

TIME IS RUNNING OUT ON PENSION PLANS WHAT TO DO NOW?

Bradford N. Dewan, J.D., MBA
Miller, Monson, Peshel, Polacek & Hoshaw
619-239-7777 bndewan@mmpph.com
San Diego, CA

Morgan H. Smith Jr., IMBA, CFP®
Burns Advisory Group
858-792-9122 msmith@burnsag.com
San Diego, CA

Commencing January 1, 2010, all pension plans must include language or be amended to incorporate a newly required provision directly addressing the disparity in treatment between spousal and non-spousal beneficiaries with respect to IRAs and pension plans. This new rule comes from Congress via the Worker, Retiree, and Employer Recovery Act of 2008 (“2008 Act”). As an administrator or participant in a pension plan, there are some important questions to be answered before deciding what to do next. To be sure, necessary actions need to be taken soon.

Currently, non-spouses (e.g. sons, daughters, domestic partners) have very minimal rights and options when designated as the beneficiary of a qualified pension plan account. Typically, the qualified pension plan has mandated that any designated beneficiary of a plan account must withdraw the full balance from the account within five years of the death of the former account holder. For a spouse, this usually doesn’t pose a problem since a spouse can rollover the funds directly into his or her own IRA.

A non-spouse beneficiary, unlike a spouse beneficiary, is currently unable to rollover assets directly to their own IRA, from either a qualified plan account or an IRA. However, a non-spouse beneficiary of an IRA (but not a pension plan) *does* have the right to re-designate the IRA as an “Inherited IRA”. Once re-designated as an “Inherited IRA,” the non-spouse beneficiary has the option to secure the benefits of “stretching out” the taxable distributions from the IRA over such beneficiary’s remaining life expectancy. By electing to stretch out the distributions, the non-spouse beneficiary will likely realize the investment benefits of tax-deferred, compounding rates of return.

The 2008 Act made it very clear that it was Congress’ intent that non-spouse beneficiaries must be given the right to transfer the funds from the pension plan account to an “Inherited IRA” which they could create upon the death of the plan participant. These new provisions for pension plans, which were previously optional, are now about to become mandatory. As a result, individuals who have influence over pension plans, such as business owners and plan fiduciaries, need to be informed of this mandate and understand their responsibility to incorporate these non-spouse beneficiary provisions into existing pension plans by January 1, 2010.

Before you make any decisions about what you might need to do by this deadline, you should have some perspective on why your pension plan was initially established. Certain plans allow a higher contribution amount than others, and if contributing a maximum annual pre-tax amount is a goal, and your current income level allows you to take advantage of this, then it may make sense to amend the plan and be done with it. But, if you have a legacy pension plan that is not receiving any contributions but only holding assets, you may want to consider avoiding the burden of amending the plan by simply rolling over the assets to an IRA and then terminating the plan altogether.

Many pension plans have been maintained and/or plan participants have left their funds in the qualified plan because in the past such plans provided better creditor protection than IRA's, both within and outside of bankruptcy. However, with the passage of the Bankruptcy Act of 2005 and a recent California court case (*McCullen v. Haycock*, 2007) IRAs now provide the same maximum creditor protection in California for those funds rolled over into an IRA from a pension plan, as do pension plans. Therefore, creditor protection is no longer an advantage when maintaining your investments inside a qualified pension plan. With this in mind, perhaps it makes sense to rollover qualified pension assets to an IRA.

It should also be stressed that once funds have been rolled over from the pension plan to an IRA, the IRA owner will then have a far greater number of accessible estate planning options and strategies than were previously available. Moreover, while the new non-spouse beneficiary provisions are certainly beneficial, there exists a "trap for the unwary" that could virtually eliminate these possible benefits. The "trap" is in the deadline given the non-spouse beneficiary to exercise this right to transfer the funds into an Inherited IRA before December 31 of the year following plan participant's death. If the election is not exercised within this time period, the five-year rule is then applied. This may serve as another reason to rollover the pension funds into an IRA, rather than assuming that this new provision will be utilized.

Many qualified pension plans are more of a burden administratively than IRAs and can be more costly to owners, participants, and beneficiaries. A truism in investing is that the rate of return of an investment is most likely reduced by the fees and expenses related to the investment. Any reduction in costs related to investing should be a positive over the long term. Of course, the discount in fees and expenses should not be replaced with a discount in intelligent and independent advice and access to superior investment choices. Another truism in investing that can have even more of an impact than expenses is that bad investor behavior often gets in the way of good investor returns. A simple equation sums up this idea: **Investor Returns = Investment Returns +/- Investor Behavior**. Given this, it may make sense to rollover any pension plan assets to an IRA in such a way that the expenses and fees can be aligned with quality advice and guidance of an investment advisor. Furthermore, many qualified pension plans do not have open investment platforms for investing. If the right investment advisor or platform can be found, the participant may find that they have more options available for managing their assets if they roll them into an IRA.

In summary, qualified pension plans will need to be amended by January 1, 2010. Here are some points to consider when evaluating how to implement the changes:

- Evaluate whether the original benefits and intent of the pension plan are still applicable for you today.
- Individuals who have influence over pension plans such as business owners, plan fiduciaries, participants, as well as beneficiaries, need to be informed of the mandate and the impact of the changes.
- Avoid unintended consequences by seeking good advice from an attorney, a tax advisor, and/or an investment advisor. Consult someone knowledgeable about these required provisions and what options are available to you.

This article is limited to the dissemination of general information pertaining to Burns Advisory Group's ("BAG") investment advisory services and general economic market conditions. The information contained herein should not be construed as personalized investment advice, and should not be considered as a solicitation to buy or sell any security or engage in a particular investment strategy. Past performance is no guarantee of future results, and there is no guarantee that the views and opinions expressed in this article will come to pass. Individual client needs, asset allocations and investment strategies differ based on a variety of factors.

BAG is an SEC registered investment adviser with its principal place of business in the State of Oklahoma. BAG and its representatives are in compliance with the current registration and notice filing requirements imposed upon registered investment advisers by those states in which BAG maintains clients. BAG may only transact business in those states in which it is noticed filed, or qualifies for an exemption or exclusion from notice filing requirements. Any subsequent, direct communication by BAG with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of BAG, please contact BAG or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about BAG, including fees and services, send for our disclosure statement as set forth on Form ADV using the contact information herein.