ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning For Your Retirement Savings

WHAT'S INSIDE?

Join the Retirement Planning Conversation

Pitfalls of the 60-Day Rollover

The 2019 summer movie season is coming to an end, and the undisputed box-office champ is Walt Disney Studio's *Avengers: Endgame*, which has grossed almost $2.8 billion worldwide, making it the highest-grossing movie in history. It just goes to show how much moviegoers love watching comic book heroes manage all those nail-biting, hair-raising escapes from danger.

When it comes to facing the IRS, narrow escapes aren't so fun to watch. Sometimes, they're just too close for comfort – *especially if they could have been easily prevented.*

That's what happened in the recent Tax Court case Nancy Burack v. Commissioner; T.C. Memo. 2019-83; No. 11819-17; July 8, 2019 when a simple IRA rollover spiraled into a five-year ordeal in which the taxpayer just missed being assessed $257,000 in taxes and penalties on a late 60-day rollover.

The Burack Case

On June 25, 2014, Nancy Burack received a distribution of $524,981 from an IRA. She used the funds to purchase a new home while awaiting the closing of the sale of her former home. Nancy intended to redeposit the sale proceeds back into her IRA with the same financial institution as a 60-day rollover.

On August 21, 2014, Nancy received a check in the same amount from the closing of her old house and, following the instructions of the financial institution, overnighted the check to them.

The institution received the check on August 22, 2014 – *58 days after the June 25 distribution.* However, the bank did not deposit the check into Nancy's IRA account until August 26 – *62 days after the distribution.*

The IRS determined that Nancy's redeposit of funds was not made within the 60-day rollover period and therefore assessed her $524,980 (oddly, a dollar less than the $524,981 distribution amount) of additional taxable income for 2014. This meant she owed more than $257,000 in taxes and penalties.

Nancy appealed to the Tax Court. First, she argued that the late deposit of funds was due to a bookkeeping error on the part of the financial institution. Second, she argued that the payment qualified for an automatic hardship waiver.

The Court accepted both arguments, allowing Nancy to make a Captain Marvel-like escape. But the real significance of the case is not the outcome; it's how vividly the case illustrates several important IRA lessons with which advisors must be familiar.

Executive Summary

Pitfalls of the 60-Day Rollover

- The 60-day rollover deadline can easily be missed, and the tax consequences can be catastrophic.
- 60-day IRA rollovers are subject to the once-per-year rule. The 12-month period is not a calendar year, and it starts on the date when funds are received.
- The once-per-year rule applies to traditional IRA-to-traditional IRA rollovers and Roth IRA-to-Roth IRA rollovers. It does not apply to company plan-to-IRA rollovers, IRA-to-company plan rollovers or traditional IRA-to-Roth IRA conversions.
- Reverse rollovers are made the same way as plan-to-IRA rollovers – *either through a direct rollover or a 60-day rollover.*
- 60-day rollovers from company plans are subject to 20% tax withholding.
- Instead of a 60-day rollover, clients should be strongly advised to do a direct transfer whenever possible.
- When the 60-day rollover deadline is missed, relief can potentially be achieved through an automatic hardship waiver, PLR or self-certification.

The Backdoor Roth IRA – A Beautiful Friendship

- In order to contribute directly to a Roth IRA, a person and/or a spouse must have earned income.
- After age 70½, contributions are allowed to a Roth IRA but *not* allowed to a traditional IRA.
- The backdoor Roth IRA is a legal strategy that allows higher income clients phased out of making contributions directly to a Roth IRA to contribute to a traditional IRA and then convert those dollars to a Roth IRA.
- The pro-rata rule, which includes all of a client's traditional IRAs, including SEP and SIMPLE IRAs, must be considered prior to converting a traditional IRA to a Roth IRA.
- Funds must leave the plan or traditional IRA by December 31 in order to be a conversion for that year.
- Allow the initial IRA contribution for the backdoor Roth IRA strategy to sit for roughly a month prior to the conversion in order to create the first step on a statement paper trail.

