Retirement Planning for Already Retired Couples

Strategies for Stretching Your Retirement Savings

by

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I

Introduction

This is a book about retirement planning for already retired married couples. Are there tax and other strategies that the already retired couple can adopt, today, to position themselves, including the surviving spouse, in the best position possible to maximize and protect the after-tax benefits they receive from their retirement savings, including Social Security, over their lifetimes?

One of the most important tax principles to recognize in this analysis is the fact that, as illustrated on page 4, except at the 37% tax bracket each of the current progressive federal income tax brackets is now reached twice as quickly by a single individual than it is by a married couple. Thus, when it comes to retirement planning for already retired couples, there is a definite "single filer penalty" that must be considered in planning for a surviving spouse.

If the interests of the couple's children are also to be considered, another important tax principle is the fact that, under the SECURE Act passed in late 2019, it is no longer possible to defer IRA and 401k fund balances over the lifetime of the couple's children after the couple passes. Instead, the balance in the couple's IRAs and 401k plan accounts must be paid out to the children over the 10 years after the couple passes, years in which the children are likely to be in their peak income tax brackets.

Based upon the foregoing tax principles and considerations, logic would dictate that already retired married couples consider taking voluntary withdrawals from their IRAs and 401k plan accounts which are earlier and larger than what the law requires. The same logic would also dictate that, if the retired couple also owns significant highly appreciated taxable account assets, it will be worthwhile for them to consider taking steps, while they are married, to reduce potential capital gains taxes to the surviving spouse.

II

Minimizing Income Taxes on IRAs and 401Ks

Under "SECURE Act 2.0" passed in late 2022, it is now possible for an individual who is not already receiving required minimum distributions from IRAs or 401k plans to defer beginning the receipt of the same until the individual attains age 73 (and in the future, age 75). The important retirement planning question for already retired couples to ask themselves is whether it makes financial sense for them to take maximum advantage of this new extended deferral period. In order to answer this question we first must continue to explore how the federal income tax system works for a married couple filing their taxes jointly as compared to for a surviving spouse filing as a single taxpayer.

Set forth on the next page is a table of the 2023 federal tax brackets and rates for married couples filing jointly and for single individuals. As the table illustrates, in recent years the federal income tax system has evolved to the point where, except at the very highest tax brackets, widowed spouses reach the same federal income tax brackets at half the level of income that married couples do. Their standard deduction ($13,850) is also half the level of a married couple ($27,700).

Taxable income	Taxes owed
Married Filing Jointly	
$22,000 or less	10% of the taxable income
$22,001 to $89,450	$2,200 plus 12% of amount over $22,000
$89,451 to $190,750	$10,294 plus 22% of amount over $89,450
$190,751 to $364,200	$32,580 plus 24% of amount over $190,750
$364,201 to $462,500	$74,208 plus 32% of amount over $364,200
$462,501 to $693,750	$105,664 plus 35% of amount over $462,500
$693,751 or more	$186,601.50 plus 37% of amount over $693,750
Single Individuals	
$11,000 or less	10% of the taxable income
$11,001 to $44,725	$1,100 plus 12% of amount over $11,000
$44,726 to $95,375	$5,147 plus 22% of amount over $44,725
$95,376 to $182,100	$16,290 plus 24% of amount over $95,375
$182,101 to $231,250	$37,104 plus 32% of amount over $182,100
$231,251 to $578,125	$52,832 plus 35% of amount over $231,250
$578,126 or more	$174,238.25 plus 37% of amount over $578,125

Bearing in mind that it is not at all unusual today for one spouse to survive the other by 10 years or more, in retirement planning for already retired married couples the first goal should be to minimize the potential effects of this "single filer penalty," thereby maximizing the after-tax retirement funds for the surviving spouse.

