

Using In-Service Retirement Plan Distributions with Roth Conversions to Fund Special Needs Planning

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ABSTRACT

Active employees participating in pretax retirement plans are eligible for in-service distributions at age 59½. For employees who support family members with special needs, in-service distributions offer some unique advantages to outright Roth conversions where taxes are paid with lump-sum funds. These include: (1) use of increased withholding taxes to “pay as you go” versus a lump sum due at the time of conversion; (2) they can be automated and extended until the source of funds is fully converted; (3) increased investment choices; (4) greater control, especially against losses; and (5) the reduction of principal of an in-service retirement account reduces in turn the required minimum distributions (RMDs) for the account when these become due.

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Overview

There is an increasing need for alternative sources of funding for special needs financial planning among older working adults who support a child with disabilities over the course of the child’s lifetime.¹ Hershey and Kelly note the use of legacy retirement accounts (i.e., retirement accounts with former employers) as a potential source of funding for special needs planning (SNP).² For adults who continue to work after age 59½, this article explores another funding source for SNP: in-service distributions from ongoing retirement accounts.³

In analyzing the perplexities financial planners face in addressing new “working in retirement” trends, Cutler states, “Retirement options, choices, and practices have expanded to include early retirement, delayed retirement, phased retirement, and for some of us workaholics—never retirement.”⁴ Reports from the U.S. Bureau of Labor Statistics (BLS) emphasize that it has become more commonplace for people to work into their later years and the number of older adults in the workforce is expected to continue to grow. Toossi and Torpey summarize these concerns more glibly: “You enter the labor force, you work until a certain age, and you retire...[o]r maybe you don’t.”⁵ The latest data available from the U.S. BLS states that 64 percent of people aged 55 to 64 were working or actively looking for work in 2016 and this figure is expected to grow to 66 percent by 2026.⁶

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As such, labor force participation rate is expected to increase fastest for the oldest segments of the population—most notably, people aged 65 to 74, and 75 and older—through 2024.⁷ In consideration of these cultural shifts, this article explores another SNP funding source for adults who continue to work after age 59½: in-service distributions from a retirement account maintained by the employee's current employer.⁸

Financial planners should recognize that adults aged 59½ and older who continue to work represent an exciting emerging market of clientele. This population of working adults has access to unique financial strategies under the U.S. law—federal law allows in-service distributions from qualified retirement plans for working employees who are aged 59½ and over without a tax penalty.⁹ In this vein, Hershey and Kelly encourage older adults to consider using Roth conversions of legacy retirement accounts as a potential source of funding for SNP.¹⁰ There are seven advantages of this strategy for clients with SNP issues: (1) access to funds at age 59½; (2) no required minimum distributions (RMDs) during the lifetime of the account owner; (3) no future taxes; (4) reduced risk; (5) wealth transfer in perpetuity; (6) generally not subject to Medicaid recapture if properly structured (subject to certain conditions); and (7) no limitation on the amount of money that can be converted.¹¹ This article takes the above recommendations one step further to explore the many advantages of using in-service withdrawals combined with Roth conversions spread out over the year over lump-sum conversions.¹² By building the Roth principal over time through in-service distributions and conversion, families with intergenerational SNP issues can provide a source of tax-free funding for SNP over the lifetime of the beneficiary with disabilities.

Unlike rollover and conversion strategies from legacy retirement accounts, the in-service distribution strategy withdraws funds from an active retirement plan that may still be receiving ongoing contributions from the employer, the employee, or both.¹³ While subject to some limitations, working employees who are older

than 59½ may be able to access these funds for Roth conversions.¹⁴ This in turn might benefit their family members with special needs, if coordinated with specific SNP vehicles, as discussed elsewhere.¹⁵ The in-service distribution strategy has some advantages to lump-sum end-of-the-year conversions, especially for client families who are still working and personally providing the bulk of the primary care for their special needs family members. Additionally, for long-serving employees, in-service distributions may be the only source for generating Roth conversions that can be used to fund SNP planning, as they may not have legacy retirement plans from other employers to draw upon.¹⁶

The attraction of the Roth conversion is the potential for tax-free growth of the assets and the lack of RMD during the lifetime of the original owner and their spousal beneficiary. Additionally, the family member with a disability who is the eventual beneficiary of the Roth account (or a trust set up for the family member), can still qualify for the stretch provision allowed under the Setting Every Community Up for Retirement Enhancement (SECURE) Act.¹⁷ The tradeoff is the need to pay tax on the amount converted. In general, the longer the account has a chance to grow, the more attractive the conversion becomes as an SNP tool. As such, the account can help pay for the financial needs of the beneficiary with special needs over their lifetime.