Rolling Out of Rigid Retirement Plans

- TIAA products include CREF variable annuities, with multiple investment options. Such holdings can easily be rolled into a new or existing IRA.
- Participating workers may have a TIAA Traditional Annuity. Access to this asset may be restricted while the upside is limited, so some clients might want to reduce or eliminate this holding and diversify.
- TIAA offers a Transfer Payout Annuity (TPA) as an option for people who want to move some or all of their TIAA Traditional balance elsewhere.
- If clients have a TPA account with TIAA when they are age 70½ or over, communicate with these clients every January to alert them of a possible required minimum distribution (RMD) trap.
- To help clients comply with their RMDs, guide them through the "Backdoor IRA Transfer."

60-Day Rollover Lessons

Lesson #1: The 60-day deadline can easily be missed. One important lesson is just how risky a 60-day rollover can be. It is tempting for a client to want to use an IRA distribution as a short-term loan with the intention of paying it back within 60 days. *Yet, advisors should be extremely hesitant about recommending rollover funds be used in that manner.* Too many unanticipated events can cause the 60-day deadline to be missed. For the same reason, advisors should be wary of accepting IRA funds based on what the client believes to be a valid 60-day rollover. Timing must be verified.

Lesson #2: The tax consequences can be catastrophic. Another crucial lesson is that a failed rollover can create devastating tax consequences. If the IRS had prevailed in the *Burack* case, the entire rollover amount would have been considered a taxable distribution, adding over $500,000 of taxable income to Nancy's 2014 tax bill. In addition, if she were under age 59½, an additional 10% early distribution penalty would have applied.

Finally, if considered late, the rollover could have been deemed an excess contribution in the receiving IRA and subject to a 6% annual penalty unless timely withdrawn.

Lesson #3: 60-day IRA rollovers are subject to the once-per-year rule. Even a rollover made within 60 days won't relieve clients from potentially serious tax consequences if they violate the once-per-year rule. Certain 60-day rollovers are limited to one per person (not one per account) in every 12-month period. The 12-month period is not a calendar year, and it starts on the date when funds are received.

The once-per-year rule applies to traditional IRA-to-traditional IRA rollovers and Roth IRA-to-Roth IRA rollovers. It does not apply to company plan-to-IRA rollovers, IRA-to-company plan rollovers or traditional IRA-to-Roth IRA conversions.

While there may be relief available when the 60-day deadline is missed, there is no similar relief when the once-per-year rule is violated. Clients who run afoul of this rule will face the same serious tax consequences as if the 60-day deadline had been missed.

Example: Zoë, age 52, has a Roth IRA and a traditional IRA, both with Teberg Bank. She withdraws her Roth IRA funds on October 22, 2019 and subsequently rolls them over to a Roth IRA with YZ Bank.

Zoë also wants to do a 60-day rollover of her traditional IRA. If she withdraws her traditional IRA funds any time before October 22, 2020, that withdrawal will be taxable, even if rolled over within 60 days. Since she is under age 59½, the withdrawal will also be subject to a 10% early distribution penalty.

Zoë's traditional IRA deposit will be considered an excess contribution (and not a valid rollover) and subject to a 6% penalty each year it stays with YZ Bank until fixed.

Lesson #4: 60-day rollovers from company plans are subject to 20% tax withholding. If a 60-day rollover comes from a company plan, the plan must withhold 20% of the distribution for federal income taxes and may be required to withhold even more for state taxes. (Note that 20% mandatory withholding does not apply to IRA distributions.)

Clients who run afoul of this [once-per-year] rule will face the same serious tax consequences as if the 60-day deadline had been missed.

Lesson #5: Keep track of the 60-day period. Despite the possibility of things going wrong, a client may still opt to go ahead with a 60-day rollover either because the client is unaware of the risks or because the client wants to use the rollover money for something outside the IRA. In these cases, it is crucial to keep track of the 60-day time limit.

Lesson #6: Direct transfers are the solution. Instead of a 60-day rollover, clients should be strongly advised to do a direct transfer, often called "direct rollovers" when the distribution is paid from a company plan, when possible. In a direct transfer, the IRA custodian or plan trustee of the outgoing funds directly transfers the funds to the receiving IRA custodian. The funds are never made available to the IRA owner or plan participant.