Assume, for example, that a married couple is making $100,000 a year in retirement (excluding, at this point, any discussion of Social Security benefits and the taxation of the same, and that none of this income is qualified dividends or capital gains). After factoring in the couple's $27,700 standard deduction (in 2023), their federal income tax liability assuming 2023 rates and brackets would be $9,346. If either spouse was deceased, however, the surviving spouse's federal income tax liability, on the same amount of gross income, would be $14,260, or 52.6% more than when the couple was still married. Given the significant unfavorable tax position of a surviving spouse, it begs the question what proactive steps can be taken by a married couple to ameliorate the situation.

Let's now assume a retired married couple with no other income takes a $100,000 voluntary withdrawal from a regular IRA and converts the after-tax amount, or $90,654, into a Roth IRA. Also for simplicity purposes let's assume the Roth grows by 10% the following year, or to $99,719, and that the husband dies during the year. Ignoring potential penalties for a Roth withdrawal shortly

after the conversion, the wife would net $99,719 if she withdrew the entire Roth amount the following year.[1]

Had the Roth conversion not taken place while the couple was still married, however, and the wife made a withdrawal of the $100,000 plus 10% growth, or $110,000, the year after her husband died, her federal income taxes on the withdrawal would be $16,475, or 76.3% more than the $9,346 in federal income taxes which the couple would have paid if they made the IRA withdrawal/Roth conversion while they were still married.

Again assuming the Roth conversion had not taken place while the couple was married, now further assume the wife made a withdrawal of $110,000 plus another year of 10% growth, two years later, or $121,000. The wife's federal income tax liability would be $19,115, or now more than double the $9,346 the couple would have paid in federal income taxes had the Roth conversion been made while the husband and wife were both alive, and the wife would net $101,885. Had the Roth conversion during the couple's marriage been made, the wife would have netted $109,691, for a difference of $7,806.

Multiply this growing annual disparity by, say, 10 years worth of these annual $100,000 voluntary IRA withdrawals/Roth conversions during the couple's lifetime, including after their required beginning date, while also assuming the surviving spouse lives 10 years after the first spouse to die passes, and the single filer income tax

[1]The numbers in this discussion would be higher if the couple paid the "Roth conversion tax" out of other savings.

penalty for deferring withdrawals from IRAs and 401k plans for as long as possible becomes self-evident.

To further illustrate the extent of the potential single filer income tax penalty, assume the same retired married couple in the first example, with $100,000 in federal gross income (again ignoring, at this point, Social Security benefits, and assuming none of the couple's income is qualified dividends or capital gains), or $72,300 in taxable income after the couple's $27,700 standard deduction. This places the couple in the 12% marginal federal income tax bracket. After one of the spouses passes, however, the survivor will be in the 22% marginal federal income tax bracket on the same $100,000 in gross income, or $86,150 in taxable income, after the survivor's 50% lower $13,850 standard deduction.

Now assume this same retired married couple elects to voluntarily withdraw $17,150 from their IRA during their marriage, making their total taxable income $89,450. They would still be taxed in only the 12% marginal federal income tax bracket on this additional income. However, if the couple waited until after the first spouse died to voluntarily withdraw the same amount, the survivor's taxable income would be $103,300 (because of his or her lower standard deduction), which would place the surviving spouse in the 24% marginal federal income tax bracket for a single filer, or an increase of 100% in marginal federal income tax bracket.

An analogous situation arises when both spouses die, this time as a result of the SECURE Act. Assume the couple's gross income in retirement is the same $100,000, or $72,300 after their standard deduction. Assume also that when they pass the couple's children are all married,

and that their spouses and they are each in their peak earning years, making a combined $250,000 per couple, or $222,300 after their standard deductions. The married couple's children will be in the 24% marginal federal income bracket; again a 100% increase over the marginal federal income tax bracket of the married couple. As a result of the SECURE Act, the couple's children will now be required to add the balance in their parents' IRAs to their likely higher taxable incomes over the 10 years following their parents' passing.

Each situation of course will need to be independently analyzed, but in general the point is made that a retired married couple can stretch their own retirement savings, and also benefit their children, by paying attention to this "tax brackets factor" in their IRA and/or 401k plan distribution planning, both before and after their required beginning date. If the couple and their financial advisor feel that the stock market will only rise in the future, this may be an obvious additional reason for making Roth conversions earlier rather than later.

