

RETIREMENT

Introduction	537	Have the QDRO Rules Changed?	550
Overview of New Regulations	538	Types of Retirement Plans	550
Distributions during the Owner's/Employee's Lifetime	538	Defined Contribution Plans	550
Determination of Designated Beneficiary	540	Defined Benefit Plans	554
Distributions after the Owner's/Employee's Death	540	Individual Retirement Plans	558
IRA Reporting of Required Minimum Distributions	543	I.R.C. 501(c)(3) Organizations and Public Schools	559
Choosing a Beneficiary	544	Rollovers and Transfers	560
What Is a Designated Beneficiary?	544	Excise Taxes under Prop. Reg. §54.4972-2	561
When Is the Designated Beneficiary Determined?	544	Case Studies for Decision Making	562
Are There Any Changes in the Case of a Spouse as a Beneficiary?	545	Miscellaneous Questions and Answers	568
What Are the Rules for Multiple Beneficiaries?	546	Appendix	571
Can a Trust Be the Beneficiary?	547	Applicable Distribution Periods ("Uniform Table")	571
		The MDIB Table	572
		Single Life Expectancy Table	573
		Joint and Last Survivor Life Expectancy Table	574

INTRODUCTION

During their working years, taxpayers have the option to set money aside for retirement, either through company-sponsored retirement plans or individual retirement arrangements (IRAs). When they reach the age of 59½, they have the option to begin withdrawing that money without paying a penalty. Upon reaching age 70½, however, they no longer have an option; at that point they are *required* to begin a withdrawal program, and there are rules to determine the amount that must be withdrawn each year. The only exceptions to the age 70½ rule are:

1. Employees covered by company-sponsored retirement plans, who do not own more than 5% of the company, can wait until the year they actually retire, and
2. Individuals who have Roth IRAs (distributions are not required during the life of the owner).

In the past, the required minimum distribution (RMD) depended upon formulas resulting from taxpayers' decisions about beneficiaries, joint versus single life expectancies, and the question of recalculation.

On January 17, 2001, the IRS issued revised proposed regulations that simplify the way minimum distributions from retirement plans are calculated under I.R.C. §§401, 403, 408, and 4974. These revised proposed regulations have the potential to reduce required withdrawals, thus allowing more money to remain in tax-deferred status.

2001 Workbook

Observation. Owners/Employees who are withdrawing more than the minimum distribution for living expenses are not affected by the new rules. Owners/Employees who do not need to withdraw money from their retirement accounts for living expenses will benefit from the new rules because they can leave more in their retirement accounts to grow at a tax-deferred rate.

OVERVIEW OF NEW REGULATIONS

DISTRIBUTIONS DURING THE OWNER'S/EMPLOYEE'S LIFETIME

The first required minimum distribution must be taken by April 1 of the year after a person turns 70½.

Example 1. Bob was born February 1, 1931, so he turned 70½ on August 1, 2001. He retired from his job when he turned 65. He must take his first required minimum distribution by April 1, 2002.

Example 2. Susan was born February 1, 1931, so she turned 70½ on August 1, 2001. She enjoys her job and can't picture retiring for several more years. She does not have any ownership in her company. Her retirement savings are in a company plan. She must take her first required minimum distribution by April 1 of the year after the year she actually retires.

Example 3. Mark was born February 1, 1931, so he turned 70½ on August 1, 2001. All of his retirement savings are in a Roth IRA. No distributions are required.

Observation. Nothing in the new rules changes the fact that a person is allowed to withdraw, without penalty, *any* amount once he or she reaches the age of 59½.

Under the old rules, the required minimum distribution depended on whether or not there was a beneficiary, the age of the beneficiary, and the method the taxpayer chose to calculate the required minimum distribution. If the owner/employee designated an older beneficiary after the beginning date, the required minimum distribution increased.

With the new rules, there is only one table and, in most cases, all that is needed is the age of the retiree. Divide the account balance at the end of the previous year by the applicable divisor given in the table (based on the owner's/employee's age at the end of the distribution year), and that will be the required minimum distribution. **Beneficiaries are no longer part of the equation, as long as the owner/employee is still living, unless a spouse who is more than 10 years younger is the sole beneficiary.**

Practitioner Note. The new table, referred to as the "Uniform Table," is printed in its entirety in the appendix to this chapter.

Example 4. On December 31, 2000, the balance in Bill's IRA was \$335,000. Bill turned 70½ in 2001, so he is required to make a minimum withdrawal. He uses the table (see partial table that follows) and finds his divisor to be 26.2 since he will still be 70 at the end of 2001. Therefore, by April 1, 2002, he must withdraw \$12,786 ($\$335,000/26.2$)

Observation. The December 31, 2000, balance is used because Bill reached age 70½ in 2001. Deferring the first distribution until April 1, 2002, does not change the retirement account valuation date.

2001 Workbook

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5

For each distribution year, the previous year's ending account balance must be determined. The owner's age at the end of the distribution year and the appropriate table are used to determine the divisor. The balance is divided by the divisor. The result is the required minimum distribution for the year.

Practitioner Note. In effect, everyone will now use the recalculation method, for distributions during the owner's/employee's lifetime.

Effective Dates

Although the proposed effective date is January 1, 2002, these new rules are available in 2001, if desired. **Anyone who is required to receive his first distribution by April 1, 2001, must use the old rules** in Publications 575 and 590 since that distribution is a 2000 amount. The 2001 required minimum distribution, required by December 31, 2001, can be calculated under the old or the new rules.

Example 5. Barbara turned 70½ in April of 2000. She is single and has not named a beneficiary. At the end of 1999, her IRA account balance was \$260,000. At the end of 2000, her IRA account balance was \$280,000. To calculate her 2001 distribution, which can be deferred until April 1, 2001, use the Single Life Expectancy Table.

1. Divide \$260,000 by the Single Life Expectancy (see below) factor of 15.3; this results in a required minimum distribution of \$16,993.

SINGLE LIFE EXPECTANCY

Age	Divisor
68	17.6
69	16.8
70	16.0
71	15.3

2. Assuming Barbara deferred the 2000 distribution to April 1, 2001, subtract the required minimum distribution distributed by April 1, 2000, from the balance at the end of 2000 (\$280,000 - 16,993 = \$263,007)
3. Using the adjusted balance from step 2, calculate the required distribution for the year 2001 under the new rules and the Uniform Table shown below. Divide \$263,007 by the age 72 factor (Barbara will be 72 at year-end) of 24.4 to get a required minimum distribution of \$10,779.

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5

Example 6. What if Barbara, in Example 5, instead of being single, is married to John, age 68, and has named him as her beneficiary? Still using the same numbers, the calculation for her April 1 distribution is made using the Joint and Last Survivor Life Expectancies Table.

2001 Workbook

1. Divide \$260,000 by the Joint and Last Survivor Life Expectancies factor of 21.2; this results in a required minimum distribution of \$12,264.

JOINT AND LAST SURVIVOR LIFE EXPECTANCIES

Ages	65	66	67	68	69	70	71	72	73	74
69	23.4	22.9	22.4	21.9	21.5	21.1	20.7	20.3	20.0	19.6
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6

2. Subtract the required minimum distribution from the balance at the end of 2000 (\$280,000 – \$12,264 = \$267,736)
3. Using the adjusted balance from step 2, calculate the required distribution for the year 2001 under the new rules and the Uniform Table shown below. Divide \$267,736 by the age 72 factor of 24.4 to get a required minimum distribution of \$11,063.

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5

Examples 5 and 6 provide an opportunity to compare the results of the old proposed regulations versus the new. The required minimum distribution in both cases is substantially less under the new regulations.

Minimum Distribution Incidental Benefit (MDIB) Rules (Old and New)

A typical application of the old minimum distribution incidental benefit rules occurred when an IRA owner chose his or her grandchild as the beneficiary. By taking withdrawals over the joint life expectancy of a grandparent and grandchild, the required minimum distribution could be substantially reduced; this enabled more of the account to be passed on to the heir(s) when the grandparent died. Under the MDIB rules, the maximum allowable age difference is 10 years, and no matter what the actual difference may be, the chart is based on the joint life expectancies of an individual and a survivor 10 years younger at each age level.

In Examples 5 and 6, it is easy to see that the numbers used to divide the balance in the account are larger under the new rules, resulting in lower distribution requirements. The new Uniform Table is actually the old MDIB chart. No matter what the true age difference is, the calculation automatically allows a 10-year span. The current application for the table is much more beneficial for most people.