If the custodian or trustee cannot or will not transfer the funds directly, there is a workaround. The custodian or trustee can issue a check to the IRA owner or plan participant – *payable to the receiving custodian (not to the IRA owner or plan participant)* – and instruct the IRA owner or plan participant to deposit the check with the receiving custodian.

Example: Steve Rogers wants to make a direct transfer of his IRA funds to Bank B, but his current bank will not do a custodian-to-custodian transfer. If the current bank instead mails Steve Rogers a check payable to: "Bank B as custodian of the IRA of Steve Rogers," his deposit of that check with Bank B would qualify as a direct transfer.

A direct transfer not only guarantees that the 60-day rollover deadline won't be missed but also avoids the once-per-year rule. And, if the distribution comes from a company plan, a direct transfer is also exempt from the 20% mandatory withholding.

Avenues for Relief

Taxpayer Nancy Burack's court case also provides lessons on options available to a client who proceeds with a 60-day rollover but misses the deadline.

Lesson #7: Stay out of court. Clearly, a client should be advised to stay away from court if at all possible. As illustrated by Nancy, going to court will force a client to spend substantial amounts in legal fees and time. And it may not end when a verdict is finally reached – *the IRS can always appeal the Tax Court decision, stretching matters out even further.*

To help clients avoid expensive and time-consuming litigation, advisors need to know that avenues of relief outside the courtroom may be available when the 60-day deadline is missed.

Lesson #8: Don't forget the automatic hardship waiver. An automatic hardship waiver is an often-overlooked strategy for relief when the 60-day rollover deadline is missed. Clients who qualify for the waiver do not even have to apply.

Under Rev. Proc. 2003-16, IRS will automatically grant a waiver when

BOTH of these criteria are met:

1. The funds are deposited into an eligible retirement plan within one year from the date the distribution was received; and
2. The rollover would have been a valid rollover if the financial institution had deposited the funds as instructed.

Lesson #9: PLR relief may be available. In Rev. Proc. 2003-16, the IRS allowed taxpayers to apply for a waiver of the 60-day rule by requesting a PLR, and hundreds of taxpayers have taken advantage of that opportunity.

However, PLR requests are expensive (the IRS user fee is $10,000 and professional fees can add thousands of dollars more) and slow (a ruling can take as long as nine months). And, depending on the facts surrounding the late rollover, there is no guarantee of success. In the *Burack* case, for example, Nancy may have been out of luck, because IRS does not usually grant PLR relief for late 60-day rollovers when the distribution is used as a short-term loan.

Lesson #10: Self-certification can be a godsend. A client who misses the 60-day rollover deadline can obtain relief through self-certification under Rev. Proc. 2016-47 – *a cheaper and faster alternative to a PLR.*

He can use self-certification only if the late rollover was for one or more of the 11 reasons specified in the Revenue Procedure. Your client must complete a self-certification letter (IRS provides a "Model Letter" in the appendix to the Revenue Procedure) and submit it to the IRA custodian or plan administrator – *not to the IRS.*

The late rollover should be completed as soon as practicable, but preferably within 30 days.

There is no filing fee for using self-certification. Self-certification is available only if the late rollover is otherwise valid. For example, if the once-per-year rule is violated, self-certification will not help. Self-certification is not a waiver of the 60-day rule. It does allow the late rollover, but it is possible for the IRS to disallow it later in an audit.

The Most Important Lesson

Lesson #11: If a direct transfer is used instead of a 60-day rollover, the client does not have to worry about complying with all of the strict IRS rollover guidelines or about fixing the transaction if any of those rules are violated.

If your clients insist on using the 60-day rollover, advisors can become an *Avengers* comic book hero by ensuring that the funds are eligible to be rolled over and that the rollover is completed before the 60-day deadline. ■

The Backdoor Roth IRA – A Beautiful Friendship

Like Humphrey Bogart in the movie *Casablanca*, nightclub managers must maintain strict control over their establishments. Bouncers are given firm rules as to who and who cannot enter.