Active employees who continue to work can use in-service distributions of retirement savings beginning at age 59½ coupled with Roth conversions of the distributions to help save for and fund SNP. Once set up, the in-service distribution and Roth conversion strategy can be a substantial source of funding and implementation for SNP, depending upon how long the employee continues to work. For example, should the employee continue to work until age 70½, a full 11 years of conversions can be accumulated before retirement.¹⁸ Depending upon the amount of conversion in each year, this increase in the Roth principal can add up quickly. For example, an employee converting \$20,000 per year over 11 years adds \$220,000 in additional basis to the Roth account.¹⁹ At \$50,000

per year over 11 years, an additional \$550,000 is added. The potential increases in basis at four levels of yearly in-service distributions coupled with Roth conversion are summarized in Table 1.

While any Roth conversion has tax implications, it is important to note that the in-service distribution with Roth conversion is *not* suggested here primarily as a tax strategy; it is a strategy for creating a source of funding for long-term SNP. As noted above, the in-service distribution with Roth conversion may be helpful to fund SNP if the family, hypothetically, has no other source to fund SNP. Also, even if the family has a Roth but has not fully funded it or only recently started making contributions, future contributions may be limited due to income. But conversions are not limited by statute, only by the ability of the taxpayer to pay the tax on the conversion. As discussed below, the in-service distribution option can be combined with other strategies to help build a Roth account faster than by contributions alone.

Advantages of In-Service Distributions for Roth Conversions

Given the potential boost to a Roth account by a multiyear conversion strategy, the in-service distribution can be an important tool for the financial advisor helping clients with SNP issues.²⁰ In discussing with clients the in-service distribution strategy, the financial advisor can point out at least five advantages of the strategy versus an end-of-the-year lump-sum conversion from another account, such as an existing traditional IRA. These include: (1) use of increased withholding taxes to “pay as you go” versus a lump sum due at the time of conversion as in an end-of-the-year conversion; (2) distribution can be automated and extended until the source of funds is fully converted; (3) increased investment choices; (4) greater control; and (5) the reduction of principal over time of tax-deferred retirement accounts that reduces in turn RMDs for the account owner as these become due, depending upon the type of account and applicable law.²¹ Each advantage is discussed in greater detail in the following sections.

Advantage 1: Use of Increased Withholding to Pay for the Conversion

Perhaps a major obstacle to making lump-sum end-of-the-year Roth conversions from a traditional IRA is the necessity of having a source for paying all the tax due on the amount converted all at once.²² Many clients, but perhaps especially those with special needs issues, may have trouble saving the extra aftertax amount owed due to the conversion at the end of the year and at the top marginal rate. They may also have an emotional reticence to writing a check to the IRS for a large sum to pay the tax due. In either case, one solution is to increase the withholding amount for taxes by an estimate of average tax due amortized over each paycheck over the course of the year. This has a minimal impact on the net amount received from each paycheck versus paying a lump-sum amount for an end-of-the-year conversion. Additionally, the amount withheld reduces the net income by slightly less than the additional withholding. While hardly substantial, this is an objective reason why using pay as you go withholding is superior to paying a lump sum at the end of the year.²³ As with all such tax-related strategies, the financial advisor should check with the client’s tax professional to ensure all obligations are built into the eventual withholding strategy.²⁴

It should be remembered that Roth conversions are considered ordinary income and subject to taxation at the time the income is realized, although there are at least four ways to meet that obligation: at conversion, through withholding, via estimated taxes,

TABLE 1
Total Amount Added to Basis from Yearly Conversions over 11 Years

Amount of In-Service Distribution per Year	Number of Years Converting	Total Added to Basis
\$20,000	11	\$220,000
\$50,000	11	\$550,000
\$75,000	11	\$825,000
\$100,000	11	\$1,100,000

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and at tax-filing time. Of these, the use of additional withholding is the most prudent for it assures that the employee will not be subject to penalties that might be incurred if any of the other payment methods does not pay sufficient taxes when due.²⁵

The next task then is to determine how much to add to a client's withholding to cover the estimated taxes on the conversion. It is important to keep in mind that withholding is already occurring for the client's salary, so meeting the expected additional tax due on the conversion-only is the objective. The need here is to meet at least a minimum expectation for additional taxes to avoid possible interest or penalty, while at the same time seeking to maximize the net take-home pay for the client. Put another way, this strategy does not seek to *over-pay* estimated taxes due, as the client will benefit from use of such funds over the year. As such, it is useful to consider what might be a continuum for estimated taxes with a minimum amount to withhold to avoid interest and penalties on the low end as a "floor" and the highest likely taxes due on the high end as a "ceiling."