For the majority of situations, the old MDIB rules are no longer in effect. The only age that is applicable during the owner's lifetime under the new proposed regulations is his or her own age.

Observation. If there is *more than 10 years* age difference between spouses, and the spouse is the sole beneficiary, the required minimum distribution will be reduced by using the Joint and Last Survivor Life Expectancy Table, a portion of which can be found in the Appendix to this chapter. This option is *only* available for spouses.

DETERMINATION OF DESIGNATED BENEFICIARY

It is no longer a requirement to have a beneficiary in place as of the required distribution date. Under the old rules, the beneficiary was an integral part of the calculation of the required distribution, and the selection of a beneficiary could adversely affect long-term financial goals and planning. With the new

2001 Workbook

regulations, the calculation is based upon the age of the employee (or IRA owner), as long as he or she is still living, without regard to the beneficiary, unless the beneficiary is a spouse more than 10 years younger than the employee/owner.

The determination of a beneficiary can now be made by the end of the year following the year of death of the employee or IRA owner. Obviously, the deceased will not return from the grave to make the decision, but the regulation allows for some other possibilities.

1. It is now possible to allow a change of beneficiary during the lifetime of the owner without also requiring an increase in the distribution amount. Under the old rules, a switch to a beneficiary with a shorter life expectancy also required a larger distribution amount because one determining factor was the age of the beneficiary.
2. After the death of the employee or IRA owner, the beneficiary can still be changed in the event that one or more of the beneficiaries either disclaim (choose to not be a beneficiary) or are cashed out. Formerly, the beneficiary needed to be determined by the time the required distributions began. **Note that the changes are dependent upon choices made by the beneficiaries and not by the inclusion of previously unnamed beneficiaries.**

DISTRIBUTIONS AFTER THE OWNER'S/EMPLOYEE'S DEATH

Under the new rules, if the designated beneficiary of the owner/employee is an individual, such as the owner's/employee's spouse or child, minimum required distributions for years after the year of the owner's/employee's death generally are based on a term certain distribution period that can be determined using the beneficiary's single life expectancy. This rule applies whether or not the death occurred before the owner's/employee's required beginning date. If the owner's/employee's beneficiary is not an individual (for example, if the beneficiary is the owner's/employee's estate), the rule for determining minimum required distributions for years after the owner's/employee's death depends on whether or not the death occurred before the owner's/employee's required beginning date.

If the Owner's/Employee's Designated Beneficiary is an Individual

To figure the minimum required distribution for 2001, divide the account balance at the end of 2000 by the distribution period from Table I (Single Life Expectancy) on page 75 of Publication 590. Determine the distribution period as follows:

■ Spouse as sole designated beneficiary

The distribution period is the divisor listed in the table next to the spouse's age in each distribution year. If the owner/employee died before the year in which he or she attained age 70½, distributions to the spouse need not begin until the year in which the owner/employee would have attained age 70½.

■ Other designated beneficiary

The distribution period is the divisor listed in the table next to the beneficiary's age (as of his or her birthday in the year following the year of the owner's/employee's death), reduced by one for each elapsed year since the year following the owner's/employee's death.

If the Owner's/Employee's Beneficiary is not an Individual

Determine the minimum required distribution for 2001 as follows:

■ Death on or after the required beginning date

Divide the account balance at the end of 2000 by the distribution period from Table I (Single Life Expectancy) on page 75 of Publication 590. The distribution period is the divisor listed next to the owner's/employee's age (as of his or her birthday in the year of death), reduced by one for each elapsed year since the year of death.

■ Death before the required beginning date

2001 Workbook

The 5-year rule continues to apply. Under this rule, the entire account must be distributed by the end of the fifth year following the year of the owner's/employee's death. No distribution is required for a year before that fifth year. This rule may also be elected by a beneficiary who is an individual.

Observation. A significant advantage of the new regulations is the elimination of the possibility that the entire balance of the account must be distributed by December 31 of the year following the owner's/employee's death.

Example 7. (Old Law) Bill died at age 68 in 1999; his beneficiary is his daughter, Sara, age 40. She had until December 31, 2000, to elect to take distributions over her single life expectancy. If she failed to make the election, the 5-year rule would go into effect and she would have to withdraw all of the money by December 31, 2004.

Example 8. (New Law) Bill dies at age 68 in 2002; his beneficiary is his daughter, Sara, age 40. The distributions will be calculated over her single life expectancy without requiring an election. Using the chart for a single life expectancy, Sara's age would be calculated as of the year *after* Bill's death (41 in this case). If Sara fails to take the required annual distribution, she may be subject to an excise tax discussed later in this chapter.

Example 9. Bob dies at age 75; his beneficiary is his estate rather than an individual. Because he died after his required beginning date, his age is used to calculate subsequent distributions. The divisor for age 75 is 12.5(see table that follows). Distributions will be as follows, assuming an account balance of \$200,000. For the sake of simplicity, no increase is made for interest earned, although that would normally be the case. Note that the divisor decreases by one each year.

$$\text{Year 1: } \$200,000 / 11.5 = \$17,391$$

$$\text{Year 2: } \$182,009 / 10.5 = \$17,391$$

$$\text{Year 3: } \$165,218 / 9.5 = \$17,391$$

Follow the same pattern for all subsequent years.

Practitioner Note. Distributions begin the year after death using the owner's/employee's age in the year of death reduced by one each year [Prop. Reg. §1.401(a)(9)-5].

SINGLE LIFE EXPECTANCY

Age	Divisor
73	13.9
74	13.2
75	12.5

Example 10. Bob dies at age 65; his beneficiary is his estate. Because he died before beginning the required distributions, the entire account balance must be withdrawn by December 31 of the fifth year after the year of his death.

Observation. As a practical matter when the 5-year rule applies, the withdrawals can happen in any manner at any time during the period. The only requirement is that the money must all be withdrawn by the deadline.

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The rules above apply if there is no provision in the plan to specify the method of distribution after the death of an employee. There are, however, optional plan provisions that allow an election of the five-year rule by the employee or the beneficiary [Prop. Reg. §1.401(a)(9)-3(A-4)].

The plan may adopt a provision specifying either that:

1. The 5-year rule will apply to certain distributions after the death of an owner/employee even if the owner/employee has a designated beneficiary.
2. Distribution in every case will be made in accordance with the 5-year rule.

A plan need not have the same method of distribution for the benefits of all owners/employees.

A plan may adopt a provision that permits owners/employees (or beneficiaries) to elect on an individual basis whether the 5-year rule or the life expectancy rule applies to distributions after the death of an owner/employee who has a designated beneficiary. Such an election must be made no later than the earlier of:

1. The end of the calendar year in which distribution would be required to commence in order to satisfy the requirements for the life expectancy rule, or
2. The end of the calendar year that contains the fifth anniversary of the date of death of the employee

As of the date determined under the life expectancy rule, the election must be irrevocable with respect to the beneficiary (and all subsequent beneficiaries) and must apply to all subsequent calendar years. If a plan provides for the election, the plan may also specify the method of distribution that applies if neither the owner/employee nor the beneficiary makes the election. If neither the owner/employee nor the beneficiary elects a method and the plan does not specify which method applies, distribution must be made as if there were no plan provision.

Example 11. Scott's pension plan specifies that he *or* his beneficiary can elect whether to use the 5-year rule or the life expectancy rule. When he dies at age 72, his beneficiary is his son, Donald. If Scott has not elected which method to use, Donald must make that choice by December 31 of the next year, because that would be the earlier of the two test dates. If Donald doesn't make a choice by that date, the "no plan provision" rules go into effect. In that case, since there is a designated beneficiary, the distributions will be made under the life expectancy rule.

IRA REPORTING OF REQUIRED MINIMUM DISTRIBUTIONS

In addition to the potential for much smaller required payments, there is another benefit for IRA owners and beneficiaries. The calculation process has been simplified to the point that the IRA trustees, custodians, and issuers, who are already reporting the account balance at the end of each year, will now be required to report the required minimum distribution for each account. Although the details of that reporting are still in the planning stage, the individual will also be reminded that the distribution may be taken from *any* of the owner's IRA accounts. The reporting is scheduled to begin in 2002.