"Club Roth" is no different. The IRS stands sentry at the front door, monitoring the crowd along the velvet rope line. Those refused entry can still hear the music inside Club Roth and some crafty patrons, determined to get in, will walk around the perimeter of the building. There, in the back, they will find another entry point. The line is short and there are just a few steps to enter. Welcome to the backdoor of Club Roth.

Roth Eligibility

To contribute directly to a Roth IRA, a person and/or a spouse must have earned income.

Individuals can make contributions to a Roth IRA for themselves and/or their spouses who are not working (or have very little income) as long as they file a joint tax return. The working spouses simply must make enough income to cover the contributions made for both of them.

> To contribute directly to a Roth IRA, a person and/or a spouse must have earned income.

Age is not an impediment. Roth owners age 70½ or older and still working (have earned income) can make Roth IRA contributions.

For 2019, Roth IRA contributions are limited to $6,000 (or $7,000 if age 50 or older). The amount of modified adjusted gross income (MAGI) also factors into Roth IRA eligibility.

Additionally, phase-out limits exist. For 2019, they are:

- **Married/filing joint: $193,000 - $203,000**
- **Single or head of household: $122,000 - $137,000**

If a person or couple's income is above these phase-out limits, entry into Club Roth's front door will be denied.

If a client overcomes these hurdles, nothing can prevent a person from contributing directly to a Roth IRA.

The Backdoor Strategy

The backdoor Roth IRA is a work-around strategy that allows higher income clients phased out of making contributions directly to a Roth IRA to get new money into a Roth IRA on a regular schedule.

An individual contributes to a traditional IRA and then converts those dollars to a Roth. Typically, these will be non-deductible contributions to the traditional IRA (reported on Form 8606, discussed later) that will avoid taxes when the conversion is completed.

However, if a deduction is taken for the original contribution to the traditional IRA, or if the conversion includes other pre-tax dollars, taxes will be due. (Taxes are also due if there is investment gain between the date of contribution and the date of conversion.)

There are no maximum income limits of any kind that can reduce or eliminate a client's ability to make a *traditional* IRA contribution. Furthermore, active participation in an employer-sponsored retirement plan has no impact on traditional IRA contribution eligibility. (Note that it may impact deductibility.)

2019 phase-out ranges for IRA deductibility for those covered by a company retirement plan are:

- **Married/filing joint: $103,000 - $123,000**
- **Single or head of household: $64,000 - $74,000**

Remember, because the first step of the backdoor Roth process is a traditional IRA contribution, the client must have earned income. In addition, the client must not reach age 70½ during the year for which the contribution is made. Older clients will be shut out of the backdoor Roth IRA strategy because of their age.

Example: Rick would like to make a Roth contribution. Unfortunately, his $300,000 MAGI puts him above the allowable "front door" threshold. Rick actively participates in a 401(k) plan, so he is also phased out of taking a deduction for his traditional IRA contribution. Rick does not have any traditional, SEP, or SIMPLE IRAs.

If Rick contributes $6,000 to a traditional IRA, he will have no deduction and his contribution will go in as after-tax funds.

A month later, when his IRA account has risen to $6,100, Rick converts his traditional IRA to a Roth IRA. Since $6,000 of the $6,100 converted consists of after-tax dollars, only the $100 gain will be taxable upon conversion. Thus, Rick will have already paid tax on a total of $6,100 – *the entire balance of his new Roth IRA at that point.*

> The backdoor Roth IRA is a work-around strategy that allows higher income clients phased out of making contributions directly to a Roth IRA to get new money into a Roth IRA on a regular schedule.

The Pro-Rata Rule Effect

The pro-rata rule dictates the taxation of an IRA distribution (or conversion) when the IRA owner has an IRA containing after-tax amounts. The rule states that, in general, an IRA distribution or conversion will consist of the same proportion of pre-tax and after-tax amounts as the IRA owner owns in all their IRAs combined. All of a client's traditional IRAs, including SEP and SIMPLE IRAs, are considered one giant IRA.