For example, returning to Table 1, using the \$20,000 figure for in-service distribution on a salary of \$162,360,²⁶ additional withholding can be treated as if it were part of the employee's salaried compensation. Adding that amount to the client's salary paid in 24 installments over the year matches the conversion to the pay period and the withholding for the salary already being paid. The final tax owed will be based upon adjusted gross income (AGI) and whatever deductions are claimed, if any, but it will probably not be less than if the conversion amounts were taxed on average as if they were income received subject at each pay period along with salary.²⁷ In this case, an additional \$150 is made to withholding for each paycheck.²⁸ This is the planning floor for the client to consider.

Second, the ceiling simply treats the 24 separate conversions as an end-of-the-year lump-sum conversion would and subjects the total to the highest marginal rate for the client. In the same example as above, the client reaches a 24-percent marginal rate by year's end, and so would owe \$4,800 additional

tax on the conversions. But rather than pay this as a lump sum at the end of the year or when filing taxes, the client amortizes that amount across the 24 withholding periods with an additional \$200 withheld (rounded up to the nearest dollar, resulting in \$4,800 additional withholding annually, federal only).

To take advantage of the use of additional withholding to pay for the in-service distribution with Roth conversion, the client should set the additional withholding somewhere between \$150 and \$200 each paycheck to meet estimated taxes due. What precise figure to use may ultimately depend upon other factors, such as unexpected increases or decreases in income or the client's cash-flow needs. In any case, the financial advisor can work with the client to determine their preference in setting the actual level for additional withholding.

In contrast, consider the challenges for clients wishing to make Roth conversions *after* retirement or leaving service in the amounts shown in Table 1. If still working, they will continue to face the impact of the conversion amount on their then marginal tax rate. If retired, they may indeed be in a lower tax rate but without the additional means of ongoing revenue from work and the use of additional withholding to contribute to the tax due on the conversion. Additionally, as discussed in greater detail under advantage 5 below, they will face greater RMDs in the tax-deferred account, including subsequent possible gains in the interim, than they would if they make the conversions while in-service and pay the conversion tax through additional withholding.

Advantage 2: Options to Automate and Extend Withdrawals and Conversions

Once set up, the in-service distribution and Roth conversion strategy is automatic and can be extended until the source of funding is exhausted. The employee can even continue to make new contributions while the distributions are being made. The financial planner and the client should plan to speak with the vendor holding the funds to be sure that proper paperwork is filed. For example, for the twice-monthly pay period illustrated above, two separate forms must

be filed, one for each of the two separate monthly distributions. In this case, the client is paid on or before the 15th and the 30th of each month, and so one form authorizes the transfer of the monthly amount on the 15th of each month and the other form authorizes the transfer on the 30th of the month.²⁹ Calling in advance also allows the vendor to make note that these are two different and intended in-service distributions to ensure that one is not cancelled by mistake. Further, this “set it and forget it” strategy frees the client from having to manage the process manually or regularly, a savings of both time and energy so important to the family whose resources may already be stretched in supporting the family member with special needs.³⁰

Advantage 3: Increased Investment Choices

Most employer plans offer a limited menu of investment options, typically based on risk tolerance and/or target dates for the employee’s anticipated retirement. In general, such plans focus on mutual funds and bonds, though a cash-only option may be available. While there are some exceptions in plans with self-directed “brokerage windows,” most do not allow the employee to choose stocks directly.³¹ By exercising the in-service distribution and Roth conversion strategy into the client’s Roth account, the funds can be allocated across the full range of investment options typical of all brokerage accounts.