Observation. If an IRA owner has multiple IRA accounts with varying banks and/or mutual fund families, he or she will receive distribution requirements for each of those accounts. While this might be confusing to some people, the requirements should be totaled and a decision made as to which accounts to actually use for withdrawal purposes. Consideration should always be given to the individual accounts and the cost of making a withdrawal (i.e., certificates of deposit should be used for withdrawals at renewal time, not in the middle of a period).

CHOOSING A BENEFICIARY

With the proposed regulations eliminating beneficiary concerns for calculating lifetime distributions, an owner/employee might make the mistake of deciding that a beneficiary is not important. However, having a designated beneficiary affects how soon distributions are made *after* the death of the IRA owner or employee, and is still vital for good estate planning.

WHAT IS A DESIGNATED BENEFICIARY?

The designated beneficiary must be an *individual* who is entitled to all or part of the benefit, contingent upon the death of the employee (or IRA owner) or another specified event. The terms of the plan may specify that the beneficiary or the owner/employee or his or her surviving spouse can make that determination. The key is the word “designation” [Prop. Reg. §1.401(a)(9)-4(A-1)].

A designated beneficiary need not be specified by name in the plan, or by the owner/employee, in order to be a designated beneficiary, so long as the individual who is to be the beneficiary is identifiable on the last day of the calendar year following the calendar year of the owner’s/employee’s death. The members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable, if it is possible, as of the date the beneficiary is determined, to identify the class member with the shortest life expectancy. The fact that an owner’s/employee’s interest under the plan passes to a certain individual under applicable state law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan.

Example 12. Robert is an employee of XYZ Company, which offers a pension plan. When he turns 65, he selects the option of receiving his distribution as a joint and survivor annuity over his life and that of his son, Ed. Ed must be named as a beneficiary of Robert’s plan, either by name or category (i.e., children), for him to be a designated beneficiary.

Observation. In most cases, an annuity distribution, established before the required beginning date, will continue unchanged when the employee reaches the age of 70½, because single or joint life annuities normally meet the life expectancy requirements.

Example 13: Andy never saw any need to name a beneficiary for his IRA. He didn’t have any close relatives and never really got to know any more distant family members. When he died, the state determined his beneficiary to be his second cousin, Al. For purposes of determining the minimum distribution period, there is no designated beneficiary.

Example 14: When Edith established her IRA, she knew that she wanted to leave something to her brother’s children, so she designated them as her beneficiaries. At the time there were only three children, but a fourth was born later. This is considered an expandable class, and the new child is a designated beneficiary.

Observation. Many plans require specific identification of beneficiaries. In that case, Edith will need to inform her plan administrator in order to add another beneficiary.

WHEN IS THE DESIGNATED BENEFICIARY DETERMINED?

The determination is made as of December 31 of the year following the year of death. This makes it possible to “clean up” the beneficiary designations in the event that some of the multiple designations are no longer desired. Since the age of the *oldest* designated beneficiary determines the payout rate, the account can be preserved for the longest possible period. Prop. Reg. §1.401(a)(9)-4(A-4) states:

2001 Workbook

“General rule. . . . The employee’s designated beneficiary will be determined based on the beneficiaries designated as of the last day of the calendar year following the calendar year of the employee’s death. Consequently, except as provided in 1.401(a)(9)-6, any person who was a beneficiary as of the date of the employee’s death, but is not a beneficiary as of that later date (e.g., because the person disclaims entitlement to the benefit in favor of another beneficiary or because the person receives the entire benefit to which the person is entitled before that date), is not taken into account in determining the employee’s designated beneficiary for purposes of determining the distribution period for required minimum distributions after the employee’s death.”

Example 15. Mel dies March 15, 2002. The beneficiaries of his IRA are his two daughters, Melanie, age 47, and Melinda, age 27. Melanie is always in trouble over money and currently is in danger of losing her house. She doesn’t want to receive an annual distribution but instead wants her money now. The value of the IRA is determined and Melanie gets her half in cash (which she promptly wastes, but that’s another story). Because she has cashed out, she is no longer a designated beneficiary. This means that the IRA distribution schedule is based on Melinda’s age.

Example 16. Bonnie dies December 15, 2002. The beneficiaries of her retirement plan are her three children, Buster, Bruce and Betty. Betty is a major rock star, earning in excess of \$20 million per year while her two brothers have never amounted to much. Betty formally disclaims the inheritance in January 2003, leaving the boys as the only designated beneficiaries.

The requirements for a formal disclaimer are given in I.R.C. §2518. To be valid, a disclaimer must be:

- An irrevocable and unqualified refusal to accept property
- In writing
- Made within nine months after death

The disclaiming party cannot:

- Benefit from the property
- Designate who gets the property being disclaimed

An employee plan may permit a surviving spouse who was named as beneficiary to name a replacement beneficiary who would receive the account if the spouse dies during the interval between the employee’s death and the spouse’s required beginning date for distributions [Prop. Reg. §1.401(a)(9)-3, A-4(b)]. If this occurs, the spouse’s date of death replaces the employee’s date of death in determining the required beginning date for the new beneficiary. The replacement beneficiary’s age may be used to determine the distribution period.

Example 17. John, age 68, dies in December 2001, naming his wife, Sue, as his beneficiary. Sue dies June 1, 2002, before being required to receive any distributions. Her beneficiary is her son Fred. Sue’s date of death is substituted for John’s, and the 5-year rule [I.R.C. §401(a)(9)(B)(ii)] and the life expectancy rule [I.R.C. §401(a)(9)(B)(iii)] are applied as if she were the employee. The applicable date is now December 31, 2003, the end of the year after Sue’s death, and the designated beneficiary is Fred.

ARE THERE ANY CHANGES IN THE CASE OF A SPOUSE AS BENEFICIARY?

In many cases, the individual chooses to make his or her spouse the beneficiary. For an IRA, the spouse has the option to either postpone receiving distributions until the year the deceased spouse would have turned 70½, or to make the IRA his or her own. The previous proposed regulations had already provided that the election to make the IRA the beneficiary’s own is deemed made when he or she either contributes to the IRA or fails to take a required distribution.

2001 Workbook

Example 18. Charlie dies at age 72. His wife, Norma, is the beneficiary of his IRA. Norma is 62 and financially secure. Because Norma is the spouse, she can elect to consider the IRA as her own, and no distributions will be required until she is 70½.

Under the new proposed regulations, however, the deemed election rules are clarified as follows:

- Any required distribution for the year of death must be made before the deemed election
- Spouse must be the sole beneficiary
- Spouse must have unlimited right to withdraw from the account

Example 19. Using the facts in Example 18, Charlie died after reaching the age for required distributions. If Norma wants to consider the IRA to be hers, Charlie's required minimum distribution for the year must first be withdrawn.

Example 20. Instead of using the deemed election rules, Norma has the option of rolling over the IRA account into her own name. In this circumstance, Charlie's required minimum distribution for the year must be withdrawn and is not eligible to be rolled over.

Observation. If the spouse has *already* started receiving distributions, he or she can still make the election to treat the remaining balance of the account as his or her own IRA [Prop. Reg. §1.408-8 (A5)].

Example 21. If Charlie named a trust as his beneficiary and then named Norma as the beneficiary of the trust, she would not be able to make the election. The election to treat the IRA as belonging to the spouse is only available if the spouse is the actual, and sole, beneficiary (see "Can A Trust Be the Beneficiary?" later in this chapter).

WHAT ARE THE RULES FOR MULTIPLE BENEFICIARIES?

Under the new rules, distributions after the owner's/employee's death are made over the life of the designated beneficiary. When there is more than one beneficiary, the age of the oldest beneficiary is used to determine the required minimum distribution.

Example 22. Myron dies at age 75, leaving his IRA to his three children, Max, age 29, Millie, age 34, and Milton, age 39. The balance in the account on December 31 of the year of Myron's death (after his final required distribution) is \$700,000. Because Milton is the oldest, his life expectancy is used to determine the distribution of \$16,471 (\$5,490 per beneficiary) as follows:

\$700,000	(December 31, 2002 balance)
42.5	(divisor for age 40, Milton's age the year after his father's death)

SINGLE LIFE EXPECTANCY

Age	Divisor
30	52.2
31	51.2
32	50.2
33	49.3
34	48.3
35	47.3
36	46.4
37	45.4
38	44.4
39	43.5
40	42.5

2001 Workbook

Tax Planning for Multiple Beneficiaries

The age of the oldest beneficiary determines the payout amount, and it cannot be changed once the distributions begin. If, in Example 22, the oldest son dies at age 50, the distributions will continue to be paid out over his remaining life expectancy. Although nothing can be done about the payout period once it has begun, there is some tax planning that offers a more beneficial time period for beneficiaries of varying ages.