The pro-rata formula is often overlooked by clients eager to get into Club Roth and can result in an unexpected tax bill. This is a bigger problem now than it was in the past, because the 2017 Tax Cuts and Jobs Act (TCJA) did away with recharacterization. With no more "do-overs" for unwanted conversions, advisors must make certain that clients who use the backdoor Roth IRA strategy understand the tax consequences.

Example: Ilsa is in the same situation as Rick, except she also has a SIMPLE IRA from a previous employer with a balance of $54,000. Ilsa makes a non-deductible contribution of $6,000 to a separate traditional IRA and wants to immediately leverage the backdoor Roth strategy by converting those dollars to a Roth.

The pro-rata formula requires Ilsa to consider her total balance in all IRAs to calculate the tax on her conversion. Of her $60,000 total, 90% ($54,000) is pre-tax. When Ilsa converts the $6,000 to a Roth, she will owe tax on 90% ($5,400).

Who Can Do a Roth IRA Conversion?

Anyone with a retirement account that's eligible to be rolled over can do a Roth IRA conversion. There are no longer any income limits on Roth conversions, although they still exist for Roth contributions. This strange anomaly in the tax rules creates the opening for the backdoor Roth strategy.

As for timing, the funds must leave the plan or traditional IRA by December 31 in order to be a conversion for that year. You do not have until April 15 as you do with a Roth contribution. There is no such thing as a "prior year conversion."

Is the Backdoor Roth IRA Strategy Legal?

In the past, there were concerns over whether the backdoor Roth strategy was legal. *Did it violate the step-transaction doctrine which is usually applied to prevent tax abuse?* This is no longer a worry.

The Congressional Conference Report for the TCJA said multiple times that the backdoor Roth was acceptable, specifically stating:

> *"Although an individual with AGI exceeding certain limits is not permitted to make a contribution directly to a Roth*

IRA, the individual can make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA."

Custodial Tax Reporting

If your client contributes to her traditional IRA, the custodian should issue IRS Form 5498. The custodian has no responsibility to distinguish whether such a contribution is deductible or not.

Deductibility is handled entirely on a client's personal tax return using either IRS Form 8606 to report a nondeductible contribution or IRS Form 1040 to report a deduction.

When the traditional IRA funds are later converted, the custodian will issue a Form 1099-R for the Roth IRA conversion. Once again, clients are responsible for reporting the tax impact of such a transaction on their personal returns using IRS Forms 8606 and 1040.

Finally, the Roth IRA custodian will issue a Form 5498 showing the amount of the conversion received by the Roth IRA. From these forms, the IRS will look for taxes due.

Advisor Takeaway

Be aware of the four common obstacles on the way to the back door, as they are a tripping hazard:

1. A person and/or a spouse must have earned income to gain access via the backdoor.
2. Traditional IRA contributions can no longer be made for the year one turns 70½ and thereafter.
3. The pro-rata rule applies to backdoor Roth conversions.
4. The funds that end up in the Roth IRA through a backdoor conversion are converted funds, NOT Roth IRA contributions.

Consider ordering rules for withdrawals; this makes a significant difference for those under age 59½. The 10% early distribution penalty is not assessed at the time of a Roth IRA conversion. However, it can be assessed if any of the converted amounts are distributed to the Roth owner within five years of the conversion when the owner is under age 59½ at the time of the distribution.

Consider ordering rules for withdrawals; this makes a significant difference for those under age 59½.

If the funds entered via the front door as Roth IRA contributions, they would be accessible immediately, tax and penalty-free.

It is important to remember that a 2019 IRA contribution can be made up to the tax filing due date, April 15, 2020. There is no extension beyond that date, regardless of whether an extension is filed for the tax return.

If a contribution is made for the prior year, the conversion of that contribution will apply to the calendar year when the conversion is actually done.

In addition, it is recommended that the initial IRA contribution be allowed to sit for roughly a month prior to the conversion. There are no rules stating that a contribution cannot be converted immediately but by waiting a few weeks, the contribution should appear on a statement and start the paper trail.