Only when the retired couple's other income is very low, and they are under age 73, in which case voluntary IRA or 401k withdrawals can cause a significant portion of the couple's Social Security receipts to be taxed when it would otherwise not be[2], or very high, when the disparity in marginal federal income tax rates for married couples versus surviving spouses, as well as for the couple's children, is not as great, and where a significant increase in Medicare premiums may result, would it not normally make sense for a retired married couple to consider taking

[2]This is discussed further in chapter IV.

significant voluntarily IRA and/or 401k plan withdrawals, both before and after their required beginning date, and then reposition the after-tax funds into a tax-free Roth IRA or, as a potential option, into income tax-free life insurance or other nontaxable or low-tax investments.[3] Given the likely higher marginal federal income tax rates which will be imposed on the income of the surviving spouse and the couple's children, it only makes financial sense for the couple to take voluntary IRA and/or 401k withdrawals in a much lower federal income tax environment, and then reposition the after-tax proceeds into an income tax-free or lower-tax vehicle of some sort.

Even though SECURE Act 2.0 may have changed the IRA or 401k account owner's required beginning date to age 73 (and, in the future, age 75), waiting until these ages to begin taking voluntary withdrawals from the IRA or 401k plan will likely cause more income to be subject to income tax to the surviving spouse, later, and therefore to be subject to the single filer penalty of as much as 100%. It can also cause significantly higher income taxes to the couple's children after both spouses pass, as the children will be required to include the balance of the IRA or 401k plan account in their taxable income over the following 10 years, years in which the children are likely to be in their peak income tax brackets.

Logic would therefore dictate that, except in situations where voluntary withdrawals may result in an otherwise unnecessary and significant tax on Social Security benefits, or to the extent the voluntary

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[3]This latter concept is explored further in the author's book, *Estate Planning for IRAs and 401Ks*.

withdrawals could cause the couple significantly higher Medicare premiums,[4] taking voluntary withdrawals from IRAs and 401k plan accounts will likely have the eventual result of significantly stretching the couple's after-tax 401k plan and/or IRA retirement savings, during their combined lifetimes, as well as the eventual effect of reducing income taxes to the couple's children on the balance in these accounts when the second spouse passes. The optimum amount of the voluntary withdrawals will again depend on all the tax facts and circumstances, both for the couple combined and as projected for the surviving spouse and children.

Finally, notice that, to the extent the retired couple is able to lower their federal income tax liability during their lifetime, obviously there will be that much more in the way of assets remaining for the children, when both spouses pass.

[4]These situations are discussed in chapter IV.

III

Minimizing Capital Gains Taxes on Taxable Retirement Accounts

Now that we understand the wisdom of a retired married couple taking voluntary withdrawals from their IRAs and 401k plans, the question becomes what to do with the after-tax withdrawn funds. While, as discussed in chapter II, it definitely makes tax sense to transfer some of these amounts to an income tax-free Roth IRA and/or into income tax free life insurance or other low-tax investments, it can also makes tax sense to use a portion of these voluntary withdrawals to pay the couple's living expenses, at least before the couple sells significantly appreciated assets, and pays the corresponding capital gains taxes, in order to obtain funds for these purposes.

Unless the sale of significantly-appreciated assets is recommended to offset otherwise nondeductible losses or for other non-tax reasons, for retired married couples, at least, liquidating significantly-appreciated assets should be low on the priority table. The reason for this is that appreciated assets owned and held until death by one spouse receive a new income tax basis in the hands of the surviving spouse equal to the fair market value of the assets at the death of the decedent spouse, thus eliminating income taxes on any "pre-death" appreciation should the surviving spouse elect to later sell the same. A surviving spouse would thus be able to liquidate these stepped-up income tax basis assets at a low tax cost, and use the

proceeds for his or her retirement needs over and above his or her other sources of income, including required minimum distributions and Social Security benefits, thereby also preserving the tax-free buildup in his or her Roth IRAs for a later day.