Example 23. Myron could have established three different IRAs and made each child a beneficiary of one. That would give Milton a required minimum distribution of \$5,490, Millie, \$4,933, and Max, \$4,470. The required distribution amounts were determined by dividing the \$700,000 value by 3 and then dividing that amount (\$233,333) by the divisor from the Single Life Expectancy table for each age category (ages 30, 35, and 40).

An alternative to separate IRAs is to use subaccounts, defined in Prop. Reg. §1.401(a)(9)-8(A-3). “A separate account in an individual account is a portion of an employee’s benefit determined by an acceptable separate accounting, including allocating investment gains and losses and contributions and forfeitures, on a pro rata basis in a reasonable and consistent manner between such portion and any other benefits. Further, the amounts of each such portion of the benefit will be separately determined for purposes of determining the amount of the required minimum distribution.” In simpler terms, the beneficiaries are allocated a percentage of the activity in the IRA.

Example 24. In establishing his IRA beneficiaries, Myron gives 1/3 of the gains, losses, contributions, and forfeitures to each of his three children. The required minimum distributions can now be calculated based upon the age of each beneficiary. If he simply lists the three children as his beneficiaries without specifying the percentage, the age of the oldest must be used for all three.

Example 25. Using the same situation as Example 22, Myron dies, leaving his IRA to his three children. They can *choose* to split the IRA into separate accounts as long as they do it before December 31 of the year after Myron dies, if that option is permitted by the IRA contract.

What About Contingent Beneficiaries?

As a matter of good planning, it is important to have one or more contingent beneficiaries, in the event the chosen beneficiary dies before the death of the IRA owner (or employee). Whether or not to consider the contingent beneficiary depends upon timing.

Example 26. Albert names his daughter, Gwen, as his primary beneficiary for his IRA. If Gwen dies before she receives the entire amount, her daughter Jane becomes the beneficiary. Albert dies in 2001. The IRA will be distributed using the Single Life Expectancy divisor (see Table) for Gwen as of December 31, 2002. If Gwen dies after she starts receiving the distributions, Jane will continue to receive distributions at the same rate. That is because Jane’s receiving the distributions is contingent upon *Gwen’s* death.

Example 27. The facts are the same as for Example 26 except that primary beneficiary Gwen dies in 2002. Because the determination of beneficiary is not made until the end of the year following the death of the IRA owner, Jane is no longer a contingent beneficiary but, instead, is the primary beneficiary. As a result, the distributions are figured over Jane’s life expectancy.

Observation. The concern about designated, contingent, and multiple beneficiaries is only relevant when they opt to take periodic distributions. If a beneficiary chooses to take all the money at once, the required minimum distribution is not an issue.

2001 Workbook

CAN A TRUST BE THE BENEFICIARY?

The proposed regulations specify that the designated beneficiary must be an individual. A nondesignated beneficiary is limited in two ways:

1. If distributions have already begun, the amount cannot be changed.
2. If distributions have not begun, the entire account must be withdrawn by December 31 of the fifth year after the year of death.

Many times good tax planning calls for the creation of a trust, and a trust cannot be considered an individual. There is, however, a provision in the proposed regulations that allows the beneficiaries of a trust to be considered the designated beneficiaries for an IRA or employee plan. The key is to meet the requirements of Prop. Reg. §1.401(a)(9)-4(A-5), as listed below:

1. The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
2. The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.
3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable from the trust instrument.
4. Required documentation has been provided to the plan administrator.

Example 28. Leroy has 10 grandchildren, ranging in age from 18 to 30. He set up a testamentary trust (one that begins after his death) with all the grandchildren named as beneficiaries. His IRA will be used to fund the trust, so the trust is the beneficiary of the IRA. Leroy dies in 2002 at age 80. If Leroy meets all of the requirements, his IRA will be distributed to the trust over the life of his oldest grandchild. If he does not meet the requirements, the IRA will be distributed by reducing Leroy's life expectancy divisor by one until it is all distributed (see Example 9).

Example 29. Using the same facts as Example 28, assume Leroy died at age 68. In that case, he would not have started to receive his required distributions. If Leroy meets all of the requirements, his IRA will be distributed to the trust over the life of his oldest grandchild. If he does not meet the requirements, the IRA must be withdrawn by December 31, 2007, under the five-year rule.

What Documentation Is Required?

The employee or IRA owner must do one of the following:

- Provide to the plan administrator a copy of the trust instrument and agree that if the trust instrument is amended at any time in the future, he or she will, within a reasonable time, provide a copy of each such amendment *or*
- Meet *all* of the following requirements:
 1. Provide to the plan administrator a list of all the beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions on their entitlement)
 2. Certify that, to the best of his or her knowledge, this list is correct and complete
 3. Agree that, if the trust instrument is amended at any time in the future, he or she will, within a reasonable time, provide to the plan administrator corrected certifications to the extent that the amendment changes any information previously certified, and
 4. Agree to provide a copy of the trust instrument to the plan administrator upon demand

2001 Workbook

After the death of the employee or IRA owner, the trustee of the trust has until December 31 of the year after the year of death to do *one* of the following:

- Provide the plan administrator with a final list of all beneficiaries of the trust (including contingent and remainder beneficiaries with a description of the conditions on their entitlement) as of the end of the calendar year following the calendar year of the employee's death; certify that, to the best of the trustee's knowledge, this list is correct and complete; and agree to provide a copy of the trust instrument to the plan administrator upon demand **or**
- Provide the plan administrator with a copy of the actual trust document for the trust that is named as a beneficiary of the employee under the plan as of the employee's date of death

What Happens if There Is a Discrepancy?

If there is a discrepancy between the actual trust instrument and the certifications or earlier trust instruments, the use of the beneficiaries of the trust as designated beneficiaries of the IRA or employee plan will not automatically be disallowed. In order to keep their status as designated beneficiaries, there are two further requirements.

- The plan administrator must have reasonably relied on the information provided *and*
- The required minimum distributions for calendar years after the calendar year in which the discrepancy is discovered are determined based on the actual terms of the trust instrument

In the event that excise tax is due, the amount will be figured based on the actual terms of the trust in effect during the year. The excise tax is discussed later in this chapter.

What About a QTIP Trust?

A Qualified Terminable Interest Property (QTIP) trust is one that meets two requirements:

- The surviving spouse must be entitled to receive all income from the property for life, payable at least annually *and*
- No person can have the power to give the property to anyone other than the surviving spouse

The QTIP trust restricts the spouse's ability to dispose of the property. Its purpose is to protect the assets from a spouse who is not able to manage them, to protect the assets from the surviving spouse's creditors, or, most commonly, to guarantee the ultimate disposition of the assets to a remainder beneficiary. When a person has children from a first marriage, he or she might opt for the QTIP trust to provide income for the spouse of the second marriage while still assuring that the assets will go to the children of the prior marriage. From an estate planning viewpoint, the QTIP trust allows the property to qualify for the marital deduction without having to give the spouse complete control of the asset.

In *Rev. Rul. 2000-2, 2000-3 IRB*, the IRS concluded that the executor of the estate could make the QTIP election with respect to an IRA that named a trust as the beneficiary. The trust met all of the QTIP requirements. The decedent's surviving spouse could compel the trustee to withdraw from the IRA an amount equal to all the income earned on the assets held in the IRA and pay that amount to the surviving spouse at least annually.

The proposed regulations have incorporated *Rev. Rul. 2000-2* with respect to beneficiaries and required distributions, making a distinction between trusts with multiple beneficiaries and those with just one.

Example 30. Alex made his testamentary trust the beneficiary of his estate and his wife, Lucy, the beneficiary of the trust. When Alex dies, the trustee is to distribute all income from the trust annually to Lucy. After her death, the assets will go to Alex's three children. The trust meets all of the QTIP requirements. Since Lucy is the sole beneficiary, the trustee can elect to wait until the year Alex would have turned 70½ before beginning to take the distributions. When required minimum distributions begin, they will be calculated over Lucy's life expectancy.

