



**NEWS BULLETIN: February 21, 2007**

## **The New and Unimproved Rules for Non-spousal Beneficiary Rollovers**

On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006. Among its numerous provisions was one that changed the inheritance landscape for unmarried couples, married same-sex couples, and anyone else who may be named as beneficiary of a non-spouse's retirement plan.

Before the Pension Protection Act (PPA) went into effect, when a non-spouse inherited assets from a decedent's qualified retirement plan, such as a 401(k) or 403(b), the non-spouse was forced to withdraw most if not all assets immediately, triggering a large tax liability. The rationale being that the employer did not want to bear the administrative cost of having this non-employee in their plan.

The good news is that PPA changed this by allowing all non-spouse beneficiaries who inherit qualified plan assets to roll over his or her interest into a beneficiary Individual Retirement Account (IRA). This allows for the continued tax deferral of accumulation while mandatory distributions are taken over the beneficiary's life expectancy.

The bad news is that the Internal Revenue Service just released notice 2007-7, which basically states that employer plans may offer this non-spousal beneficiary rollover option, but they are not required to do so. In other words, if a plan chooses to incur the cost of amending its plan documents to benefit non-spouses, so be it. However, qualified plans will not be forced to do so.

The only loophole here is that if a retirement plan currently allows non-spouse beneficiaries to withdraw inherited plan assets over a 5-year period, which is more likely the exception than the rule, then the non-spousal rollover is permitted as long as the rollover into the IRA takes place prior to the end of the year following the year of the plan participant's death.

So, where do we go from here? Back to square one.

In my book, *Money Without Matrimony: The Unmarried Couple's Guide to Financial Security*, which was published before the PPA of 2006 was enacted, I suggested that individuals with inactive retirement plans from former

employers consider the advantages of rolling the assets over to an IRA to maximize their non-spouse beneficiary's tax deferral versus maintaining the qualified plan account for its enhanced creditor protection. (Assets in a qualified retirement plan are generally untouchable to creditors, while IRA assets could be up for grabs.) Then in mid-August 2006, I started advising clients to keep the assets in the qualified plan to maintain the creditor protection and get the added benefit of the non-spousal rollover.

Now that the 2007-7 clarification has been issued, I am going back to the pre-PPA days and my pre-PPA ways. Given the intricacies of this new ruling and the opportunity for error, I am recommending that clients, barring any explicit creditor issues, simply roll old qualified plan assets into IRAs.

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