

RETIREMENT Plan Trends



A benefits update

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Retirement Plan Rollover Options Expanded To Non-Spouse Beneficiaries

Starting in 2010, all employer-sponsored qualified retirement plans are required to allow non-spouse beneficiaries of inherited retirement plan accounts to roll over these distributions into individual retirement accounts (IRAs) on a tax-free basis. Retirement plan administrators have been advised to notify plan participants of these rule changes, and plans are required to give all non-spouse beneficiaries written notice explaining their options prior to making the distribution.

The provision allowing rollovers by non-spouse beneficiaries was included in the Pension Protection Act of 2006 (PPA) and initially went into effect on January 1, 2007. Prior to the enactment of the PPA, only the husband or wife of the deceased

retirement plan account owner was permitted to defer taxation on the account by rolling over the funds to an inherited IRA, while any beneficiary who was not the spouse of the deceased was required to take a lump sum distribution from the account. Non-spouse beneficiaries were thereby

obligated to pay taxes on the full amount received and to declare the income on their personal tax return, potentially creating a challenging tax situation. Starting in 2007, non-spouse beneficiaries were allowed to make the same tax-free rollovers as spouses.

However, under the PPA, tax-qualified employer-sponsored retirement plans were not required to offer direct rollovers to non-spouse beneficiaries. Consequently, many non-spouse beneficiaries—including domestic partners, parents, siblings, other relatives, friends, or trusts—did not have access to these tax-free rollovers unless the plan sponsors had voluntarily chosen to provide the option.

Congress closed this gap through the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA),

Also In This Issue

- More Employers Consider Annuities For 401(k) Plans
- Confidence In Defined Contribution Plans Endures

**Furr &
Associates**
Insurance and Investment Services

2-B Terrace Way
Greensboro, NC 274 03

(336) 852-4554
(336) 852-4559 *fax*
(887) 273-7755

www.furrandassociates.com

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Retirement plan sponsors must offer a non-spouse beneficiary the option of making a direct rollover, or a trustee-to-trustee transfer, of eligible rollover distributions to an inherited IRA.

in a provision making it mandatory for employer-sponsored retirement plans to offer the rollover option to non-spouse beneficiaries in plan years beginning after December 31, 2009. The WRERA provision also stipulates that beneficiaries who do not opt for a direct rollover, and instead choose to take distributions in the form of a cash lump sum, will be subject to mandatory 20% income tax withholding rules. As a result of IRS Notice 2008-30, non-spouse beneficiaries may also choose to roll over retirement account funds into an inherited Roth IRA.

Under the rules, non-spouse beneficiaries are permitted to directly roll over funds inherited from employer-sponsored retirement plans—including defined benefit plans, 401(k) plans, employee stock ownership plans (ESOPs), 403(b) annuities, and governmental 457(b) plans—into inherited IRAs. According to the IRS, retirement plan distributions to a non-spouse beneficiary are subject to many of the same rules that apply to other eligible rollover distributions. Retirement plan sponsors must offer a non-spouse beneficiary the option of making a direct rollover, or a trustee-to-trustee transfer, of eligible rollover distributions to an inherited IRA. This means the transfer is made from the retirement plan to the IRA, and not to the beneficiary.

Other restrictions apply. The rollover must be made to a new IRA, not one already owned by the non-spouse beneficiary, and the new IRA must bear the name of the deceased, not the beneficiary. In addition, beneficiaries are not permitted to make additional contributions to the inherited IRA. The beneficiary must have the same basis in the inherited IRA as the original deceased account owner, and the beneficiary may not combine the basis in the inherited IRA with the basis in his or her own IRAs.

After the rollover has occurred, the beneficiary must begin receiving distributions under the beneficiary distribution rules. The beneficiary will not owe taxes on the inherited IRA assets until he or

she starts to receive distributions. Non-spouse beneficiaries who wish to extend payments over their life expectancy must complete the rollover by December 31 of the year following the retirement plan account holder's death.

These rule changes apply to all retirement plans starting in 2010, and they provide important options to non-spouse beneficiaries of employer-sponsored qualified retirement plan accounts.

More Employers Consider Annuities For 401(k) Plans

As companies look for ways to provide their employees with a steady stream of income during retirement, and as the Federal government considers incentives to encourage retirement plan sponsors to encourage retirement plan sponsors to provide lifetime distribution options, the number of 401(k) plan sponsors offering annuities to plan participants is likely to grow, according to a report by human resources consultancy Watson Wyatt.

Results of the survey of 149 employers showed that nearly one in four companies that sponsor defined contribution plans (22%) currently offer an annuity as a distribution option, and 10% of plan sponsors that do not currently do so are considering adding annuities. The main reasons plan sponsors did not provide an annuity option included a lack of participant demand, cited by 56% of respondents, and administrative complexity, cited by 36%.

“Annuities in 401(k) plans were rarely discussed a few years ago,” said Robyn Credico, a senior retirement consultant at Watson Wyatt. “But in the recent economic downturn, employees without traditional pension plans could not retire because their 401(k) balances were decimated. With this weakness in 401(k) plans now exposed, more employers are exploring ways to minimize their employees’ exposure to risk—including the use of annuities.”