2001 Workbook

Example 31. If Alex, in Example 30, had specified that Lucy would receive the required minimum distribution each year and the rest of the income would be accumulated for the benefit of his children as remainder beneficiaries, the rules change. Lucy is not considered the sole beneficiary, even though the children can't get the money until after Lucy dies. She can no longer qualify to wait until the year Alex would have turned 70½ to begin distributions; instead, they must begin by the end of the year after his death. As in Example 30, they will be calculated over her life expectancy, assuming she is the oldest beneficiary.

HAVE THE QDRO RULES CHANGED?

The rules for a qualified domestic relations order (QDRO) were established in the 1987 proposed regulations and have not been changed. A QDRO is defined in I.R.C. §414(p) as a decree, order, or property settlement under state law relating to child support, alimony, or marital property rights that assigns part or all of a participant's plan benefits to a spouse, former spouse, child, or other dependent of the participant. The major points of those rules are summarized below:

- The former spouse is treated as a spouse (including being a surviving spouse, if applicable) even if the QDRO does not specifically provide for spousal treatment.
- The rule applies no matter how many former spouses qualify.
- Required minimum distributions to the former spouse must begin by the employee's required beginning date.
- The required minimum distribution for the former spouse may be determined based upon the age of the employee in the distribution calendar year or, if the age difference between the two is more than 10 years, on the joint life expectancy of the employee and the former spouse.

The new regulations also allow a delay for a period of up to 18 months in the required minimum distribution if there is an amount segregated in connection with the review of a QDRO pursuant to I.R.C. §414(p)(7).

TYPES OF RETIREMENT PLANS

Over the course of their working lives, taxpayers participate in a variety of retirement plans. One company might offer a defined benefit plan, another a profit sharing plan. Some offer no plan at all, and the only option available is an individual retirement arrangement (IRA). This section takes a closer look at each type of plan to see how the proposed regulations affect it.

DEFINED CONTRIBUTION PLANS

In a defined contribution plan, each employee has an individual account established for him or her that is maintained by his or her employer. The benefit payments are based on the total amount in the account at the time of retirement. Defined contribution plans are of three principal types:

■ Money Purchase Plan

The employer is required to contribute a stated percentage of the participant's compensation annually.

■ Target Benefit Purchase Plan

This is similar to a money purchase plan except that the participant's age is taken into account in determining the contribution percentage.

■ Profit Sharing Plan

There is no stated contribution percentage; instead, it is determined annually and, in some cases, there is no contribution at all. Plans with employee contributions (and often an employer match) fall into the categories of thrift savings or 401(k) plans.

2001 Workbook

The new rules for required minimum distributions from defined contribution plans are found in Prop. Reg. §1.401(a)(9)-5.

General Rule

The required minimum distribution is determined by dividing the account by the applicable distribution period. The required minimum distribution, however, can never exceed the vested account balance on the date of the distribution. Under I.R.C. §401(a)(9)(A)(ii), the entire interest of an employee in a qualified plan must be distributed, beginning not later than the employee's required beginning date, over the life of the employee or over the lives of the employee and a designated beneficiary (or over a period not extending beyond the life expectancy of the employee and a designated beneficiary).

Example 32. Alice, who is single, retired from Smith Company at age 65. She was fully vested in the 401(k) at the company. Because she wants to leave her estate to her two nephews, she took a minimal draw when she retired. Since she turns 70½ and 71 in the same year, she will need to divide the balance in her account by her divisor of 25.3 to ensure that she is withdrawing the required minimum distribution (see below).

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4

Distribution Date

For a non-owner employee, the required minimum distribution date depends upon when he or she actually retires. Normally the first distribution must be made by April 1 of the year after the employee turns 70½. A non-owner employee who continues to work beyond his or her seventieth birthday, however, can defer receiving the first distribution until April 1 of the calendar year following his or her actual retirement.

Example 33. Susan turns 82 in 2001 and decides to retire. No matter when in the year she actually retires, she must take her first required minimum distribution by April 1, 2002. Betty, on the other hand, retired at age 65; she must take her first required minimum distribution by April 1 of the year after she turns 70½.

Observation. An employee who waits until April 1 to take his or her first required minimum distribution will then be in the position of having to take two distributions in one year. From a tax viewpoint, it might be advantageous to take the April 1 distribution before the end of the previous year. Just because it *can* be delayed until the next year does not automatically mean it is a good idea to delay.

Annuity Contracts

The employee has the option of purchasing an annuity contract from an insurance company using the entire proceeds of the individual account. In that case, the annuity payments will be used in lieu of the required minimum distribution amounts as long as the provisions of Treas. Reg. §1.401(a)(9)-6 are met (see "Defined Benefit Plans" later in this chapter).

Observation. An employee can also purchase an annuity contract without using his or her entire account. In that case, the annuity account and the remaining defined contribution account will be treated separately. Each will have its own required minimum distribution.

2001 Workbook

No Credit Allowed

Because the new required minimum distribution amounts are, in most cases, less than the prior ones, the logical assumption is that there should be some way to make up for overdrawing the account under the old rules. Logical assumptions have no bearing in this situation, and there is no credit allowed.

How Is the Account Value Calculated?

Defined contribution plans are individual accounts, so the relevant account balance is the value at the end of the year before distributions must begin. Any contributions by the employee or forfeitures from other employees allocated after the end of the year to the previous year will increase the balance, and any allocated distributions will decrease it. Since the required minimum distribution for the first year can be delayed until April 1 of the year following the year a person turns 70½, there will automatically be an adjustment if the distribution is delayed. **When using the table to determine the distribution period during the lifetime of an employee, use his or her age in the year of the distribution requirement, not the year of the valuation. That would be the person's age at the end of the year in which he or she turned 70½.**

Example 34. Maria retires from ABC Co. She was a participant in the 401(k) plan and is fully vested. She has been taking irregular withdrawals until now, but she turned 70½ on March 1, 2002. On December 31, 2001, the value of her account was \$75,000. No contributions, forfeitures, or distributions were allocated to her account in 2002 for the prior year. Her required minimum distribution is \$2,964 (\$75,000 divided by 25.3, the distribution period for a person who is 71) even though she elected to wait until April 1, 2003, to take the distribution.

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8

Example 35. In 2003, Maria, from Example 34, must take a required minimum distribution for 2003 in addition to the \$2,964 distribution she took for 2002 on April 1, 2003, distribution is treated as if it were made before the end of 2002. Therefore, the balance in the account at the end of 2002 is reduced by that distribution before calculating the 2003 required minimum distribution.

Assuming the account balance on December 31, 2002, was \$78,000, Maria's 2003 required minimum distribution is calculated as follows:

Balance on December 31, 2002	\$78,000
Less April 1, 2003 distribution	2,964
Adjusted balance	<u>75,036</u>
Divisor (for a person who is 72)	÷ 24.2
Required minimum distribution	\$3,075

Example 36. Maria, in Example 34, decided to take a trip to Europe in 2003, so, instead of withdrawing only the required minimum distribution by April 1, she withdrew \$10,000 to pay for her travels. When her account is valued for the required minimum distribution at the end of 2002, it is only decreased by the amount she was required to withdraw, exactly the same as in Example 34. Her required minimum distribution for calendar year 2003 is still \$3,075. Since the \$10,000 distribution covered both of her

2001 Workbook

required minimum distributions in the year 2003, she does not have to take another withdrawal that year.

Example 37. Continuing with Example 36, Maria withdrew \$3,961 more than she was required to in calendar year 2003 (\$10,000 – \$2,964 – \$3,075). On December 31, 2003, the account is valued at \$70,000. The distribution period for a person who is 73 is 23.5, so her required minimum distribution for 2004 is \$2,979 (\$70,000 divided by 23.5). **She cannot use her excess distribution in 2003 to satisfy her minimum requirement but instead must withdraw another \$2,979 in 2004.**

How Are Distributions Handled after the Employee Dies?

If an employee dies on or after his or her required beginning date for distributions, the age-based divisor switches to that of the designated beneficiary *or* is reduced by one each year if there is no designated beneficiary.

Example 38. Violet dies October 12, 2002, at the age of 72. Her designated beneficiary is her son, Robert. Violet's final distribution will be calculated using her age in the calendar year of her death. When the 2003 distribution is determined, Robert's age will be used to determine the required minimum distribution using the Single Life Expectancy Table. In subsequent years, he will decrease his life expectancy by one for each year since the death of Violet.

