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The End of File & Suspend for Married Couples

A great claiming strategy to try & optimize Social Security benefits disappears.

Congress just changed the Social Security benefit rules. On October 30, Capitol Hill lawmakers approved a two-year federal budget deal. As part of that agreement, they authorized the most significant change to Social Security policy seen in this century, disallowing two popular strategies people have used to try and maximize retirement benefits.[1]

The file-and-suspend claiming strategy will soon be eliminated for married couples. It will be phased out within six months after the budget bill is signed into law by President Obama. The restricted application claiming tactic that has been so useful for divorcees will also sunset.[2]

This is aggravating news for people who have structured their retirement plans – and the very timing of their retirements – around these strategies.

Until the phase-out period ends, couples can still file and suspend. The bottom line here is simply stated: *if you have reached full retirement age (FRA) or will reach FRA in the next six months, your chance to file and suspend for full spousal benefits disappears in Spring of 2016.*[3]

Spouses and children who currently get Social Security benefits based on the work record of a husband, wife, or parent who filed-and-suspended will still be able to receive those benefits.[3]

How exactly did the new federal budget deal get rid of these two claiming strategies? It made substantial revisions to Social Security's rulebook.

One, "deemed filing" will only be allowed after an individual's full retirement age. Previously, it only applied *before* a person reached FRA. That effectively removes the restricted application claiming strategy, in which an individual could file for spousal benefits only at FRA while their own retirement benefit kept increasing.[2]

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The restricted application claiming strategy will not disappear for everyone, however, because the language of the budget bill allows some seniors grandfather rights. Individuals who will be 62 or older as of December 31, 2015 will still have the option to file a restricted application for spousal benefits when they reach Full Retirement Age (FRA) during the next four years.[2]

Widows and widowers can breathe a sigh of relief here, because deemed filing has no bearing on Social Security survivor benefits. A widowed person may still file a restricted application for survivor benefits while their own benefit accumulates delayed retirement credits.[2]

Two, the file-and-suspend option will soon only apply for individuals. A person will still be allowed to file for Social Security benefits and voluntarily suspend them to amass delayed retirement credits until age 70. This was actually the original definition of file-and-suspend.[2]

Married couples commonly use the file-and-suspend approach like so: the higher-earning spouse files for Social Security benefits at FRA, then suspends them, allowing the lower-earning spouse to take spousal benefits at his or her FRA while the higher-earning spouse stays in the workforce until 70. When the higher-earning spouse turns 70, he/she claims Social Security benefits made larger by delayed retirement credits while the other spouse trades spousal benefits for his/her own retirement benefits.[4]

No more. The new law says that beginning six months from now, no one may receive benefits based on anyone else's work history while their own benefits are suspended. In addition, no one may "unsuspend" their suspended Social Security benefits to get a lump sum payment.[2]

To some lawmakers, file-and-suspend amounted to exploiting a loophole. Retirees disagreed, and a kind of cottage industry evolved around the strategy with articles, books, and seminars showing seniors how to generate larger retirement benefits. It was too good to last, perhaps. The White House has wanted to end the file-and-suspend option since 2014, when even Alicia Munnell, the director of the Center for Retirement Research at Boston College, wrote that "eliminating this option is an easy call ... when to claim Social Security shouldn't be a question of gamesmanship for those with the resources to figure out clever claiming strategies."[4]

Gamesmanship or not, the employment of those strategies could make a significant financial difference for spouses. Lawrence Kotlikoff, the economist and *PBS NewsHour* columnist who has been a huge advocate of file-and-suspend, estimates that their absence could cause a middle-class retired couple to leave as much as $70,000 in Social Security income on the table.[3]

What should you do now? If you have been counting on using file-and-suspend or a restricted application strategy, it is time to review and maybe even reassess your retirement plan. Talk with a financial professional to discern how this affects your retirement planning picture.

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An Inherited IRA

Here are some things to consider when you receive IRA assets.

Be sure you understand your options. When the owner of an IRA passes away, his or her heirs must be aware of the rules and regulations affecting Inherited IRAs. Ignorance can lead straight toward a tax disaster.

Please note that this is simply an overview. Rather than use this article as a guide, use it as a prelude before you talk to a financial services professional well-versed in IRA rules and regulations. *Inherited IRA rules are remarkably complex, and that conversation is essential.*

First, make sure you have actually inherited the IRA. Your spouse, parent or grandparent may have left their traditional or Roth IRA to you in a will, but that doesn't mean you have inherited it. In all but rare cases, an IRA beneficiary designation form takes precedence over a bequest made in a will or living trust. (The same applies to annuities and life insurance policies.)[1]

Your first task is to find the beneficiary form. The financial firm serving as the custodian of the IRA assets should have a copy on file if you cannot locate one (although this is not a given).

What if I'm not the beneficiary named on the form? The IRA assets are destined to go to whoever the primary beneficiary is. One or more contingent beneficiaries are also usually named; if the primary beneficiary is now deceased, then the contingent beneficiaries will inherit the IRA assets.[2]

What if no beneficiary is named on the form? Then the financial firm supervising the IRA will choose a beneficiary according to its rules and/or IRS guidelines. It may decide that the decedent's estate will be the beneficiary of the IRA, which is often the poorest outcome in terms of taxation.[2]

Spousal heirs who inherit a Roth or traditional IRA have options. Here they are, stated as straightforwardly as their complexities allow.