If funds over and above the surviving spouse's proceeds from the sale of stepped-up income tax basis assets and other income, including Social Security and required minimum distributions from his or her IRA, are needed for living expenses, the preference will usually be to take distributions from a (hopefully now significant) nontaxable Roth IRA prior to taking distributions from a taxable IRA. The reason for this is that voluntary taxable distributions from a regular IRA will be subject to the single filer penalty discussed in chapter II. Unless the surviving spouse is certain his or her "single filer" tax amount will be lower than the income tax which the couple's children are likely to pay on the balance in the IRA or 401k plan over the 10 years after the survivor's passing (i.e., under the SECURE Act), it is normally best not to pay the single filer penalty tax voluntarily.

There are many approaches to achieving income tax basis step-up at the passing of the first spouse to die, the choice of which depends upon all the circumstances. In community property states such as Texas, California and Wisconsin, for example, all community property owned by the husband and wife, regardless of how titled between the husband and wife, other than so-called "income in respect of a decedent" [which is basically income an individual is entitled to receive at the time of his or her death, but which is not actually received, such as IRA proceeds, annuity income, deferred compensation, or sales proceeds],

receives a new income tax basis at the death of the first spouse to die, equal to the fair market value of the property at that time. What is more, most community property states also allow a married couple to elect to treat non-income in respect of a decedent assets which were not previously classified as community property, as community property going forward, thus qualifying any such "elected" appreciated assets for full income tax basis step-up at the death of the first spouse to die.

In other, non-community property, states, appreciated assets which are jointly-owned by a husband and wife at the time of the first spouse's passing receive only a 50% income tax basis step-up at the first spouse's death, and property owned by a surviving spouse at the time of the first spouse's death receives no income tax basis step-up at that time. It is for these two reasons that married couples living in non-community property states need to plan with their advisors to achieve the maximum income tax basis step-up possible on their taxable accounts at the death of the first spouse. Included below are some planning thoughts and options designed to achieve this end.

Rather than keep all assets in joint names, the married couple could opt to transfer more of the highly appreciated assets to the name of the spouse who is more likely to pass first. Considerations such as age, male versus female, and overall health situations, are obviously relevant here. In the approximately 20 so-called "tenants by the entirety" states, however, where property owned jointly by a husband and wife is largely protected from lawsuits and creditors of either spouse individually, this element needs to be considered before severing tenants by the entirety property and transferring the appreciated assets

to either spouse.[5] Another obvious disadvantage to this plan is that the spouse who is more likely to pass first may not actually pass first.

In non-community property situations where one spouse is terminally ill, it will normally be advisable to transfer all of the appreciated assets into that spouse's name. However, Congress imposes a one-year waiting period in such situations, meaning that if one spouse transfers an interest in property to the other spouse, including the donor spouse's one-half interest in jointly-owned property, there will be no income tax basis step-up on the same if the donee spouse dies within one-year of the transfer and bequeaths the asset back to the donor spouse.

In an effort to respond to this "one-year rule," one option is to draft the couple's estate plan so that the terminally ill spouse's highly appreciated assets do not pass outright to the surviving spouse, but instead pass to a discretionary trust for the benefit of the surviving spouse, children and grandchildren. The trust instrument then makes it clear that the surviving spouse is purely a discretionary beneficiary of the trust, meaning that he or she has no rights to either the income[6] or principal of the trust, but rather is only a permissible discretionary beneficiary with no greater interest in the trust than that of

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[5]Some tenancy by the entirety states, such as Missouri, allow tenancy by the entirety property to be severed into two shares of a revocable trust, and still maintain its tenancy by the entirety protections.

[6]Arguably the surviving spouse may be an income beneficiary of the trust, under a theory that the Internal Revenue Code's "one year rule" does not apply to post-death income.

the children or grandchildren. The trust instrument should also be drafted so that the surviving spouse's other assets, including IRAs, must be factored into the trustee's decision-making process in determining the need for distributions of trust income and principal to or for the benefit of the surviving spouse.