Example 39. Bill dies October 12, 2002, at the age of 72. Because he left his pension to his estate, he is not considered to have a designated beneficiary. The distribution for the year of Bill's death is computed using the Uniform Table. Distributions in the following year are computed using the single life factor for Bill's age in the year of his death, reduced by one each year until the entire pension is disbursed.

If the employee dies before his or her required beginning date, the age of the designated beneficiary is the starting point, assuming there is a designated beneficiary.

Example 40. Albert dies October 12, 2002, at the age of 68. His designated beneficiary is his daughter, Ann, age 34. Since the applicable date for determining the beneficiary is December 31, 2003, Ann will use the Single Life Expectancy Table to determine her divisor based upon her age as of that date. The divisor is 47.3, according to the table. In each subsequent year, she will reduce that divisor by one.

SINGLE LIFE EXPECTANCY

Age	Divisor
30	52.2
31	51.2
32	50.2
33	49.3
34	48.3
35	47.3

Example 41. Ben dies October 12, 2002, at the age of 68. His wife, Bernice, is his sole designated beneficiary. Bernice will not be required to draw any distributions until April 1, 2005, the year after the year that Ben would have turned 70½. Note that she did *not* transfer the IRA to her own account.

Example 42. If Bernice, in Example 41, dies in 2008, distributions continue over her life expectancy. Her daughter, Julie, becomes the beneficiary. Julie will use the factor for Bernice's age as of the end of the calendar year of her death and reduce the distribution period by one each year. **Once the designated beneficiary starts receiving the benefits, the subsequent beneficiary continues with those payments.**

2001 Workbook

If the employee dies before his or her required beginning date without designating a beneficiary, the five-year rule applies.

What If There Are Multiple Beneficiaries?

Designated beneficiaries qualify the pension plan for more beneficial treatment in terms of distribution time requirements, but multiple beneficiaries can confuse the issue. In general, the designated beneficiary with the shortest life expectancy, i.e., the oldest beneficiary, is the one used to determine the distribution period. **All of the beneficiaries must qualify as designated beneficiaries, or the employee will be treated as having none.**

Example 43. Susan designates her three children, Ralph, age 30, Rhonda, age 28, and Michelle, age 25, as her beneficiaries. Because Ralph has the shortest life expectancy, his age is used to determine the required minimum distribution if Susan dies.

Example 44. Susan, in Example 43, gets some questionable financial advice and adds her estate to her list of beneficiaries. By including a nondesignated beneficiary (the estate), all distributions must be made over the remainder of her life expectancy if she dies after her required beginning date, instead of over the much longer life expectancy of her oldest child.

The age of a contingent beneficiary is considered only if the contingency is not dependent upon the death of the employee or another beneficiary.

Example 45. Susan, in Example 43, designates her three children as her beneficiaries, but also includes her 48-year-old physically handicapped brother, if his primary caregiver, Susan's mother, is unable to care for him. If Susan dies, the age of her brother must be used to calculate the required minimum distributions.

Example 46. If, in Example 45, Susan made her brother a beneficiary only in the event that one or more of her children died, his age would not be included in the required minimum distribution calculation if the children were all living on the required beginning date. The age of the oldest child, Ralph, would be the relevant age. Even if Ralph dies before the distribution period is complete, the distribution period will be unchanged.

Example 47. Referring to Example 46, if any of the children died before the required distributions began, her brother's age would become the one used to determine the required minimum redistribution.

DEFINED BENEFIT PLANS

Defined benefit plans provide a specific amount of benefit to an employee at retirement. A variety of formulas are used to determine the amount of the benefit; typically the formula uses the employee's earnings averaged over the number of years of employment. This type of plan generally provides for annuity distributions.

What Are the Requirements for Annuity Distributions?

Annuity distributions must be paid in periodic payments at intervals not longer than one year. They can be paid over a single life or over a joint life expectancy. Once the distribution period has been established, it cannot be lengthened. According to Prop. Reg. §1.401(a)(9)-6, the dollar amount of payments can be increased only as follows:

1. With any percentage increase in a specified and generally recognized cost-of-living index

2001 Workbook

2. To the extent of the reduction in the amount of the employee's payments to provide for a survivor benefit upon death, but only if the beneficiary whose life was being used to determine the period described in I.R.C. §401(a)(9)(A)(ii) over which payments were being made dies or is no longer the employee's beneficiary pursuant to a qualified domestic relations order (QDRO) within the meaning of I.R.C. §414(p)
3. To provide cash refunds of employee contributions upon the employee's death, or
4. Because of an increase in benefits under the plan

Distributions can be made under a life annuity (or joint and survivor annuity). Currently it is not a problem if distributions from a variable annuity increase due to the investment performance of the underlying assets, but that is an area that is still under study.

Annuity payments must begin on or before the employee's required beginning date and must match the stated intervals for payment. If that interval is annual, there will only be one required payment per year, but the payments can also be bimonthly, monthly, or semiannually.

If an annuity contract is purchased after the required beginning date, the first payment interval must begin on or before the purchase date.

Example 48. George, an unmarried participant in a defined benefit pension plan, turns 70½ in 2001. The plan provides for monthly annuity payments of \$750 per month for life with a 10-year period certain. In order to meet the requirements, George must begin to draw the payments on or before April 1, 2002, and continue to receive the \$750 monthly for the rest of his life. If he dies before March 2012, his beneficiary would receive the payments for the remainder of the 10 years.

Example 49. Beth participated in a profit sharing plan during her working career. When she was required to take minimum distributions, she calculated the amount each year and made timely withdrawals. At the age of 75, she decided to transfer all of the balance of her account into an annuity so that she no longer had to deal with the calculations. Assuming she purchased the annuity June 1, she can use any date between January 1 and June 1 as the starting date for her payment intervals. She will now be receiving a set amount at regular intervals.

Observation. If Beth does not receive her required minimum distribution for the current year due to selecting the annual option on June 1, she will still need to take the required minimum distribution for the prior year under the profit sharing plan. This is not a method for skipping a payment.

10

Life Annuity Limitations for Non-Spouse Beneficiaries

Payments made under a joint and survivor annuity with the *spouse as the beneficiary* can be 100% of the annuity payment payable to the employee no matter the age difference between the two. In this case, after the employee dies, his or her spouse can continue to receive the identical amount of payment; an employee who was receiving \$300 per month can be assured that his or her survivor spouse will also receive \$300 per month. If, however, the joint and survivor annuity has a non-spouse beneficiary who is more than 10 years younger than the employee, a separate table must be used to limit the payment because the old minimum distribution incidental benefit (MDIB) rules are still in effect in this situation. The applicable percentage must be applied to any benefit increases as well as to the regular survivor benefits. **If there is more than one beneficiary, the age of the youngest will be used to calculate the percentage.** There is a new table that gives the percentage used to compute the allowable payment.

Example 50. Jeff is 65 years of age. After participating in his company's defined benefit plan during his working career, he is now ready to receive his retirement. Jeff's beneficiary is his 40-year-old daughter, Jenny. Under the terms of his plan, he will receive \$800 per month until his death; at that point Jenny

2001 Workbook

will start receiving the monthly payments. Since Jenny is 25 years younger than Jeff, the MDIB rules (see partial table below) will only allow her to receive 66% of his payment, or \$528, and the plan must be amended to include that provision.

Excess of Age of Employee Over Age of Beneficiary	Applicable Percentage
18	77
19	75
20	73
21	72
22	70
23	68
24	67
25	66

Period Certain

If an employee elects to take payments over his or her own life, there is the potential for substantial lost wealth in the case of premature death. One way to prevent that loss is to take a lesser payment with the guarantee that payments will be received for a certain number of years even if the employee dies during that time. A period certain decision ensures an inheritance for the beneficiaries if the employee dies before the end of the period. There is, however, a limit on the allowable period certain under an annuity contract, based upon the beneficiary and whether or not the required beginning date has passed.

Example 51. Ray and his wife, Martha, are both 71, and she is the sole beneficiary of Ray's annuity. The maximum period certain is based upon the joint life and last survivor expectancy of the two of them as of the required starting date, or 19.8 years.

