



Beneficiary Designations: Preserving the Tax Benefits of Retirement Plans

We encounter it often. When we open a bank account, when we purchase life insurance, when we open an IRA or begin contributing to a 401(k) plan, we are faced with this question. Who should I name as my designated beneficiary? Increasingly, the question becomes not “who,” but “what?” In addition to naming our spouse, children, or other persons as the primary and contingent beneficiaries of these accounts, it is not unusual for the account owner to name his or her estate, or his or her revocable trust, as the beneficiary of the account upon the owner’s death. Depending on your particular estate plan, the consequences of this practice may range from perfectly acceptable to utterly disastrous.

For example, consider an individual, married with two children, whose net worth is \$1,500,000 (comprised of \$500,000 in cash and real estate and a \$1,000,000 life insurance policy). He designates his “estate” as the beneficiary of that life insurance policy. Assuming he dies leaving his spouse and his children \$1,500,000 in total assets, the beneficiary designation was likely innocuous.

However, qualified retirement plans, such as 401(k) plans and IRAs, while quite possibly the best financial favor your government ever did for you, carry the most serious risk involved with this practice. The hallmark of these accounts is that they grow income-tax free, until such time as “minimum required distributions” must be made. This is usually when the account owner (or beneficiary, if the account owner died and named an individual as the beneficiary) reaches age 70½. Income is not recognized, and therefore there is no income tax liability, until such time as distributions are actually made. Generally, the amounts of the minimum required distributions are computed with reference to the life expectancy of the account owner (or beneficiary) based upon actuarial tables.

Disaster strikes if we again consider the individual in the above example, except now we assume he owns a \$1,000,000 401(k) plan instead of a life insurance policy, and he designates his “estate” as the beneficiary of that 401(k) plan. Since his estate is the designated beneficiary, it is impossible to determine the timing and amount of required minimum distributions from the plan, because his estate is not a “being” with a life expectancy by reference to which minimum required distributions may be determined. In such a situation, the Internal Revenue Code requires that the entire plan be distributed to the beneficiary (i.e., the decedent’s estate) within five years. Not only must all of the distributions from that plan be received by the estate within five years, but all of the income tax must be paid by the estate within the same period. Generally, this is a catastrophe from an income tax perspective because it is almost always best to stretch the deferral of income tax over as long a period as possible.

As with many topics in the areas of estate planning and tax, there are tools to enable you and your advisors to avoid the dire pitfalls of an admittedly easy mistake to make. For example, a properly-drafted will or revocable trust, (continued)

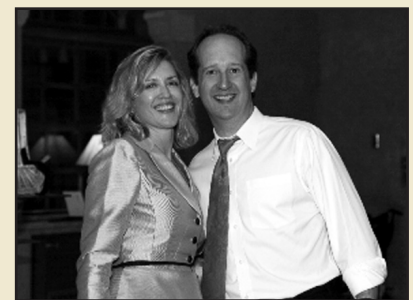
Greg S. McLaughlin Joins SS&R

In March, the firm was pleased to welcome Greg S. McLaughlin to the litigation team as an Associate. Greg brings over twelve years of successful litigation practice and three rewarding years of in-house litigation experience to our group as well as expertise in areas such as real estate, employment, contract and compliance legal work.

A cum laude graduate of Boston College Law School, Greg previously practiced law in Atlanta, Georgia where he was a very active member of the Bar, founding their Creditor’s Rights Section, and chairing the YLS Judiciary Section.

After being a partner in a commercial litigation firm and Vice President in a national finance company, Greg was able to fulfill his dreams by relocating to Colorado with his wife, Laura. They enjoy the natural beauty of our great state, skiing and taking motorcycle trips.

Greg’s practice will emphasize commercial litigation, commercial law, insurance litigation, business and employment law and creditor’s rights. We hope that you will stop in soon and meet him.



Federal Initiative Eliminates “Foreclosure Tax”

The softening economy, declining property values, and imprudent adjustable rate mortgages have led to all time high foreclosure rates. Troubled borrowers often attempt to avoid foreclosure through a “short sale,” where the property is sold for less than the amount owed, or by a “deed in lieu” of foreclosure, where the property is transferred directly to the lender. If these efforts fail, the property is sold at a foreclosure sale, sometimes for less than the amount owed to the lender.

Under the prior tax code, if a short sale, deed-in-lieu, or foreclosure resulted in the forgiveness of part of the indebtedness, the lender could report the deficiency as earned income to the borrower. There were a few exceptions to this rule. The result was to hit unwary borrowers with a huge tax bill at a time when they could least afford it.

The Mortgage Forgiveness Debt Relief Act, enacted on December 20, 2007, provides that, under certain circumstances, mortgage debt forgiveness will be treated as a non-taxable event, eliminating the “foreclosure tax” in some cases. It does this by reducing the basis in the borrower’s home to the amount the lender receives. The act applies to debt forgiven in connection with the purchase money mortgages on the borrower’s primary residence, but not to investment properties or second homes. With a few exceptions, the value of the property must have decreased since it was acquired. The law applies to forgiven debt up to \$2 million (couples) or \$1 million (singles). It applies retroactively to January 1, 2007, and it “sunsets” on January 1, 2010.

We have successfully assisted clients in negotiating short sales, deeds-in-lieu and other loan work outs. Feel free to contact us if we can be of service in this area.

About the author: Scott Fitzke is Special Counsel to the firm and his practice areas include Civil Litigation (Trials and Appeals), Defense Litigation, Real Property, HOAs, Professional Liability and Malpractice, Entertainment Law, Business Law and Business Associations, Wills, Trusts and Estates, Probate.

(continued from page 1) along with a proper beneficiary designation, could ensure the desired stretch-out of a qualified plan. On the other hand, your particular estate planning objectives may dictate that you sacrifice the stretch-out of a qualified plan in favor of management of those funds in a discretionary trust.

Each person’s estate planning objectives are personal and unique, and the third dimension that a qualified retirement plan’s beneficiary designation adds to the landscape certainly poses some challenges, but they are not insurmountable. Don’t let time get away from you; we would be delighted to review your current beneficiary designations and estate plan to make sure your wealth is preserved for those you intend.

About the Author: Brent Hultquist is an Associate with the firm and his practice areas include Wills; Trusts and Estates; Probate; Asset Protection; Tax Law; Business Law; Corporate Law; Partnership Law; Insurance; and Real Estate Law.

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