You can have the assets rolled over into your own IRA. This way, you can withdraw those inherited assets based upon your own life expectancy. If you transfer the inherited assets into a traditional IRA you already own, you don't have to take Required Minimum Distributions from those assets until age 70½. If you transfer the inherited assets into a Roth IRA you already own, you don't have to take RMDs from those assets at all. (Inherited Roth IRA assets can only be rolled over into Roth IRAs; inherited traditional IRA assets can only be rolled over into traditional IRAs.) Only spouses have this rollover option.[3,4]

You can transfer the assets into a new Inherited IRA in your name. If your spouse was older than 70½ when he or she died, then you must start taking RMDs from the Inherited IRA by December 31 of the year after the year of your spouse's death (or pay penalties to the IRS). If your spouse passed before age 70½, you might be able to postpone RMDs until the date when your spouse would have turned 70½.[3]

You can create an Inherited IRA to house the assets, and then roll over the assets from the Inherited IRA

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into a new Roth IRA in your name. Yes, you will pay taxes on the Roth conversion. The upside is that the assets will go into a Roth IRA, paving the way for no RMDs, potentially lifelong contributions and tax-free withdrawals.[3,4]

You can "disclaim" all or some of the inherited assets. If you don't want or need the money from an Inherited IRA, here is another option. By doing this, the disclaimed inheritance can go to the contingent (or successor) beneficiary named on the beneficiary form. Spousal IRA heirs sometimes do this with the goal of reducing income and estate taxes.[3]

What choices do non-spousal heirs have? Before discussing that, it is worth noting that non-spousal heirs often get little or no guidance when it comes to Inherited IRAs. Too often, the financial firm overseeing the IRA just asks, "What do you want to do?" Often the IRA heir doesn't know what to do.

First, ask the financial firm overseeing the IRA to help you retitle it as an Inherited IRA. This has to be done by September 30 of the year following the year in which the original IRA owner passed away. Usually the new title for the Inherited IRA is something like "Mary Jones IRA (Deceased 8/25/2015) for the benefit of Thomas Jones, beneficiary." This retitling tells the IRS that this is now an Inherited IRA (for which you may name a beneficiary).[5,6]

This retitling is a key first step to a *direct rollover* of the Inherited IRA assets – a transfer of those assets from the financial firm the original IRA was held with to the financial firm your investments are held with. If you are a non-spousal IRA heir, this direct rollover (also called a direct IRA-to-IRA transfer) is very important. It gives the funds a chance to have further tax-advantaged growth.

Non-spousal heirs have a basic either-or choice when it comes to withdrawals from Inherited IRAs. They can either take lump-sum withdrawals or Required Minimum Distributions (RMDs).

Usually, your poorest option is a lump-sum withdrawal. If you touch the money at any point – that is, if the IRA custodian cuts you a check for the Inherited IRA assets and you deposit it in a bank account or IRA you have – that is not a direct rollover. That is an *indirect rollover,* and the entire amount withdrawn is treated as taxable income by the IRS. (An exception: if you cash out an Inherited Roth IRA, it is not a taxable event if the Roth IRA has existed for five or more years.) A direct rollover – in which only the custodian brokerages touch the money as they transfer it from one IRA to another – is not a taxable event.[5,6]

Taking RMDs is usually the better option. A beneficiary can arrange RMDs from an Inherited IRA, with the following variations:

Does the Inherited IRA contain assets originally held in a traditional IRA? If so, the beneficiary must schedule RMDs over his or her life expectancy if the owner of that original, traditional IRA died after age 70½. If the original IRA owner passed away *before* age 70½, a beneficiary can either take RMDs based his or her life expectancy or by the 5-year method (whereby the entire Inherited IRA balance is depleted incrementally in five years).[6]

Does the Inherited IRA contain assets originally held in a Roth IRA? If so, the beneficiary can schedule RMDs

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over his or her life expectancy or by the aforementioned 5-year method. The age at which the original IRA owner died is irrelevant.[6]

Generally speaking, the RMDs must start by the end of the year following the year in which the original IRA owner passed away. If you don't start taking these required withdrawals by December 31 of the following year, you will pay a penalty. Taking smaller withdrawals allows some of the IRA assets to stay invested with tax deferral, and it spreads the income tax liability on the Inherited IRA money over a multi-year period.[3]

What other things should IRA heirs know? Well, here are three important notes in closing.

Non-spousal heirs cannot contribute to an Inherited IRA. Spousal heirs who elect not to treat an Inherited IRA as their own or roll it over to their own retirement account also lose the ability to contribute to an Inherited IRA.[7]

You may be eligible for a tax deduction related to Inherited IRA income distribution(s). Income from an Inherited IRA is what the IRS terms "income in respect of a decedent." This means you can take an income tax deduction for the portion of the estate tax attributable to the Inherited IRA (this is detailed in IRS Publication 590).[5]

If multiple beneficiaries are inheriting the IRA, you may be able to split the IRA up. Some IRA custodians allow division of Inherited IRA assets among multiple beneficiaries.[5]

So if you inherit an IRA, study the rules. The more informed you are and the more guidance you have, the better the potential outcome.

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