JOINT AND LAST SURVIVOR LIFE EXPECTANCIES

Ages	65	66	67	68	69	70	71	72	73	74
68	23.8	23.3	22.8	22.3	21.9	21.5	21.2	20.8	20.5	20.2
69	23.4	22.9	22.4	21.9	21.5	21.1	20.7	20.3	20.0	19.6
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6

Example 52. If Ray, in Example 51, is single and his beneficiary is his son, Ray, Jr., the maximum period certain is the lesser of Ray's applicable distribution period in the year of the annuity start date or the joint life and last survivor expectancy of the two of them. If Ray is 71 and his son is 48, Ray's life expectancy is 25.3 per the Uniform Table, and the joint and survivor expectancy is 35.6, so the maximum period certain would be 25 years.

If the distributions begin after the death of the employee, the period certain cannot exceed the life expectancy of the designated beneficiary using the applicable distribution period.

Example 53. If Ray, in Example 52, dies before he turns 70½, Ray, Jr.'s applicable distribution period will determine the allowable period certain. In this case, it is the Single Life Expectancy amount for a 48-year old, or 34.9 years.

Annuities Purchased from an Insurance Company

Defined benefit plans are not the only source for annuities. An employee might opt to purchase an annuity from an insurance company, using the money that is in his or her plan. In that case, there is also an exception to the nonincreasing requirement in that it allows a cash refund when the employee

2001 Workbook

dies (item #3 under “Requirements for Annuity Distributions”). The amount of the refund is equal to the excess of the premiums paid over the prior distributions. In other words, the employee’s beneficiary is allowed to recapture all of the premiums paid.

Accrual of Additional Benefits after the Required Beginning Date

Any additional benefits added after the required beginning date must be accounted for separately. Realistically, that can produce some administrative delay so there is flexibility in the law. As long as the total amount required is paid by the end of the calendar year following the year the benefit accrues, the plan is in compliance with the law.

If an employee is not fully vested in the plan as of December 31 or the required beginning date in the first year, the unvested portion is not included in the accrual amount. Only when an additional portion of the benefit becomes vested is it included.

An actuarial increase will be required for any employee (other than a 5% owner) who retires after the year in which he or she turns 70½. The increase must take into account those years between the age of 70½ and the actual date of retirement when the employee was not receiving benefits. If the plan does not allow distributions to be delayed and the amounts paid are sufficient, there is no requirement for an actuarial increase, nor is it required for defined contribution plans, governmental plans, or church plans.

Early Distributions from an Annuity

When an employee starts receiving distributions from an annuity, the payment of which is irrevocable, prior to his or her required beginning date, the starting date of the annuity is treated as the required beginning date. Designated beneficiaries will be determined at that time and, if the employee dies before he or she is 70½, the remaining portion of the benefits must be distributed over the established period. No adjustments or recalculations are required when the employee turns 70½.

Example 54. Arthur retires at age 65 from Crane Company. He chooses to take his retirement in the form of an annuity and names his daughter, Laura, age 40, as his beneficiary. Arthur is treated as beginning his required minimum distribution at age 65 and no changes are required when he turns 70½ as long as he meets the minimum distribution incidental benefit rules.

Example 55. If Arthur, in Example 54, dies after the annuity begins but before he turns 70½, the distributions will continue to be made according to the annuity contract (single or joint lives and, if applicable, period certain). Note, however, that the minimum distribution incidental benefit rules must be met on Laura’s share of the annuity payments.

Example 56. Arthur’s life expectancy is calculated differently because he is under the age of 70 when the annuity begins. His applicable distribution period is 26.2 (the amount for a person age 70) plus 5 (the difference between his age when the annuity begins and 70), for a total of 31.2.

Example 57. If Arthur, in Example 54, named his wife, Anna, as his beneficiary, the same provisions would apply. If Arthur dies before turning 70½ and Anna also dies before the required beginning date, her date of death will *not* be substituted for his (see Example 17). Instead, the annuity distributions will continue as begun under the annuity contract.

Still under Study

Although there have not been changes in the annuity rules, there have been some administrative adjustments. Some issues are still under discussion. The preamble to the proposed regulations states:

“One of the rules in the 1987 proposed regulations that the IRS and Treasury are continuing to study and evaluate is the rule providing that if the distributions from a defined benefit plan are not in the form of an annuity, the employee’s benefit will be treated as an individual account

2001 Workbook

for purposes of determining required minimum distributions. The IRS and Treasury are continuing to consider whether retention of this rule is appropriate for defined benefit plans. Similarly, the IRS and Treasury are continuing to consider whether the rule permitting the benefit under a defined benefit plan to be divided into segregated shares for purposes of §401(a)(9) is useful and appropriate for defined benefit plans.”

Amendment of Qualified Plans

The proposed regulations are effective for distributions in calendar years beginning on or after January 1, 2002, but plan sponsors can continue to rely on the 1987 proposed regulations if they desire until the final regulations are effective. For those who want to switch to the rules of the *new* proposed regulations, the model amendment shown below can be adopted:

“With respect to distributions under the Plan made in calendar years beginning on or after January 1, 2001 (ALTERNATIVELY, SPECIFY A LATER CALENDAR YEAR FOR WHICH THE AMENDMENT IS TO BE INITIALLY EFFECTIVE), the Plan will apply the minimum distribution requirements of §401(a)(9) of the Internal Revenue Code in accordance with the regulations under §401(a)(9) that were proposed in January 2001, notwithstanding any provision of the Plan to the contrary. This amendment shall continue in effect until the end of the last calendar year beginning before the effective date of final regulations under I.R.C. §401(a)(9) or such other date as may be specified in guidance published by the Internal Revenue Service.”

The preamble to the proposed regulations states:

“The Service will not issue determination, opinion or advisory letters on the basis of the changes in these proposed regulations until the publication of final regulations. Until such time, the IRS will continue to issue such letters on the basis of the 1987 proposed regulations and Small Business Job Protection Act of 1996 (SBJPA). Although the IRS will not issue determination, opinion or advisory letters with respect to the model amendment, the adoption of the model amendment will not affect a determination letter issued for a plan whose terms otherwise satisfy the 1987 proposed regulations and SBJPA. Plan sponsors should not adopt other amendments to attempt to conform their plans to the changes in these proposed regulations before the publication of final regulations. The IRS intends to publish procedures at a later date that will allow qualified plans to be amended to reflect the regulations under I.R.C. §401(a)(9) when they are finalized.”

INDIVIDUAL RETIREMENT PLANS

The basic rules for distributions under the proposed regulations also apply to IRAs, including the simplified employee pension (SEP) and SIMPLE plans to which employers contribute. Below is a summary of the applicable rules:

- Lifetime payouts are calculated using the new Uniform Table.
- After the death of the IRA owner with a designated beneficiary, the remainder of the account is paid out over the life expectancy of the beneficiary.
- If there is no designated beneficiary, and the IRA owner dies after the required beginning date for distributions, the balance is paid out over his remaining life expectancy.
- If there is no designated beneficiary, and the IRA owner dies before the required beginning date for distributions, the balance must be paid out within 5 years after the year of his death.
- Annuity payments follow the rules outlined in the “Defined Benefit Plans” section.

Rules that are applicable to IRAs only are listed below:

- Required beginning date is April 1 of the year after the year in which a person turns 70½.

2001 Workbook

- A surviving spouse who is the sole beneficiary may make the election to treat the IRA as his or her own.
- An eligible surviving spouse is deemed to have made the election to treat the IRA as his or her own if he or she does not take required distributions *or* make contributions to the account.
- A “deemed election” cannot be made until the final required minimum distribution for the deceased has been withdrawn.
- The required minimum distribution must be calculated separately for each IRA, but the actual distribution can be taken from any account in which the individual is an owner.
- The trustee, custodian, or issuer of an IRA is required to report the required minimum distribution for each account to the IRA owner and to the Internal Revenue Service.

Separate Calculations for Each Account

Since IRA accounts can include a variety of types of contracts, a separate calculation must be made for each one [Prop. Reg. §1.408-8(A-9)]. However, the amounts that must be withdrawn from each account can be totaled and the total amount can be withdrawn from any one or more of the accounts.

For the purposes of this rule, IRAs that an individual holds as an IRA owner can be aggregated only with other IRAs the individual owns. Amounts that are in IRAs the individual holds as a beneficiary of the same decedent can be aggregated with each other, but not with IRAs the individual holds as the IRA owner.

Distributions from I.R.C. §403(b) plans do not satisfy the IRA distribution requirements, nor do distributions from IRAs satisfy the distribution requirements from I.R.C. §403(b) plans. Distributions from Roth IRAs do not satisfy the distribution requirements for regular IRAs or for I.R.C. §403(b) plans.

