to you in January and says, “I did not take my RMD last year. I understand that I owe the IRS a 50 percent accumulation penalty. What should I do?” The first step is to find out whether or not the deadline was missed due to reasonable cause. In that case, you or the CPA can file IRS Form 5329 to ask for the waiver. You take the RMD; you include proof that the RMD has been taken or that steps have been taken to remedy the RMD shortfall, and you include an explanation to the IRS. It is very likely that they will honor the request to waive the penalty. The penalty is not paid unless the IRS comes back and says, “I am denying your waiver request,” so it gives your clients some time to get their house in order.

Aggregation Rules

A few months ago, I got a call from a financial advisor, and he was working with someone who had a 403(b) account and an IRA. He was not working with a school district anymore, so he was supposed to take RMDs. He liked how the 403(b) was performing, so he decided that he was going to leave the 403(b) as is and take the RMDs for the 403(b) and the IRA from his traditional IRA, and he had been doing that for ten years.

What is wrong with that picture? He knew that there was such a thing as an RMD aggregation rule. To honor the RMD aggregation rule, you can calculate your RMD for multiple accounts separately, but you can total the amount and take it from one or more of those retirement accounts.

The RMD aggregation rule does not apply to all types of retirement accounts, and if someone applies the RMD aggregation rule when it should not be applied, then technically, he is missing their RMD deadline. In his case, because he did not take any RMD from the 403(b), he missed the RMD deadline from the 403(b) for ten years, so he owed the IRS for ten years of the 50 percent excess accumulation penalty.

What does the RMD aggregation rule allow? If someone has multiple traditional IRAs – which for this purpose, are traditional SEPs and Simple IRAs – then the RMD for those retirement accounts must be calculated separately, but they can be totaled and taken from one or more of those IRAs. If someone has multiple 403(b) accounts, he or she can be calculated separately, but they can be totaled and taken from one or more of those accounts.

If someone has assets in multiple 401(k) plans – because that does happen, where clients may leave 401(k) assets at old employers – then the RMD for those accounts must be taken from the individual accounts. You cannot aggregate employer-sponsored qualified plans for RMD purposes.

The RMD aggregation rule is permitted only for multiple 403(b)s and for multiple traditional IRAs, and you cannot cross account-types. You cannot take the RMD for a 403(b) from an IRA and vice versa because if someone does that, then they are going to have an RMD shortfall for the account for which no RMD was taken.

Move Inherited IRAs Using the Transfer Method

If an IRA owner dies and leaves the IRA to a child, it is possible that that child might want to change financial institutions because they have a financial advisor that they like or prefer. They may not like their mother is financial advisor, so they want to move it to you because they like you.

The question becomes how should they move it to you, and if they use the wrong method to move that to you, then what happens? We are going to have the consequence of loss of tax-deferred status, excess IRA contributions from ineligible rollovers, and the 6 percent excise tax if not corrected.

Non-spouse beneficiaries that take distributions from retirement accounts cannot roll over those distributions. The only way to move inherited assets for non-spouse beneficiaries is to use the trustee-to-trustee transfer method. If the assets are coming from an employer-sponsored retirement plan such as a 401(k) and you are moving it to an IRA, it must be done as a direct rollover. If the assets are paid to the non-spouse beneficiary, then those assets cannot be rolled over.

If that happens, what you are going to have is a client who is a beneficiary with a check in hand for, say, $1 million, and they are sitting in your office saying, “This is my $1 million check. I took it from the IRA that I inherited from my rich uncle, and I want to put it in my IRA with you,” and you are going to have to deliver that bad news to say, “Well, because you took that check as a distribution, it is all over. You are no longer eligible to keep it in an IRA.”

As you know, in some cases, beneficiaries can take distributions over their life expectancy, which allows them to continue the tax-deferred benefit that was available to the IRA owner, and that can be very powerful – especially for Roth IRAs – because the earnings will eventually become tax-free for qualified distributions.

When you are talking to a beneficiary that inherited an IRA or employer-sponsored retirement plan, and they want to move those assets to you, I strongly recommend that you hold their hand throughout that transaction. Even if you tell your client, “Go tell the bank that you want a transfer,” I cannot tell you how many experienced people I have conversations with where, throughout the conversation, I have to stop them and say, “You mean a transfer, not a rollover, right?”

When you walk into a bank and tell them that you want to rollover your account when you mean you want to transfer, the bank is going to facilitate a rollover, so you want to make sure you are using the right terminology. For your client, hold their hand through the process, look at every piece of paperwork that they complete, and make sure that no paperwork is submitted to the financial institution without looking at it first and giving your client the thumbs up to say, “This is okay to be submitted.”