Advantage 4: Greater Control of Wealth Management and Loss Prevention Strategies

To be certain, watching passively managed employer retirement plans lose value is a painful and sobering experience. Many clients who maintained investments during the market crashes of the 2000s can readily confirm this state of mind. While most plans do allow some changes in asset allocation, some plans restrict how often employees can make changes.³² By using the in-service distribution and Roth conversion strategy, the account holder working with their financial advisor can exercise greater control, including the use of stop-loss strategies to protect against large downturns.³³

Upon conversion, the cash received remains eligible to automatically buy shares in assets of choice such as an exchange-traded fund (ETF) at a designated amount. As with dollar-cost averaging generally, this means the client will buy more shares when prices are low and fewer shares when prices are high.³⁴ While not a feature restricted to the in-service distribution and conversion strategy, the choices available for dollar-cost averaging to the Roth account owner are generally greater than those of the employer’s retirement plan, thus combining these last two strategic advantages and so creating greater value-added for the client.³⁵ Here too, the financial planner can work with the client to take advantage of those differences, tailoring the planning more closely to the needs of the client with special needs funding on the horizon than may be available in the retirement plan of the employer.

Advantage 5: Reduction in RMDs

A side effect of the in-service distribution is that in lowering the principal in the employee’s retirement account, eventual RMDs from the pretax retirement account will also be lower in the future than if the entire amount remained in the pretax account. While taxes are paid on RMDs and in-service distributions regardless, use of an additional withholding allows payroll deductions to meet that obligation in the latter case.

Strategic planning for RMDs has recently received increased attention in the planning literature. For example, Tacchino provides an extensive number of hypothetical examples of differing implications for RMD strategies under both the SECURE Act and the Coronavirus Aid, Relief, and Economic Security (CARES) Act.³⁶ While not addressing either in-service distributions or Roth conversions in regular installments over the entire tax year, the column underscores the importance of approaching RMDs strategically. As such, the impact on RMDs for the employee provides another opportunity for the financial advisor to bring additional value to the financial planning relationship.

Caveats and Limitations

While the benefits of in-service distribution and Roth conversion of retirement savings of a still-working employee for purposes of funding SNP can be substantial, the strategy is not without limitations. The strategy is only available to employees who are 59½ or older. Clients with special needs issues who are younger may need to seek different alternatives for funding SNP, such as permanent life insurance.³⁷ Additionally, the client must have the ability and motivation to continue to work past traditional retirement age to maximize the benefits of the in-service distribution strategy. Employees may also be limited to *which* contributions they can access. For many plans, in-service distributions are limited to only the employee's contributions, not the employer's match, which typically can only be accessed after retirement or separation from service, if fully vested.³⁸

While some retirement plans have online forms for setting up in-service distributions coupled with Roth conversions, these generalized, do-it-yourself forms can sometimes be misleading. For example, the retirement plan will almost always ask if the client wishes to withhold federal taxes or opt out of withholding but may not ask about state tax withholding at all. Additionally, some states by default require withholding for state taxes at a set percentage of the distribution, which can surprise the client who has elected to opt out of withholding when asked but did not consider *state* tax withholding. It is prudent for the financial advisor and the client to call the retirement plan administrator prior to the distribution (as noted above in "set it and forget it") to verify that an opt-out selection is applied to both federal and state taxes if that is the client's choice. The client and advisor should also work with the client's tax professional to determine any additional withholding for state taxes, to assure the client is not subject to underwithholding penalties on the state level come end of the year.

Clients paid twice a month may experience confusion from the retirement plan administrator as *each* payment must have a separate authorization, as noted

above. Further, the retirement plan itself may confuse the two authorizations as the *same* request and fail to implement both monthly authorizations. In the case example presented here, the employee received so-called SWAT letters (referring to systematic withdrawals and transfers) from the vendor only 2 days apart—one letter confirmed the opt out for both state and federal taxes for mid-month in-service distributions while the other letter still showed state withholding for the end-of-the-month in-service distributions. By working with the client, the financial planner can help minimize these problems.

Summary and Conclusions

Active employees participating in pretax retirement plans are eligible for in-service distributions at age 59½. For employees with family members with special needs who require financial planning over the lifetime of the family member with a disability, the in-service distribution and Roth conversion strategy offers some unique advantages to outright Roth conversions from existing IRAs. This is especially the case compared to year-end or lump-sum conversions. These include:

- (1) *use of increased withholding taxes to pay as you go versus a lump sum due at the time of conversion as in an end-of-the-year conversion.* By increasing withholding amounts over the entire year, the client can avoid the necessity of having a large lump sum on hand to pay taxes due on an end-of-the-year conversion, as well as experiencing an emotional sticker shock by writing a large check to the IRS.
- (2) *distribution can be conveniently automated and extended until the source of funds is fully converted.* A set it and forget it strategy essentially creates a pay yourself first situation and frees up emotional and cognitive assets associated with quarterly or end-of-the-year conversion decisions to be re-tasked to the daily care issues supporting a family member with special needs.
- (3) *increased investment choices.* Generally, the Roth account can benefit from increased investment choices over most limited-menu employer plans.