Also, in order to better prove that the surviving spouse is not in reality the only beneficiary of the trust during his or her lifetime, it may be beneficial for the trustee to actually use a portion of the trust's income or principal for the children or grandchildren. Finally, for maximum assurance that the IRS cannot argue the surviving spouse has an identifiable interest in the trust, it is best that the spouse not serve as trustee of the trust, and that the trustee's discretion be sole and absolute.

In order to address the potential situation where the spouse who is more likely to die first does not in fact pass first, another retirement planning technique in non-community property states is to divide the couple's appreciated assets roughly equally between them, so that, after the passing of the first spouse, the surviving spouse can liquidate the deceased spouse's assets, first, before liquidating his or her own assets. The portion of the surviving spouse's appreciated assets which is not liquidated by the surviving spouse during his or her lifetime will then be entitled to receive a stepped-up income tax basis in the hands of the couple's children when the surviving spouse passes.

If the above-described taxable asset-splitting techniques are not utilized, and significantly appreciated assets are retained in joint names by a couple living in a non-community property state, as each jointly-owned

appreciated asset is sold by the surviving spouse there will be taxable gain on at least one-half of the appreciation. Utilizing an asset-splitting technique, on the other hand, could end up approximating the favorable income tax basis step-up treatment afforded couples residing in community property states, i.e., to the extent it is not necessary to liquidate the surviving spouse's appreciated assets during his or her lifetime.

As alluded to above, the only potential disadvantage to appreciated asset splitting techniques applies to residents of so-called "tenants by the entirety" states, where splitting assets out of joint names can increase their exposure to creditors. Some states, such as Missouri, have solved this problem through special legislation. Couples should consult with local counsel for recommendations specific to their particular state of residence.

Although this is not a book about federal and state estate taxes, an ancillary benefit of these asset-splitting techniques arises if federal and/or state estate taxes at the surviving spouse's death are a potential issue. "Two-share planning" while the couple is still married will provide the best opportunity to reduce or eliminate the estate tax liability, regardless of whether the surviving spouse should remarry after the first spouse to die's death. Although the general rule for federal estate tax purposes is that titling assets in joint names and designating the surviving spouse as outright beneficiary of any IRA or 401k benefits may entitle the couple to a combined two estate tax exemptions, this "portability" benefit may not apply if the surviving spouse were to remarry. It may also not exist for state estate tax purposes, in states which still impose an estate tax. Finally, the "portability" rule does not apply to any

appreciation in the first spouse's to die assets occurring after his or her passing and prior to the surviving spouse's passing.

The "two-share" approach, on the other hand, guarantees the couple two full federal *and state* estate tax exemptions because all or a portion of the assets allocated to the decedent-spouse's separate share will normally be held in a federal and state estate tax-exempt trust for the benefit of the surviving spouse (and, if desired, for the couple's descendants). This guarantee applies even if the surviving spouse should remarry, and even to the extent of any appreciation in the value of the first spouse to die's assets which occurs after his or her passing and prior to the death of the surviving spouse.[7]

[7]See the discussion in chapter V, below, for the additional asset protection benefits of this trust.

IV

Maximizing After-Tax Social Security Benefits

The discussion in this chapter is not about whether it is nominally better to begin taking Social Security benefits at normal retirement age versus age 70, or whether one spouse should take his or her Social Security at normal retirement age while the other should wait until age 70. If income tax consequences and the solvency of the Social Security system are ignored, and one assumes the spouses live to their projected live expectancies, the numbers will generally argue in favor of the spouse with the larger Social Security account waiting until age 70 to begin receiving his or her benefits, with the spouse having the smaller Social Security account taking Social Security benefits at "full retirement age."

Based on the principles discussed in chapter II, however, we know that the analysis is not always this simple, at least in the situation of retired married couples. Pushing the start of Social Security benefits off until age 70, so that there will be a larger projected aggregate payout to the couple over time, also means that, on a projected basis, a greater portion of the couple's Social Security benefits will be payable to the surviving spouse after the first spouse dies, and will therefore be subject to the single filer penalty.

Bunching more Social Security benefits into the years after both spouses attain age 70 can also increase the tax bracket of the couple, including the surviving spouse.