Stick by the 72(t) Rules

I do not see many people doing 72(t) distributions any more, and I guess it is because the job market is picking up. Distributions from retirement accounts are subject to a 10 percent early distribution penalty if they are taken before age 59½ unless an exception applies, and one of the exceptions is a 72(t) distribution or substantially equal period payment – SEPP for short.

72(t) is a section of a tax code which governs the rules, which is why we refer to it as 72(t). 72(t) distributions are subject to a strict set of rules. If a client is taking a 72(t) distribution and breaks any of the rules, then you have what is referred to as a “modification,” and if there is a modification, then the 10 percent penalty that was waived under the program is now owed to the IRS, plus interest.

You are probably saying, “Well, that does not sound too bad, does it?” Someone who starts a 72(t) distribution at age 40 would be required to continue that 72(t) distribution for 19 years. Now, imagine someone coming to you in Year 10 telling you that he or she has a modification. That means for all the 10 percent penalty that was waived ten years ago; they now owe the IRS all those 10 percent penalties that were waived plus interest, so you can see how serious that is.

The lesson here is if you have a client who is taking 72(t) distributions, I strongly recommend giving them a checklist of the things that they can and can it do with a 72(t) program. If they break any one of those rules, then, of course, we are going to have to have that conversation about the recapture of the 10 percent early distribution penalty.

Other things that you cannot do with a 72(t) are once you start the program with the IRA, you cannot make a rollover contribution to that IRA. You cannot do partial transfers, you cannot commingle with other accounts, and you cannot take less or more than the 72(t) amount.

Do Beneficiary Audits

I would be willing to take a bet that if we survey IRA owners (retirement account owners and beneficiaries), it will show that one of the Top 5 mistakes made with retirement accounts is that the wrong beneficiary inherits the retirement account. In many cases, this could be prevented.

A beneficiary audit is not complicated. You are going to check to see who the beneficiary is on a retirement account and whether the beneficiary form has been completed properly.   Believe it or not, something as simple as naming three primary beneficiaries of a retirement account and giving each 25 percent could invalidate a beneficiary form (25% times 3 is 75 percent, right)? The custodian gets that form, sees that there are three beneficiaries, to whom each is allocated 25 percent. That does not add up to 100, and they kick it back and send the client a letter saying, “Your beneficiary form is invalid. You need to revise it and send one in.”

Your client gets the letter and never looks at it.   When the client dies, the kids come forward to claim the IRA, only to find out that there is no beneficiary, so they are not the beneficiaries and depending on the terms of the IRA agreement, the estate might be the beneficiary. The consequence is not only can the wrong person inherit the retirement account, but the distribution options to the beneficiaries could then be very limited.

There are also cases where if there is no beneficiary named, or if the beneficiary dies before the retirement account owner, then we have to look to the IRA agreement or plan document to determine who is the default beneficiary of the retirement account.

When naming a beneficiary, there are several things that should be taken into consideration, like whether the beneficiary is a designated or a non-designated beneficiary. You can name anyone as a beneficiary, but you can also name non-persons as a beneficiary – for instance, a charity or an estate. Usually, when it is a charity or an estate that is named as a beneficiary, then the distribution options that are available to the beneficiaries are more limited, and that remains the case even if there are multiple beneficiaries and one of those beneficiaries is a non-person.

Assume a retirement account owner dies before the required beginning date, or before they are supposed to start taking RMDs. There are two beneficiaries, one charity, and one child, so both are required to take full distribution within five years unless the charity distributes its share by accepting it by September 30th of the year following the year of death. If the distribution by the charity is done by September 30th of the year following the year of death, then the remaining individual who is a beneficiary would be able to take distributions over his or her life expectancy.

I have seen many cases where people have spent thousands of dollars updating their will. In the will, they will state, "I want John Brown to be the beneficiary of my IRA." This approach does not work for the IRA because the only way to name a beneficiary for an IRA is to complete the beneficiary form or if the beneficiary is determined under the default provisions of the IRA agreement.

