

beneficiary of her qualified retirement plan, with her credit shelter trust as the contingent beneficiary. Wife's trust identifies Husband, along with their combined children as beneficiaries. Upon Wife's death, Husband can either: (a) elect the QRP rollover for the income tax savings, instead of the potential federal estate tax savings attained through a disclaimer to Wife's trust; or (b) elect to disclaim the QRP to Wife's trust for the potential federal estate tax savings, instead of the income tax savings of a rollover. If Husband elects (a), then he must arrange his primary beneficiaries carefully to include Wife's children or they will be disinherited. However, if he elects (b), then neither he nor any of the couple's children will be disinherited.

Second, Wife creates an Irrevocable Life Insurance Trust (ILIT) that in turn applies for and owns a \$2 million insurance policy on her life. The ILIT is named as beneficiary under the policy, with Wife's children as the beneficiaries of the ILIT. Because neither Wife nor Husband is the applicant, owner or beneficiary of the policy, it is not included in their taxable estate.

Third, upon Wife's death, she is assured that her children will inherit \$2 million from her through the ILIT...even if Husband elects the QRP rollover and fails to include her children among his primary beneficiaries.

In baseball, a perfectly executed triple play may not guarantee victory, but it can help you survive a very difficult inning. Similarly, a perfectly executed QRP Insured Triple Play may not guarantee both income and estate tax savings. It can, however, help you provide for all of your loved ones and preserve family harmony.

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# RETIREMENT PLAN TAX TRAPS



Qualified Retirement Plans (QRPs) present some of the most complicated tax and non-tax planning challenges of any asset in an estate, especially for married couples. The failure to make proper Life & Estate Plans for your QRP can unnecessarily enrich the IRS and disinherit loved ones.

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**F**or many Americans, a significant portion of their estate value is in Qualified Retirement Plans (QRPs). This remains true despite the (inevitable) ups and downs of the stock market. One reason QRPs weather economic storms better than non-qualified investments is their unique tax treatment. All contributions to QRPs are made with pre-tax dollars and all of the growth inside such plans is tax-deferred until withdrawn. Hence, contributions to QRPs not only reduce your current income tax liability, but they grow with compound interest and without the barnacles of annual income taxation.

Your estate value includes everything that you own: your QRP, your life insurance death benefits, your real estate, your overall non-qualified investment portfolio and your collectibles.

Under current tax law, every taxpayer has a \$2 million Applicable Exemption Amount to protect their estate from federal estate taxes. A married couple may protect a combined total of \$4 million. However, this is not automatic. Many couples fail to maximize their federal estate tax protection.

Consider the following case study.

Husband and Wife have a combined estate value of \$4 million. Wife has a \$2 million QRP and selects Husband as the Designated Beneficiary. When Wife dies, Husband inherits the QRP as an income-tax-free rollover and no federal estate taxes are due upon Wife's death because of the Unlimited Marital Deduction. But using this deduction can be a very expensive tax trap.

Any assets passing to a surviving spouse via the Unlimited Marital Deduction *forfeit* the federal estate tax savings otherwise available under the Applicable Exemption Amount of the deceased spouse. Husband now has the full \$4 million in his estate. Since Husband's Applicable Exemption Amount is less than the estate value at the time of his death, this couple will incur an unnecessary federal estate tax liability.

Given the same basic facts as above, Wife

could create a Credit Shelter Trust (CST) to *shelter* her retirement assets from federal estate taxes by using (and not forfeiting) her available Applicable Exemption Amount instead of the Unlimited Marital Deduction.

Under this approach, Wife would select Husband as the primary beneficiary of her QRP and would designate her *trust* as the contingent beneficiary. Upon Wife's death, Husband could disclaim the retirement plan assets, making the credit shelter trust the primary beneficiary by default.

Result: Wife's Applicable Exemption Amount would be applied to the value of her QRP disclaimed to the trust, yet Husband would be the beneficiary under the trust terms.

Downside: Since the trust is not a surviving spouse, the Wife's retirement plan cannot be "rolled-over" to the Husband, and income-taxable distributions must begin to Husband, regardless of his Required Beginning Date.

While this technique may forfeit the income tax deferral available through the spousal rollover, it may achieve significant federal estate tax savings. Nevertheless, this alternative affords the surviving spouse maximum flexibility over the couple's combined wealth and its ultimate disposition. Therefore, it is most appropriate in first marriages where any children are of that marriage. Blended family situations, on the other hand, present unique planning challenges.

Fact: There are more blended families in the United States today than original nuclear families. If yours is a blended family, then you should give careful consideration to your choice of Primary and Contingent Designated Beneficiaries for your Qualified Retirement Plan.

Again, assume the same basic facts as above,

*For many Americans, a significant portion of their estate value is in Qualified Retirement Plans.*



except Husband and Wife have adult children from their respective prior marriages and a minor child from their marriage together.

#### **Dilemma #1:**

If Wife identifies Husband as the primary beneficiary of her QRP and her Credit Shelter Trust as the Contingent beneficiary, then it is possible for her children to be completely disinherited upon Husband's subsequent death. How could this happen? One of two ways: (1) Husband fails to disclaim the retirement plan assets to Wife's trust, under which her children are the ultimate beneficiaries, or (2) Husband fails to specifically identify Wife's children as among the primary beneficiaries under his rollover of Wife's QRP.

#### **Dilemma #2:**

Wife cannot designate a Credit Shelter Trust as the primary beneficiary of her retirement plan, instead of her husband, without his knowledge and consent. With very limited exceptions, under federal law a surviving spouse has special rights to the Qualified Retirement Plan assets of their deceased spouse.

Is there any alternative that would allow Husband to rollover the QRP, while ensuring that Wife's children are not totally disinherited. Yes. We will call it the QRP Insured Triple Play.

#### **Triple Play**

There are few more exciting defensive plays in the game of baseball than the triple play. It is where preparation and opportunity meet with no margin for error. So it is with the QRP Insured Triple Play. Here is how it works, assuming the same facts as above.

First, Wife identifies Husband as the primary  
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