Deferring the receipt of Social Security benefits also eliminates the ability of the couple to invest the otherwise larger pre-age 70 payments into investments which will grow with better tax attributes, e.g., capital gain and qualified dividend tax rates, and, as discussed in chapter III, with the potential for income tax basis step-up at the death of the first spouse to die.

Finally, solvency issues with Social Security simply cannot be ignored today. In years past Congress has chosen to change the way Social Security payments grow with inflation, and it has increasingly subjected Social Security payments to income tax. It only stands to reason that, in the not too distant future, additional changes to Social Security payments will be made which will not likely be to a couple's advantage. The old proverb, "a bird in hand is worth two in the bush," may therefore be applicable here.

Maximizing a retired couple's after-tax Social Security benefits also requires recognition of the couple's other sources and potential sources of income, including income from both taxable and tax-deferred accounts, especially prior to the new age 73 (and eventually age 75) required beginning date for receiving IRA and 401k plan receipts. This is because, at very low levels of outside income (whether taxable or not), a couple's Social Security benefits start becoming taxable, with up to 85% of the receipts potentially being included in the couple's taxable income. There are several different fact patterns which can come into play here, assuming the couple has also accumulated a significant IRA and/or 401k balance.

In the simplest of situations, a retired married couple, age 62, elects to take a much smaller amount of

Social Security, early. Unless the couple is receiving pension and/or other annuity-type benefits, in this situation in all likelihood the couple will need more funds to live off of, so utilizing other sources of income will most likely come out of necessity, as opposed to by design. Further, the tax on 85% of a much lower Social Security benefit amount will likely have less than a significant impact, in the grand scheme of the couple's post-retirement tax planning.

In the next situation we have a 66-year old retired couple electing to take full Social Security at this point. The couple has little or no other outside income (other than the potential to take voluntary IRA withdrawals), and is able to live off of its Social Security. Under these facts it would at first blush appear to make sense for the couple to defer taking distributions from their IRAs until age 73. By doing so the couple will not only lock in the best situation possible with respect to the Social Security benefits they are receiving, earlier rather than later, but perhaps more importantly they will also avoid income taxes on up to seven years worth of Social Security.

Obviously this planning will mean more IRA benefits could end up being paid to the surviving spouse, however, subject to the single filer penalty described in chapter II. This higher potential income tax on the larger annual IRA receipts in the long-term will need to be balanced against the zero or low income tax on the total Social Security benefits in the short-term. It should also be remembered that, once the couple attains age 73, when required minimum distributions will be forced upon them and their Social Security will become taxable regardless, the couple can then begin a plan of taking larger than

required withdrawals from their IRAs prior to the passing of the first spouse to die, and minimize (albeit now to a lesser extent) the adverse impact of the single filer penalty discussed in chapter II.

Next we have the situation of a 66-year old couple that does have significant annual income other than IRA receipts, including nontaxable income, enough to cause the maximum 85% of the couple Social Security receipts to be included in its taxable income each year. Would this couple receive an income tax benefit by taking voluntary early IRA withdrawals before age 73? The answer should normally be yes, based upon the analysis of chapter II. The only caveat is that, at higher levels of income, the couple's Medicare premiums will be adversely impacted. Higher levels of income now will mean lower levels of income later, however, which could end up balancing out the Medicare premium situation, in the long run.

Finally we have a couple age 73 or older, who is now obligated to begin receiving required minimum distributions from its IRAs. Should this couple consider taking additional voluntary withdrawals from their IRAs, and not worry about its effect on the taxability of their Social Security benefits? Again the answer should normally be yes, based upon the analysis in chapter II.

It can be argued that the single filer penalty imposed on the surviving spouse will be offset by the fact that the surviving spouse's Social Security income may be a third less than what it was while his or her spouse was alive, and so the surviving spouse's income tax will be reduced by the tax on 85% of this reduction. This is a true statement, but this is not because of some special tax treatment for a surviving spouse, but rather because the surviving spouse

is receiving less income. The reduction in Social Security benefits to the surviving spouse only adds to sting of the single filer penalty the surviving spouse is forced to incur on his or her other taxable income, in other words, and is therefore another reason for working hard to minimize the single filer penalty on the surviving spouse's other income, not the opposite.