Key Takeaways for Advisors

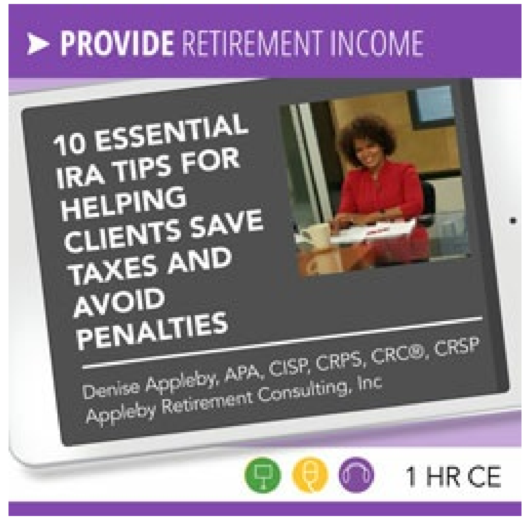
1. Ensure that clients understand the rules and limitations that apply to the different methods for moving their retirement accounts. For instance, if someone is rolling over assets from a 401(k) to an IRA, it should be done as a direct rollover to avoid the mandatory 20 percent withholding on any pretax amount.
2. Determine if there are solutions for errors that have been made with transactions. Most of my clients came to me because of mistakes that had been made, and I have developed a reputation for putting in preventative measures and fixing mistakes. Advisors will come to me very worried, saying, "My client made this mistake, and I am so worried because I do not want to have this conversation with them." You will want to check first to see if there is any solution before you give a client the bad news.
3. Add a beneficiary checkup to your annual review for your client and perform this checkup not just for the accounts that you have under management, but for accounts that they have elsewhere as well. You may find out that your client has an old 401(k) with a $10 million balance that they did not even know they could move.
4. Determine if the client will lose any exceptions to the 10 percent early distribution penalty before you recommend that they move those assets, and
5. Ensure that RMDs are taken by the deadline.

It is okay to show your clients why they need to come to you – not just for investment advice, but for information about how to help protect the tax-deferred status of their retirement account. Show them some of the cases as examples. These are people who thought they knew the rules, but they did not, and because they decided to do it on their own, they ended up losing their retirement accounts.

About Denise Appleby:
Denise Appleby, APA, CISP, CRPS, CRC®, CRSP founder and owner of Appleby Retirement Consulting, Inc, a firm that provides IRA tools and resources for financial and tax professionals.
Denise Appleby, APA, CISP, CRPS, CRC®, CRSP – IRA Strategies for Mistakes Prevention Expert
Denise Appleby, APA, CISP, CRPS, CRC®, CRSP – IRA Strategies for Mistakes Prevention Expert

Denise has over 15 years of experience in the retirement plans field, and has co-authored several books and written over 400 articles on IRA rules and regulations.

Denise held several senior retirement plans related positions with Pershing LLC, which includes Vice President of Retirement Plans Products and Services, Retirement Plans Manager, Trainer, Training Manager, Compliance Consultant, Technical Help Desk Manager and Writer. Denise has extensive experience with training the staff and financial advisors of many broker-dealers on retirement plans related topics. Denise has also provided training to hundreds of financial advisors, as well as tax and legal professionals on the rules and regulations that govern IRAs, SEP IRAs, SIMPLE IRAs and qualified plans.



10 Essential IRA Tips for Helping Clients Save Taxes and Avoid Penalties – Denise Appleby

Denise's wealth of knowledge in retirement plans led to her making appearances on CNBC's Business News, Fox Business Network and numerous radio shows, as wells as being quoted in the Wall Street Journal, Investor's Business Daily, CBS Marketwatch's Retirement Weekly and other financial publications, where she gave insights on retirement planning. Her expertise and knack of explaining complex retirement plans rules and regulation, so that they are easily understood, created a demand for her to speak at various conferences and seminars around the country.

Are you looking for a retirement speaker for your next conference, consumer event or internal professional development program? Visit the Retirement Speakers Bureau to find leading retirement industry speakers, authors, trainers and professional development experts who can address your audience's needs and budget.

RETIREMENT SPEAKERS BUREAU

Retirement Speakers Bureau

Earn 1 free Continuing Education (CE) credit for the January, 2018 Issue of InFRE's Retirement InSight and Trends

www.retirement-insight.com/earn-1-free-continuing-education-ce-credit-january-2018-issue-infres-retirement-insight-trends/

You can earn 1 CRC®, CFP®, ASPPA, and the American College's Professional Recertification Program (CLU®, ChFC®, CASL) CE credit for the January, 2018 issue of Retirement InSight and Trends.

Click here to access the quiz and earn 1 free CE credit upon successful completion of the quiz.

When you have completed the last question, click the "submit" button to submit your final answers. You may not return to review or change your answers after clicking submit or if you close the browser window. You may restart the quiz if needed.

A score of 70% is required to pass the quiz and earn CE credit. You will see your score on your screen upon submitting your answers. An email will automatically be sent to you for your records as proof of successful completion.

Click here for additional CE opportunities through InFRE's CE partner, the Int'l Retirement Resource Center.