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(4) *greater control, especially against downside losses.*

The option to actively manage the Roth account (either with self-management or through a financial advisor) gives the client greater control and ability to respond to changing market conditions.

(5) *reduction in RMDs.* A side effect of the in-service distribution is that in lowering the principal in the employee's retirement account, eventual RMDs from the pretax retirement account will also be lower in the future than if the entire amount remained in the pretax account.

Given these advantages, financial advisors can bring additional planning tools in the form of in-service distribution of current retirement plans and Roth conversion of those funds to clients aged 59½ and older who plan to continue to work and have family members with disabilities and special needs. ■

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(2) Lewis Hershey and Annemarie Kelly, "Using Roth Conversions of Legacy Retirement Plans to Fund Special Needs Planning," *Journal of Financial Service Professionals* 73, no. 2 (2019): 80-88.

(3) While this article discusses *how* to fund various SNP vehicles, it is *not* a discussion of those vehicles themselves. For such discussion, see, for example: Annemarie Kelly, Lewis Hershey, and Christina Marsack-Topolewski, "A 50-State Review of Guardianship Laws: Specific Concerns for Special Needs Planning," *Journal of Financial Service Professionals* 75, no. 1 (2021): 59-79; Annemarie Kelly, Lewis Hershey, and Christina Marsack-Topolewski, "Implementing Guardianship Policies in Special Needs Planning: Five Potential Positives," *Journal of Financial Service Professionals* 74, no. 6 (2020): 49-63; Annemarie Kelly, Lewis Hershey, and Christina Marsack-Topolews-

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(4) Neal Cutler, “Working in Retirement: The Longevity Perplexities Continue,” *Journal of Financial Service Professionals* 65, no. 4 (2011): 19.

(5) Mitra Toossi and Elka Torpey, “Older Workers: Labor Force Trends and Career Options,” U.S. Bureau of Labor Statistics, 2017; accessed at: <https://www.bls.gov/careeroutlook/2017/article/older-workers.htm>.

(6) U.S. Bureau of Labor Statistics, “Labor Force Participation Rate for Workers Age 75 and Older Projected to Be over 10 Percent by 2026,” *The Economics Daily* (2019); accessed at: <https://www.bls.gov/opub/ted/2019/labor-force-participation-rate-for-workers-age-75-and-older-projected-to-be-over-10-percent-by-2026.htm>.

(7) Toossi and Torpey (2017), endnote 5.

(8) U.S. Internal Revenue Service, “Retirement Plans: 401(k) Resource Guide: Plan Participants: General Distribution Rules,” 2020; accessed at: <https://www.irs.gov/retirement-plans/plan-participant-employee/401k-resource-guide-plan-participants-general-distribution-rules>. Finally, while a majority of retirement vehicles support in-service distributions after 59½, not all plans do, and so financial planners should verify the status of eligibility for each prospective client. See Lynnley Browning, “How to Build a Mega Roth,” *Financial Planning* (October 2021): 42.

(9) 26 U.S.C. § 401(k)(2)(B) (2020) (discussing cash or deferred arrangements for qualified pension, profit-sharing, and stock bonus plans).

(10) Hershey and Kelly (2019), endnote 2.

(11) *Ibid.*

(12) Sunwoo Tessa Lee and Sherman D. Hanna, “Financial Knowledge Overconfidence and Early Withdrawals from Retirement Accounts,” *Financial Planning Review* (August 14, 2020): e1091.

(13) See, e.g., William Bassett, “ERISA Regulated Pensions: Death Benefits and REACT,” *California Community Property Law* (2020); Patrick Purcell, *Older Workers: Employment and Retirement Trends* (New York and Oxford: Oxford University Press, 2005); Ken Dychtwald, Tamara Erickson, and Bob Morison, “It’s Time to Re-

tire Retirement,” *Public Policy and Aging Report* 14, no. 3 (2014): 1-28. See also Gordon Scott, “In-Service Withdrawal,” Investopedia, June 25, 2019; accessed at: <https://www.investopedia.com/terms/i/inserVICewithdrawal.asp>.

(14) *Ibid.* See also Browning (2021), endnote 8.