With IRS' approval of the backdoor Roth IRA strategy and a full understanding of the tax ramifications of converting, clients can confidently climb the back stairs to Club Roth. Clients will undoubtedly appreciate their advisor's backdoor Roth guidance and might say to themselves, as Bogart said to Rains in the last line of *Casablanca*, "Louis, I think this is the beginning of a beautiful friendship." ■

Rolling Out of Rigid Retirement Plans

Guest IRA Expert

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In today's world, many people do most of their retirement saving via employer-sponsored plans. Most of these plans offer acceptable options for the participant's accumulation phase, but when clients are in the distribution phase – *relying on income from their savings* – they may seek greater diversification than the choices offered by their company plan.

Should this be the case? Such desires may be found among clients who work outside the public sector, especially educators and hospital employees. Often, their retirement accounts are held at TIAA (formerly TIAA-CREF). Millions of American workers and retirees have TIAA accounts, so many advisors will be working with clients whose retirement funds are held there. Insights from experience dealing with TIAA products may be useful in helping these clients as well as others who find their company plans too limiting.

TIAA products include CREF variable annuities, with multiple investment options. We have found that such holdings can easily be rolled into a new or existing IRA.

If such clients wish to do a tax-free rollover to an IRA, then the entire CREF portion can be rolled over right away, using specific forms for that purpose. Advisors can contact TIAA to learn the procedure for a direct rollover.

10-Year Hitch

Besides CREF variable annuities, participating workers may have a TIAA Traditional Annuity. The TIAA Traditional is a fixed annuity, designed to be a guaranteed account.

Its purpose is to provide a decent interest rate for participants, during the accumulation phase. (In August 2019, the crediting rate was 3.5%.) Once these workers move into retirement, they can annuitize and receive lifetime income.

As is the case with any type of payout annuity, longevity insurance (lifetime income that goes beyond life expectancy) can be a prime benefit of TIAA Traditional. On the other hand, access to this asset may be restricted while the upside is limited, so some clients might want to reduce or eliminate this holding and instead diversify among asset classes such as stocks, bonds, and alternative investments.

Transfer Tactics

Withdrawing assets from TIAA Traditional is not simple, as this plan is designed to provide an income annuity at retirement. Although there are some contracts that allow withdrawals from TIAA Traditional (in return for crediting a lower interest rate to investors), I've never worked with a client who had this option.

In my experience, the shortest length of time to roll out of TIAA Traditional is by taking 10 payments over 9 years. TIAA offers a Transfer Payout Annuity (TPA) as an option for people who want to move some or all of their TIAA Traditional balance elsewhere, as an IRA rollover or as a cash withdrawal.

As long as the TIAA Traditional balance is at least $10,000, annual payments of about 10% of the designated amount can be moved into a new TPA contract.

Example: Alice has $500,000 in her TIAA Traditional in November 2019, when she decides to move all of that money into a TPA. Alice will receive $50,000 (10%) from this arrangement within a short time.

In succeeding years, the TPA will automatically transfer another $50,000, plus any earnings, to the rollover IRA of Alice's choice or via a taxable cash withdrawal. This procedure will continue through 2028, after which Alice will no longer hold any assets in the TPA.

As long as those annual payments from the TPA are directly rolled to an IRA, income tax won't be triggered. Alice, working with her advisor, can choose an investment strategy that meets her specific needs.

For money in a TPA, TIAA will keep the beneficiary named in the original TIAA Traditional contract. That beneficiary designation can be changed once that TPA is in place.

Note that money moved via a TPA into a taxable account will be subject to 20% withholding for federal income tax and perhaps state income tax withholding as well. Depending on the client's age, a 10% early withdrawal penalty may apply.

Regarding RMDs

Clients may want to move money from TIAA Traditional to a TPA once they have retired or as they near the end of their careers. Thus, they may already have reached age 70½, subject to required minimum distributions (RMDs), or their required beginning date (RBD) may occur during the 9-year transfer period.

> We have found that such [TIAA products] holdings can easily be rolled into a new or existing IRA.

Either way, they must deal with RMDs after age 70½. Good planning can minimize exposure to the 50% penalty for RMD shortfalls while keeping as much money as possible within tax-favored IRAs.

