NEW RETIREMENT DISTRIBUTION RULES – WHAT'S UP!

Presented by

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I. New Regulations for Qualified Plans and IRAs and What They Mean to You

Regs. 1.401(a)(9)

A. Introduction

New proposed regulations for minimum distributions from retirement plans were published by the Internal Revenue Service in 2002. The proposed regulations apply to all stock bonus, pension and profit-sharing plans qualified under the Internal Revenue Code of 1986 as amended (the "IRC") §401(a), annuity contracts under IRC §403(a), annuity contracts or custodial accounts under IRC §403(b), IRAs under IRC §408, Roth IRAs under IRC §408(a) and certain defined compensation plans under IRC §457. The proposed regulations apply for determining required minimum distributions ("RMDs") for calendar years beginning on or after January 1, 2003.

B. Simpler required beginning dates during life

A plan participant must begin taking distributions from a retirement plan at age 70 ½ but can elect to defer the first distribution until April 1 of the year following the year in which the employee attained age 70 ½. An employee is still required to begin distributions from a retirement plan on or before his or her required beginning date ("RBD"). (The RBD is April 1 of the year following the year in which the taxpayer attains age 70 ½ unless the employee has not retired.) The table used for determining RMDs is the former minimum distribution incidental benefit table. This table is based on the fiction that the employee (or IRA owner) is 10 years older than the beneficiary and that both lives are recalculated. The "Uniform Lifetime Table" is attached as Exhibit A.

<u>Practical Note</u>: The actual age of the beneficiary is no longer used in determining RBD, unless the beneficiary is the spouse and the spouse is more than 10 years younger than the employee.

Employee is no longer faced with a difficult decision of whether the RBD should be calculated using life expectancy or the recalculation method.

C. <u>RMDs During Life</u>

The employee determines his or her RMD in two steps as follows: First, the employee must find his or her current age from the Uniform Table and the applicable distribution period for that age; Second, the employee must divide his or her account balance in the plan determined as of the most recent valuation date in the prior calendar year by the applicable distribution period (also known as the Applicable Divisor) associated with his or her current age.

Example: X, individual at age 72, has an IRA account balance of $1,000,000. The distribution period (divisor) for a 72 year old is 25.6 years. Therefore, X's RMD is $39,062.50 ($1,000,000 ÷ 25.6). This result is not dependent either on the identity of the beneficiary or on the employee even having a designated beneficiary. This might be withdrawn by the end of the calendar year.

D. <u>RMDs After Death</u>

<u>Spouse as designated beneficiary</u>. If an employee dies and his or her spouse is the sole designated beneficiary and the spouse does not roll over the benefits to a spousal IRA, a different life expectancy rule applies. Under this rule, payments may be extended over the spouse's life expectancy <u>recalculated</u> each year using the "Single Life Table". The Single Life Table is attached as Exhibit B. In most cases, a spouse would be better served to roll the IRA into his or her own IRA and use the new Uniform Lifetime Table to take advantage of a joint life expectancy using the age of the spouse and that of a person ten years younger.

Example:

		RMD Under Uniform Table	*RMD Under Single Life Table*
Age of Spouse	72	25.6	15.5
Account Balance	$1,000,000	$ 39,062.50	$ 64,516.13

If the spouse dies without having rolled over the benefit, distributions can continue to beneficiaries over the spouse's remaining life expectancy not recalculated. The spouse's remaining life expectancy is determined using the Single Life Table and the spouse's age as of the calendar year of the spouse's death. In subsequent years, the applicable distribution period is <u>reduced by one</u> for each calendar year that has elapsed since the calendar year immediately following the calendar year of the spouse's death. On the other hand, if the IRA had been rolled over, minimum distributions will be based on the remaining life expectancy of the beneficiaries.

Example: Spouse dies at age 78 and account is payable to daughter (age 40). If account had been rolled over, the RMD for the year of death to spouse would be $49,261 ($1,000,000 ÷20.3). The following year, the daughter would be required to withdraw only $24,096, assuming an account balance of $1,000,000 on December 31 of the year of mother's death ($1,000,000 ÷ 42.7).

<u>Non-Spouse as designated beneficiary</u>. If a non-spouse, such as a child, is designated beneficiary, payments may extend over a period not extending beyond the child's life expectancy. The child's life expectancy is determined using the Single Life Table and the child's age as of his or her birthday in the calendar year immediately following the calendar year of the employee's death. In subsequent calendar years, the applicable distribution period is <u>reduced by one</u> for each calendar year that has elapsed since the calendar year immediately following the calendar year of the employee's death.

E. <u>Determining Applicable Divisor in Year Employee Attains Age 70 ½</u>

This rule has not changed but is important to understand. An employee who is born in the first half of the year will attain age 70 ½ in the same year. The employee who is born in the second half of the year will attain age 70 ½ in the following year. Since the Applicable Divisor is determined by the employee's attained age in the year in which the employee attains age 70 ½, the Divisors will differ. For those born in the first half of the year, the attained age will be 70 while for those born in the second half of the year, the attained age will be 71. On the other hand, for those born in the second half of the year, the RBD will be extended for one additional year.