(15) This assumes that the employee has already designated either the disabled family member as the beneficiary after death (perhaps on the second to die for a married couple) or to a trust—special needs trust (SNT) or otherwise—dedicated to the care of the special needs beneficiary. As such, it is assumed that the benefactor means for the remainder of their retirement savings account, having met their retirement needs, be dedicated to the care and maintenance of the beneficiary. As disabled beneficiaries are explicitly allowed the stretch option to extend RMDs over their projected lifetime, this is no small advantage for financial planning. For a sample of articles addressing specific SNP vehicles, see endnote 2.

(16) Yung-Ping Chen and John C. Scott, “Gradual Retirement: An Additional Option in Work and Retirement,” *North American Actuarial Journal* 7, no. 3 (2003): 62-74; Vivian Fields and Robert Hutchens, “Regulatory Obstacles to Phased Retirement in the For-Profit Sector,” *Benefits Quarterly* 18, no. 3 (2002): 35. Underfunding special needs planning is an ongoing concern; see also Academy of Special Needs Planners, “10 Costly Mistakes to Avoid When Planning for a Loved One with Special Needs,” 2014; accessed at: <https://mielderlaw.com/wp-content/uploads/2016/04/10-Costly-Special-Needs-Planning-Mistakes.pdf>.

(17) Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. 116-94, 133 Stat. 3139, codified at 26 U.S.C. § 413 (2019); see also U.S. Internal Revenue Service, “Amount of Roth IRA Contributions That You Can Make for 2020,” 2020; accessed at: <https://www.irs.gov/retirement-plans/plan-participant-employee/amount-of-roth-ira-contributions-that-you-can-make-for-2020>; Sidney Kess and Julie Welch, “Tactics for Stretching Retirement Assets under the SECURE Act,” *The CPA Journal* 90, no. 3 (2020): 16-17; Dennis Reardon, “Estate Planning with Retirement Assets after the SECURE Act,” *Journal of Financial Service Professionals* 74, no. 3 (2020): 15-18; Nathan Berti, Kenneth Hunt, and Trevor Johnson, “SECURE Act Brings Major Changes to Retirement and Estate Planning,” *Journal of Taxation of Investments* 7, no. 3 (2020): 23-30; David Pratt, “The SECURE Act Changes the Required Minimum Distribution Rules and Raises Additional Estate Planning Issues,” *Law Section Journal* 53, no. 2 (2020): 29-40; accessed at: https://nysba.org/app/uploads/2020/01/Trusts-and-Estates-Spring-EarlySummer-2020_WEB.pdf#page=29. See also Dennis Culver, “The SECURE Act’s Impact on IRAs and Roth IRAs,” Insight Wealth Strategies LLC, February 14, 2020; accessed at: <https://www.insight2wealth.com/the-secure-acts-impact-on-iras-and-roth-iras/#:~:text=A%20major%20change%20brought%20on,free%20growth%20within%20the%20account>.

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(18) The target age of 70½ is used throughout this discussion because, until recently, that was the age where the working employee would still be required to take RMDs. Under such a scenario, the RMDs might be a source for additional Roth contributions, assuming the client meets the income limits for new contributions. In response to the COVID-19 pandemic, under the SECURE Act, the age for RMDs has been pushed back to 72 but whether it remains as is going forward is unknown and pressure to collect deferred taxes seems likely to increase. In any event, conversions are not subject to compensation limitations or maximum yearly contributions. As discussed here, the 11-year additional window provides clients and financial planners a familiar frame of reference for contemplating the benefit of the strategy at different levels of conversion.

(19) The \$20,000 in-service distribution example is from an actual case study where the employee began taking the distributions in January 2020 and continues to do so. The figures related to the additional withholding example are from the employee's actual gross pay. Other distribution amounts in Table 1 are hypothetical "what if" illustrations.

(20) See James S. Welch Jr., "Measuring the Financial Consequences of IRA to Roth IRA Conversions," *Journal of Personal Finance* 15, no. 1 (2016): 47-55; Lewis Coopersmith and Alan R. Sumutka, "The Impact of Rates of Return on Roth Conversion Decisions and Retiree Savings Wealth," *Journal of Personal Finance* 16, no. 1 (2017). See also Jeff Rose, "In Service Distribution—401K Rollover While You're Still Working," *Good Financial Cents*, July 7, 2020; accessed at: <https://www.goodfinancialcents.com/in-service-distribution-401k-rollover-while-still-working>.