The same principle applies if the couple has elected a joint and survivor pension benefit, which pays the surviving spouse only 50% of the joint benefit. The reduction in the pension benefits payable to the surviving spouse is just another reason to minimize the single filer penalty on the surviving spouse's other taxable income.

In both of these latter-discussed situations, remember that if the couple opts not to take voluntary withdrawals from their taxable IRAs or 401k accounts during their joint lifetime, then the required minimum distributions payable to the surviving spouse, which will be subject to the single filer penalty, will be that much larger, including as a consequence of any appreciation inside the IRA or 401k account which is attributable to the voluntary amounts the couple elected not to withdraw during their joint lifetime.

V

Protecting Retirement Savings from Potential Creditors

In addition to the income tax saving benefits outlined thus far, there may also be a significant asset protection benefit associated with taking voluntary withdrawals from regular IRAs and converting the same to Roth IRAs. Although in many states *both* regular IRAs and Roth IRAs are fully protected from creditor claims outside of bankruptcy, the conversion of voluntary withdrawals from a regular IRA to a Roth IRA may provide additional protection from lawsuits. The reason for this can best be illustrated by the following example.

Assume a married couple does none of the proactive planning with their IRAs or 401k accounts discussed earlier in this book, and therefore only takes required minimum distributions from their regular IRAs, beginning when they attain age 73. Assume also that their option would have been to make annual voluntary $100,000 Roth conversions of their regular IRAs, beginning when they retired, at age 62.

Assuming the couple resides in a state which fully insulates both regular IRAs and Roth IRAs from creditors, if either or both of the spouses is later successfully sued after they attain age 73, the amounts which could have accumulated inside the Roth IRA up until that point, including any growth in value of the same, would have

been fully protected,[8] because, unlike a regular IRA, the Roth IRA will not require mandatory annual payments during the lifetimes of the owner and the owner's spouse. Similar asset protection results would have existed had the couple chosen to convert all or a portion of the voluntary early IRA withdrawals into income tax free life insurance. All or a portion of the cash value of the life insurance policy would be protected from the couple's creditors, and as long as the policy proceeds are paid to an asset-protected trust for the benefit of the surviving spouse, the policy proceeds should also be fully protected from claims against either spouse.[9]

To the extent neither of these proactive measures are taken by the couple, however, larger annual required minimum distributions from the couple's regular IRAs must begin at age 73. If either spouse is successfully sued, these larger, mandatory annual payments will be fully or partially subject to the claims of the couple's creditors. Proactive planning for the primary purpose of saving the couple income taxes, on the other hand, would have provided the couple additional asset protection benefits for their accumulated retirement savings by protecting the Roth or life insurance funds from a potential future creditor attack.

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[8]Assuming the Roth IRA was not funded to avoid the claims of an existing creditor or creditors.

[9]Note that for larger cash value and death benefit policies it is recommended that an irrevocable life insurance trust be utilized to completely exempt both the cash value and policy proceeds from creditors, as well as from estate taxes.

Note that many states do not fully protect IRAs or Roth IRAs from creditors, however. Local counsel should therefore always be consulted if asset protection for IRAs or Roth IRAs is desirable. Note also that the federal bankruptcy laws do not always operate in the same fashion as state creditor protection laws, so again local counsel should be consulted if complete asset protection for IRA and Roth IRA accounts is a goal in the couple's planning.

As alluded to in chapter III, some states, such as Missouri, have specific state statutes which can help insulate taxable retirement savings held inside a particular form of trust from creditor attack[10] while also allowing the person or persons establishing the trust access to the trust's income and principal. Couples should consult with local counsel for recommendations specific to their particular state of residence.