Suppose Alice was born in June 1949, so she will reach age 70½ in December 2019. If so, Alice will start RMDs for 2019, due by April 1, 2020, based on her IRA balances on December 31, 2018. Future RMDs will be due on December 31 of 2020 and each year after that, as long as Alice still has any money in her IRAs.

While helping Alice through the TPA process, her advisor can work out a plan to assure compliance with RMDs. To help clients in such circumstances, advisors should keep in mind that TIAA will no longer transfer Alice's hypothetical payment to an IRA once Alice is required to take RMDs.

Through the Back Door

In order for Alice to take her RMD and transfer the balance of her payout to her IRA, her advisor should make sure she takes certain steps.

Alice would need to change the payout by reinvesting in a CREF liquid account, then taking her RMD, and finally rolling the balance to the IRA she chooses.

TIAA suggests that such transfers to the participant's IRA be "future dated," in order to avoid the IRA transfer preceding the RMD. Unfortunately, this needs to be done every year until all the relevant payments have been

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processed in this manner. I call this the "Backdoor IRA Transfer."

Suppose that Alice's year-end 2018 balance in her TIAA Traditional Annuity was $500,000. Alice will owe an RMD for 2019, the year she reached age 70½. (She also had her 70th birthday that year.)

On the IRS Uniform Lifetime Table, the life expectancy factor for age 70 is 27.4, so Alice's RMD for the TIAA Traditional Annuity will be $500,000/27.4 = $18,248.

TIAA would pay Alice the entire $50,000 unless she does the paperwork to transfer the $50,000 payment from her TIAA account to a CREF liquid account. Only then can Alice process her RMD of $18,248 and future date a direct transfer of the remaining distribution ($31,752, in this example) to her IRA.

Realism on Returns

In addition, Alice's advisor should keep her tax preparer apprised of this arrangement. The tax pro will know that Alice's RMDs from the TIAA-CREF and direct transfer have been received, and accurately reported on her tax returns.

Advisors should remind clients entering into a TPA — *or making any similar move from a fixed product to diversified holdings* — that an RMD cannot be rolled over.

For taxpayers over age 70½, the first dollars distributed from a retirement account go to satisfy the annual RMD, after which the amount above the RMD can be allocated to desired asset classes.

Indeed, the nine annual TPA payouts can provide an ideal time for advisors to hold portfolio reviews with retirees and pre-retirees involved in these arrangements. After paying tax on the RMD, remaining assets can be rebalanced or moved into new holdings, following a conversation about these clients' current goals and objectives.

Advisor Action Plan

- Determine which clients have a significant amount of retirement funds in annuities or similar products with scant investment options. Suggest a more diversified approach to asset allocation.
- Remind clients in these arrangements that they must calculate, pay, and report the tax payments on RMDs each year.
- Emphasize that properly handled direct rollovers can address concerns about RMDs yet ensure that most money in illiquid accounts moves into IRAs.
- If clients have a TPA account with TIAA when they are age 70½ or older, communicate with these clients every January to alert them of a possible RMD trap.
- To help such clients comply with their RMDs, guide them through the "Backdoor IRA Transfer," described in this article. ■

Carol Schmidlin, MRFC is passionate about helping families with all phases of Wealth Management. She provides detailed investment consulting and guides her clients to make smart decisions about their money. Her wealth management process continues with advanced planning to minimize taxes, enhance cash flow, maximize federal benefits, protect assets, transfer wealth, and help with charitable giving for those inclined. Carol is a member of Ed Slott's Master Elite IRA Advisor Group℠ and holds the Master Registered Financial Consulting Designation (MRFC) from the International Association of Registered Financial Consultants. She practices the Fiduciary Standard and maintains the Series 65, 7 and 63 licenses along with life and health insurance licensing. Carol has been practicing financial planning for 25 years. She holds a BS degree in Business from Rowan University. Carol's financial planning practice, Franklin Planning, maintains a home office in Sewell, NJ along with a satellite office in Washington, DC. She and her husband Brett are blessed with three children, and one grandson. Carol can be reached at carol@franklinplanning.com or (856) 401-1101.