(21) In some respects, the RMD issue is a moving target. As noted in endnote 18, current law has moved the requirement to begin RMDs from 70½ to 72. Proposed legislation would move that age to 75. That said, any in-service distributions that are converted to a Roth are no longer subject to RMDs at all because Roth accounts do not require RMDs during the lifetime of the original owner. And, as noted elsewhere, a special needs beneficiary of an inherited Roth can still stretch the RMDs out over their expected lifetime. Finally, in many cases it is a moot point because most retirees withdraw more than the RMD because they need the money. See Sarah O'Brien, "Required IRA, 401(k) Withdrawals Would Start at Age 75 under Congressional Proposal. Here's Who Would Benefit," *CNBC.com*, June 17, 2021; accessed at: <https://www.cnbc.com/2021/06/17/required-ira-401k-withdrawals-start-at-age-75-under-congress-bill.html>.

(22) Ashlea Ebeling, "Ripe Time to Roth," *Forbes*, 202, no. 1 (2019): 88-90. See also Andy Ives, "Roth Conversions: Paying Taxes from Another Source," Ed Slott and Company, LLC, June 8, 2020; accessed at: https://www.irahelp.com/slottreport/roth-conversions-paying-taxes-another-source?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+theslottreport%2FjgTs+%28The+Slott+Report%29.

(23) In the real-world example that is the basis for this article, the employee with a salary of \$162,360 withholds an additional \$185 in each paycheck (\$150 federal, \$35 state) but that reduces net take-home pay by \$182.43, leaving the client with an additional \$2.57 over aftertax payment or \$61.68 over the 24 pay periods per year the employee is paid. Conversions at higher amounts may yield higher positive differences to net.

(24) As discussed in the next section, determining the amount to withhold at the \$20,000 conversion level is based upon a real-life case example. The employee discussed this strategy with his CPA, who confirmed the additional withholding would meet the tax obligations of the amount converted without penalty. Additionally, the CPA recommended that the employee withhold an additional \$35 per paycheck to meet anticipated state taxes. In both cases, the strategy was implemented beginning in January of 2020 and continues to the present. Federal and state taxes were paid without incident and the employee's ongoing distribution and conversion continues. Readers should keep in mind that an estimate is precisely that: the final tax owed at the end of the year may be greater or lesser than what has been withheld. But by increasing withholding, the taxpayer shows good faith and at least at the amounts used here, avoids interest and penalties.

(25) See Mark Sharp, "Why Paying Taxes at Conversion Using Increased Withholding Is Best," *Mark Sharp Retirement*, 2020; accessed at: <https://marksharpretirement.com/insights/what-you-need-to-know-to-avoid-roth-conversion-underpayment-fees-and-penalties>.

(26) As noted in endnotes 23 and 24, this is the actual salary of a client using the in-service strategy with conversion throughout 2020. Tax rates used are those provided by the IRS for tax year 2020.

(27) Kitces notes that when considering how to balance planning and funding between traditional and Roth IRAs, advisors should factor in the long-term net effects of both pretax contributions to traditional IRAs, *as well as the marginal rate of tax paid on lump-sum conversions to Roth IRAs*. While Kitces does not address either in-service distributions or Roth conversions in regular installments over the entire tax year, his focus on the effect of the marginal tax rates for Roth conversions is cogent to the present strategy by emphasizing that financial advisors should include the effects of marginal tax rates on Roth conversion strategies. See Michael Kitces, "Limits of Tax Diversification and the Tax Alpha of Roth Optimization," *FinancialPlanning.com*, October 6, 2021; accessed at: <https://www.financial-planning.com/news/limits-of-tax-diversification-and-the-tax-alpha-of-roth-optimization>.

(28) The client's salary of \$162,360 is subject to payroll taxes and withholding throughout the year. At that amount, the client is subjected to withholding rates of 10 percent, 12 percent, and 22 percent, which average to 14.6 percent overall, rounded to 15 percent. As salary is already subject to withholding, the floor estimate for additional withholding on the conversion is to apply the same average of 15 per-

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cent. Likewise, as the conversions themselves push the client's income into the 24 percent marginal rate, that moves the average to 17 percent. But as this only affects the final two paychecks, the 15 percent amount is more representative of the average withholding overall.

(29) The receiving vendor that holds the Roth account will require additional paperwork, including a decision to withhold federal taxes at a specific level, usually 10 percent, or to opt out of that withholding. Since the employee is using additional withholding from payroll to meet the tax owed on the conversion, the financial advisor should recommend opting out of withholding any of the converted amounts. Also, some vendors have a default withholding for state taxes *not* stated in their federal paperwork and so the financial advisor needs to help the client determine whether they can opt out of the state tax withholding on the conversion by the vendor as well. In this example, the client is able to opt out of both federal and state withholding by the vendor so that the entire conversion amount is received into the Roth and taxes owed on the conversion are paid from additional payroll deductions, which appear as separate line items on the employee's pay stub.