Another retirement savings asset protection option, available in most states, which can at least protect the surviving spouse would be to direct IRAs, Roth IRAs and other taxable retirement savings accounts which remain at the passing of the first spouse to an asset-protected "spendthrift" trust for the surviving spouse's benefit.[11] In the case of regular IRAs, paying the proceeds from the same to an asset protection trust for the surviving spouse will fix the deferral period for withdrawing distributions from the IRA at 10 years after the first spouse's death, and

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[10]Assuming that the trust was not funded at a time when the individual doing the funding was subject to a potential claim.

[11]For taxable accounts this technique is discussed in chapter III.

will not allow the beginning of required minimum distributions to be deferred until the surviving spouse attains age 73. The fixed 10-year deferral period for trust distributions will normally be shorter than the period assumed by the IRS' required minimum distribution tables when the surviving spouse is the outright beneficiary of the IRA. At some point after the couple attains age 73, however, the income tax disadvantages of paying an IRA to an asset-protected trust for a surviving spouse begin to lessen considerably, and can become a relative non-factor.

For Roth IRAs payable to a spendthrift trust for the surviving spouse, the tax disadvantage is that the Roth IRA must be distributed to the trust over 10 years after the first spouse passes, whereas had the surviving spouse become the outright owner of the Roth IRA, no distributions would have been required during the spouse's lifetime.

The "trust as beneficiary" planning technique can also help protect the retired couple's retirement savings from the claims of a new spouse in the event the surviving spouse should remarry.

If a trust is to be designated as recipient of regular IRAs and/or taxable accounts of the first spouse to die, the trust instrument should be prepared by an attorney in a fashion which will avoid the compressed federal income tax brackets imposed on trusts (which compression is even more severe than the compressed income tax brackets imposed on single individuals), but while still preserving the trust's asset protection features.[12]

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[12]These concepts are discussed in the author's book, *Estate Planning for IRAs and 401Ks*.

Finally, if it is unlikely that the surviving spouse will be sued or will remarry, e.g., because he or she is elderly and does not drive, the need for an asset-protected vehicle to house the surviving spouse's retirement savings is obviously significantly reduced.

VI

Tax Leveraging Retirement Savings for Long-Term Care Needs

It will be an unusual circumstance when a married couple will be in a position to convert all of their regular IRAs to Roth IRAs or other tax-free or low-tax investments during their joint lifetime, at least on a tax-efficient basis. There will thus be a portion of their regular IRAs which will remain. This is the portion which can be best utilized if long-term custodial care costs for the couple or the surviving spouse should arise. Subject to the annual 7.5% floor for the deduction for medical expenses, either spouse's tax-deductible long-term custodial care costs can be paid, tax-efficiently, using otherwise taxable IRA proceeds. In the case of costs incurred by a surviving spouse, this will help mitigate the single filer penalty by reducing the surviving spouse's taxable income.

Taxable IRA proceeds should normally be utilized by the couple (including the surviving spouse) to pay their tax-deductible custodial care expenses before the couple generates capital gains taxes on significantly-appreciated investments held outside of their IRAs in order to pay such expenses. This is because the taxable gains on the appreciated investments held outside of the regular IRA would have been wiped out by the step-up in income tax basis at the owner's passing, whereas the tax liability on regular IRA proceeds is not extinguished by the account owner's death.

Because potential tax deductible long-term care costs are always speculative—both because the costs may never arise and because Congress may change the tax laws in the future)—the planning outlined in this chapter should definitely not be a married couple's sole plan for minimizing income taxes on their IRAs and 401k plan accounts. Nevertheless, the planning does currently offer a convenient way for the couple to "soak up" some of the balance of its regular IRAs which they were not able to convert to Roth IRAs or other lower taxable accounts during their lifetime.

Although beyond the scope of this book, a married couple may also choose to transfer taxable retirement savings to a so called "supplemental needs trust" for the benefit of themselves or the surviving spouse, in an effort to qualify to have Medicaid pay the cost of their long-term custodial care. This technique will normally not work well with significant taxable IRAs, however, as it will require the complete liquidation of the IRAs prior to transferring the after-tax proceeds to the trust, with the attending high income tax cost.