Example:

1. X is born March 1, 1937. X will attain age 70 ½ on September 1, 2007. The RBD will be April 1, 2008 and the Applicable Divisor will be 27.4 based on an attained age of 70. If the account balance was $1,000,000 as of December 31, 2006, the April 1, 2008 RMD would be $36,496 ($1,000,000 ÷ 27.4). A <u>second</u> distribution will be required on or before December 31, 2008 based on a Divisor of 26.5. This amount will be $36,358 [($1,000,000 - $36,496) ÷ 26.5].

2. Y is born July 1, 1937. Y will attain age 70 ½ on January 1, 2008. The RBD will be April 1, 2009. The Applicable Divisor will be 26.5 based on an attained age of 71. If the account balance was $1,000,000 on December 31, 2007 (not 2006), the RMD would be $37,735 ($1,000,000 ÷ 26.5). A <u>second</u> distribution will be required on or before December 31, 2009 based on an Applicable Divisor of 25.6. This amount will be $37,589 [($1,000,000 - $37,735) ÷ 25.6].

<u>Practical Note</u>: Regs. 1.401(a)(9)-5 A-3: This account balance is determined as of the last valuation date in the calendar year immediately preceding the distribution calendar year.

Determination of designated beneficiary. The timing of the determination of the designated beneficiary has changed under the new regulations.

Old Rule: The designated beneficiary must be determined as of the required beginning date or, if earlier, as of the employee's death.

New Rule: The designated beneficiary must be determined as of the "applicable date." The "applicable date" is the last day of the calendar year following the calendar year of the employee's death. Any person who was a beneficiary as of the date of the employee's death, but is not a beneficiary as of the applicable date, because the person disclaims or dies prior to the applicable date, is not taken into account in determining the employee's designated beneficiary. Clear and unambiguous beneficiary designations are absolutely critical.

Practical Note: The applicable date rule does not affect the identity of the beneficiary entitled to the benefit, it only affects the identity of the person whose life is a measuring period for purposes of RMDs.

Naming a trust as beneficiary. The proposed regulations allow an underlying beneficiary of a trust to be an employee's designated beneficiary for purposes of determining RMDs when the trust is named as the beneficiary of a retirement plan, provided that certain requirements are met. One of these requirements is that documentation of the underlying beneficiaries of the trust must be provided in a timely manner to the plan administrator. The deadline under these proposed regulations for providing the beneficiary documentation is the end of the year following the year of the employee's death.

No designated beneficiary. If the employee dies, before the required beginning date, distributions of plan benefits must be made to the estate under the 5-year rule. This means that all plan benefits must be distributed no later than the last day of the fifth year containing the anniversary of the employee's death.

If the employee dies after the required beginning date, distributions can continue over the deceased employee's remaining life expectancy. The deceased employee's remaining life expectancy is determined using the Single Life Table and the employee's age in the calendar year of the employee's death. In subsequent years, the applicable distribution period is reduced by one for each calendar year that has elapsed since the calendar year of the death.

Practical Note: The distribution period is likely to be longer for death after the RBD than for death prior to the RBD if there is no designated beneficiary.

Separate Shares. If there are multiple beneficiaries of a trust, the age of the oldest beneficiary must be used. In the case of donor's individual exclusion, the new rules allow for the establishment of separate shares on a timely basis, in which case the life expectancy of the beneficiary of each separate share may be used to establish the applicable distribution period. When must separate shares be established?

Old Rule: Separate shares had to be established by the earlier of the employee's death or the RBD.

New Rule: (i) for lifetime distributions, separate shares must be established as of the employee's RBD or the beginning of any calendar year beginning after the employee's RBD; (ii) in the case of distributions made because of death, separate shares must be established as of the applicable date (the last day of the calendar year following the year of death).

<u>Practical Note</u>: Separate shares can now be established for multiple beneficiaries to take advantage of each beneficiary's adjusted life expectancy.

<u>Spousal Rollover</u>. The proposed regulations clarify the rules regarding spousal rollovers from an IRA to a spousal rollover as follows:

The surviving spouse may treat the deceased employee's IRA as his or her own IRA by electing to do so after the distribution of the RMD for the year of the employee's death.

Requirements: the spouse must be the sole beneficiary of the account and have an unlimited right to withdraw from the account (this requirement is not satisfied if a trust is named as IRA beneficiary even if the spouse is the sole beneficiary of the trust).

Result: The RMD for the year of the election and for subsequent years is determined based on the surviving spouse being owner and not beneficiary. An election will be deemed to have been made if the surviving spouse fails to take RMDs as a beneficiary or adds to the decedent's IRA.