The report noted that the U.S. Department of Labor announced in December 2009 its intention to explore steps the Federal government can take to encourage employers to offer lifetime annuities or similar lifetime distribution options in their defined contribution plans. Researchers also pointed out that there are various kinds of annuity options in 401(k) plans that generate a guaranteed lifetime income, some of which are available to younger employees while working and contributing to their plans and others are available at retirement. However, previous research has shown that employees' interest in life payout annuities is strongly influenced by how the pros and cons of longevity insurance are weighed.

According to Mark Warshawsky, director of retirement research at Watson Wyatt, annuities also offer clear benefits for employers, who would find it easier to predict and plan for employee retirement. However, he added, due to a perceived lack of demand, as well as the shortcomings of many providers' offerings, the market for annuities is still seen as immature by plan sponsors. This cycle, he asserted, "can be broken by employers through the design of good distribution strategies for retirees and effective communication to make the advantages of such annuities clear to employees."

Confidence In Defined Contribution Plans Endures

Despite market volatility, most 401(k) and other defined contribution plan participants continued to contribute to their accounts, and Americans with and without retirement accounts have maintained a generally positive view of employer-sponsored retirement plans, according to a study by the Investment Company Institute (ICI).

The findings of the study, "Enduring Confidence in the 401(k) System: Investor

Attitudes and Actions," are based on the results of two surveys conducted in the last two months of 2009: a poll of nearly 3,000 adults and a survey of defined contribution plan recordkeepers overseeing a total of nearly 24 million accounts.

The survey of plan sponsors showed that, even during the economic downturn, defined contribution plan participants have not tapped their accounts at higher rates than in the past. Results showed that only 2.6% of plan participants made withdrawals in the first three quarters of 2009, with only 1.3% making hardship withdrawals. As of September 2009, 16.8% of plan participants had loans outstanding. Researchers observed that withdrawal and loan activity in 2009 was roughly in line with historical experience of the past several years.

Meanwhile, plan sponsors reported that participants have continued saving, with only 5% stopping their contributions in the first three quarters of 2009. Over the same period, 9.9% of participants changed the asset allocation of their account balances, and 9.8% changed the asset allocation of their contributions.

Of the adults surveyed at the end of 2009, nearly three-quarters (73%) said they are confident that retirement plan accounts can help people reach their retirement goals. Of the respondents who currently participate in defined contribution plans or own individual retirement accounts (IRAs), 78% expressed confidence in these plans.

The study also found widespread support for key features of the 401(k) system. For example, 93% of respondents with retirement accounts agree that employer-sponsored retirement plans helped them "think about the long term, not just my current needs," and 90% agree that payroll deduction "makes it easier for me to save."

In addition, 85% of respondents who have retirement accounts said they agree that the "immediate tax savings from my retirement plan are a big incentive to contribute." While agreement with this statement was found to be high across all



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age and income groups, agreement was higher among respondents with annual incomes of \$50,000 or more (87%) than among respondents with annual incomes below \$30,000 (78%).

Further, lower earners might be more likely than higher earners to be encouraged to save by the availability of 401(k) plans in the workplace. While 40% of all respondents who currently participate in employer-sponsored plans agreed with the statement, “I probably wouldn’t save for retirement if I didn’t have a retirement plan at work,” agreement was found to be higher among respondents with annual incomes of \$30,000 or less (45%) than among respondents with annual incomes of \$50,000 or more (38%).

Among respondents who contribute to a workplace retirement plan, 98% said they believe it is important to have choice in and control of the investments in their retirement plan account, and 85% said they are satisfied with the investment options offered by their plan.

When asked about their overall impression of 401(k) and other defined contribution plans, 91% of respondents who expressed an opinion said they have a somewhat or very favorable impression. And, when those respondents were asked what factors have shaped their views of 401(k) accounts, 96% cited the ability of these accounts to accumulate significant savings, 95% said the performance of account investments, 94% said personal experience, 85% cited recent events in financial markets, 81% cited materials or seminars provided by an employer, 78% said friends and family, and 51% said media coverage.

“We have found that Americans express confidence in their 401(k) plans and support for the system’s key features in overwhelming numbers,” said Paul Schott

Stevens, ICI president and CEO. “The 401(k) system has a long and productive future ahead in providing retirement security for millions and millions of Americans.”

The study also looked at Americans’ views on proposals to change tax incentives for retirement savings. The survey found that 88% of all respondents oppose taking away the tax advantages associated with 401(k) plans, including 91% with retirement plan accounts and 83% without accounts. In addition, the vast majority said they disagree with proposals to reduce the amount individuals can contribute to defined contribution accounts (84%), to prevent individuals from making their own investment decisions in defined contribution accounts (88%), and to replace all retirement accounts with a government bond (81%).

Additionally, the survey asked about the disposition of retirement account balances, specifically about possible government mandates that retirees convert a portion of their savings into an annuity. A full 96% of all respondents agreed with the statement that “retirees should be able to make their own decisions about how to manage their own retirement assets and income.”

When asked whether they agree that “the government should require retirees to trade a portion of their retirement plan accounts for a fair contract that promises to pay them income for life from an insurance company,” 72% of all respondents, including 75% of retirement account owners and 66% without accounts, said they disagree. Roughly similar percentages indicated they disagree that “the government should require retirees to trade a portion of their retirement plan accounts for a fair contract that promises to pay them income for life from the government.”



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