(30) Annemarie M. Kelly and Christina N. Marsack-Topolewski, "Special Needs Planning," in *Encyclopedia of Autism Spectrum Disorders*, ed. F. R. Volkmar (New York: Springer, 2020). For a discussion of the impact of caring for family members with special needs, see Christina N. Marsack-Topolewski and Heather L. Church, "Impact of Caregiver Burden on Quality of Life for Parents of Adult Children with Autism Spectrum Disorder," *American Journal on Intellectual and Developmental Disabilities* 124, no. 2 (2019): 145-156; and Christina N. Marsack-Topolewski and Jillian M. Graves, "I Worry about His Future! Challenges to Future Planning for Adult Children with ASD," *Journal of Family Social Work* 23, no. 1 (2020): 71-85.

(31) Some retirement plans do offer "brokerage windows" inside the company's 401(k) plan that allow the employee more investment options than are available in the traditional plan, though this practice can be somewhat controversial. Even so, these self-directed plans may have limits such as no trades on margin and no use of derivatives. Additionally, the percentage of employees utilizing such plans is very small. See Anne Tergesen, "Why More 401(k) Plans Offer 'Brokerage Windows,'" *The Wall Street Journal*, July 1, 2016; accessed at: <https://www.wsj.com/articles/why-more-401-k-plans-offer-brokerage-windows-1467391672#:~:text=Just%201%25%20to%204%25%20of,higher%20salaries%20and%20account%20balances>. See also Mark Cussen, "The Rise of 401(k) Brokerage Accounts," Investopedia, July 31, 2019; accessed at

<https://www.investopedia.com/articles/personal-finance/061314/rise-401k-brokerage-accounts.asp>; and Wells Fargo Advisors, "Is an In-Service Distribution Right for You?" 2016; accessed at: <https://fa.wellsfargoadvisors.com/helleberg-korb-welsch/mediahandler/media/176307/korb%20pdf%206.pdf>.

(32) For example, the optional retirement program (ORP) of the University of North Carolina system changed vendors three times in the period between 2001 and 2015. While the first and third vendors allowed the employee to reallocate all assets up to 4 times a year, the second vendor allowed only changes in allocation for new contributions.

(33) While not addressing increased control issues for special needs planning per se, greater control and flexibility is a recognized feature of in-service distribution strategies.

(34) Wai Mun Fong, "Beating the Market: Dollar-Cost Averaging with the Profitable Dividend Yield Strategy," *The Journal of Wealth Management* 20, no. 2 (2017): 54-66.

(35) In general, dollar-cost averaging is a strategy for regular investing over a long period of time. See, e.g., Gary Smith and Heidi Margaret Artigue, "Another Look at Dollar Cost Averaging," *The Journal of Investing* 27, no. 2 (2018): 66-75; Richard Lu, Vu Tran Hoang, and Wing-Keung Wong, "Do Lump-Sum Investing Strategies Really Outperform Dollar-Cost Averaging Strategies?" *Studies in Economics and Finance* 38, no. 3 (2020); Michele Bisceglia and Paola Zola, "Dollar-Cost Averaging with Yearly and Biyearly Installments," *Journal of Applied Management and Investments* 7, no. 1 (2018): 1-14.

(36) Kenn Beam Tacchino, "Planning for Required Minimum Distributions," *Journal of Financial Service Professionals* 75, no. 4 (2021): 6-12. As Tacchino notes, whether the RMDs are required or not depends upon the source of the tax-deferred retirement account: under some circumstances, if the source is a 401(k), 403(b), or 457 plan, the employee may qualify for deferral of taxation until they retire. But as noted, individual retirement accounts (IRAs), simplified employee pension plans (SEPs), and savings incentive match plans for small employers (SIMPLEs) are still subject to the RMDs and their taxation. See, especially, page 9, paragraph one: "Is There Any Way to Delay or Avoid Taxation on RMDs?"

(37) For an insightful discussion on the relationship of Roth conversions and life insurance planning, see Marc Belletsky, Christina Anstett, and Mark Teitelbaum, "Life and Financial Planning in the Time of COVID-19," *Journal of Financial Service Professionals* 74, no. 4 (2020): 41-53.

(38) As cited in endnote 8, not all plans allow for in-service distributions, though a majority do. See Browning (2021), endnote 8.