Amendment of IRAs

At this time, an IRA document should not be amended in order to follow the new rules.

The preamble to the proposed regulations states:

“These regulations are proposed to be effective for distributions for calendar years beginning on or after January 1, 2002. For distributions for the 2001 calendar year, IRA owners are permitted, but not required, to follow these proposed regulations in operation, notwithstanding the terms of the IRA documents. IRA owners may therefore rely on these proposed regulations for distributions for the 2001 calendar year. However, IRA sponsors should not amend their IRA documents to conform their IRAs to the changes in these proposed regulations before the publication of final regulations. The IRS will not issue model IRAs on the basis of the changes in these proposed regulations until the publication of final regulations. Until such time, IRA owners can continue to use the current model IRAs, which are based on the 1987 proposed regulations under §401(a)(9). The IRS will publish procedures at a later date that will allow IRAs to be amended to reflect final regulations under §401(a)(9).”

Observation. Even if a person is older than 70 ½ and is already withdrawing required minimum distributions, he or she can use the Uniform Table in 2001 to figure the required minimum distribution. In most cases, that will result in a lower amount.

I.R.C. §501(c)(3) ORGANIZATIONS AND PUBLIC SCHOOLS

A tax deferred annuity plan [I.R.C. §403(b) plan] can only be adopted by certain tax-exempt organizations and public schools. The employees can either have accounts to which employers contribute, and/or they are allowed to contribute through salary reductions. For the most part, these plans are treated

2001 Workbook

in the same manner as IRAs for purposes of distributions. The following are exceptions to that similar treatment:

- The required beginning date is the later of April 1 of the year after employee turns 70½ or the calendar year in which the employee actually retires. The 5% owner restriction is not applicable in these circumstances.
- The surviving spouse of an employee does not have the option to treat an I.R.C. §403(b) contract as his or her own.

The distribution rules will be applied to all benefits accruing after December 31, 1986. The records of the balance as of that date must be kept separately, although the earnings as of January 1, 1987, are included in the benefits subject to the new proposed regulations. Required minimum distributions are taken from the post-1986 account, and any amount in excess of the required minimum distribution is paid from the pre-1987 balance. If the issuer does not keep the records separate, the entire account will be subject to the new proposed regulations.

If an employee has more than one I.R.C. §403(b) contract, the required minimum distribution must be separately determined for each one, but the required minimum distribution can be taken from any one. A person who owns both an I.R.C. §403(b) contract and an IRA must figure the required minimum distribution for each; they cannot be substituted for each other. It is also possible to aggregate I.R.C. §403(b) contracts held by a beneficiary of the same decedent.

Example 58. Randy, age 72, owns two I.R.C. §403(b) contracts, having worked as a teacher and a church counselor during his career. He also is the beneficiary of his deceased brother Roger's I.R.C. §403(b) contract and IRA and the beneficiary of his deceased wife's I.R.C. §403(b) contract. Randy will need to figure the required minimum distribution for all five accounts. He will be required to take required minimum distributions from Roger's contract, his wife's contract, and Roger's IRA. Additionally, he will be required to take the total of the two required minimum distributions from one or both of his own I.R.C. §403(b) contracts.

Example 59. If Randy, in Example 58, had been the beneficiary of Roger who owned three I.R.C. §403(b) contracts, and his wife who owned two, he could have aggregated the accounts by original owner. In that case, he would have taken one required minimum distribution (the total required from all three accounts) from Roger's contracts and one required minimum distribution (the total required from both accounts) from his wife's.

ROLLOVERS AND TRANSFERS

As people change jobs or analyze their financial positions, pension plans and IRAs are frequently repositioned. If the transfer is made from one trustee to another, it is **not** considered a rollover, and there are no tax consequences. A rollover is a tax-free distribution of cash or other assets from one retirement plan to another; the distribution is made to the IRA owner or employee and must be in the new plan within 60 days to avoid paying tax.

A required minimum distribution is not eligible for a tax-free rollover no matter how it is transferred from one account to another.

Example 60. Florence is 72 years old. Her required minimum distribution for 2002 is \$2,800. Because she is not pleased with the earnings on her IRA account, she has the entire balance transferred from one trustee to another in a search of better earnings. While the majority of the transfer is a tax-free distribution, the portion that is her required minimum distribution is taxable and cannot be transferred.

Example 61. Don is 72 years old. He rolls over \$25,000 from one of his IRAs to another on December 28, 2002. He will be required to report his 2002 required minimum distributions from both accounts based upon their balances prior to the distribution. In other words, the rollover does not decrease the

2001 Workbook

required minimum distribution for the original account nor does it increase the required minimum distribution for the second account. If Don does not take his required minimum distribution in addition to the \$25,000 he rolled over, the portion of the \$25,000 equal to the required minimum distribution is not eligible for rollover.

Example 62. Don, in Example 61, will base his required minimum distribution for 2003 on the new balance in both of his accounts.

Example 63. If the rollover in Example 61 was not completed in the same calendar year (a possibility, since it was done in late December), it is deemed to be received in the same year as the distribution.

In the event of a spin-off, merger, or consolidation, the change in pension plans will be treated as a transfer of benefits. The rules will be the same as in Examples 60–63.

EXCISE TAXES UNDER PROP. REG. §54.4974-2

If an IRA owner or an employee fails to withdraw the required amount, an excise tax equal to 50% of the difference between the actual withdrawal and the required minimum distribution is imposed.

Example 64. Fred turned 70½ in 2001 and is required to make his first required minimum distribution by April 1, 2002. Since Fred left home in October to travel in his recreational vehicle to the homes of all 25 of his grandchildren, he was still on the road in April and never even thought about his required minimum distribution. The balance in his account on December 31, 2000, was \$225,000 and his distribution period is 25.3 years since he was 71 at year end. Fred should have withdrawn \$8,893 before April 1, but he was on the road until November 2002. He withdrew \$4,000 from his IRA in February for trip expenses. By the time he got back to his house, there was too much catching up to do and the 2002 year closed without Fred making any further distribution for 2001. His excise tax for 2001 is figured on the difference between his \$8,893 required minimum distribution and his actual withdrawal of \$4,000 (\$4,893), and is 50% of that amount, or \$2,447. Fred also owes the 50% excise tax on the 2002 required minimum distribution.

Under the proposed regulations, there is now a provision for waiving the excise tax. “The tax under §4974(a) may be waived if the payee described in §4974(a) establishes to the satisfaction of the Commissioner the following:

1. The shortfall described in §4974(a) in the amount distributed in any taxable year was due to reasonable error; and
2. Reasonable steps are being taken to remedy the shortfall.”

Observation. In prior years, it was difficult for the IRS to discover failures to take a required minimum distribution since the calculation of the required minimum distribution was complex and depended upon a variety of individual decisions. Under the new proposed regulations, the IRS has added the IRA reporting requirements that provide for an annual disclosure of the required minimum distribution for each account. Look for the IRS to pursue this new revenue potential. It’s now just a matter of cross-checking the return and the amount reported by the IRA issuer.

The new proposed regulations also have a provision for an **automatic waiver** of the excise tax. “The tax under §4974 will be automatically waived, unless the Commissioner determines otherwise, if

1. The payee described in §4974(a) is an individual who is the sole beneficiary and whose required minimum distribution amount for a calendar year is determined under the life expectancy rule described in §1.401(a)(9)-3 A-3 in the case of an employee’s or individual’s death before the employee’s or individual’s required beginning date; and

2001 Workbook

- The employee's or individual's entire benefit to which that beneficiary is entitled is distributed by the end of the fifth calendar year following the calendar year that contains the employee's or individual's date of death."

Example 65. Carla dies at age 62 on November 15, 2001. Her beneficiary is her 73-year-old brother, Carl. He never began taking distributions, although they would have been figured under the life expectancy rule. Just prior to December 31, 2006, Carl withdrew the entire amount from the IRA. Since the account was closed before the 5-year period, there will be no excise tax. This exception is only available for a beneficiary, not for the original owner.

CASE STUDIES FOR DECISION MAKING

Currently, IRA owners and pension plan administrators have the option to start using the new proposed regulations. The new rules sound good, but do they make financial sense for everyone? Let's look at some sample cases and see what would be best in each situation.

Case #1. Joint Life Expectancy with Double Recalculations. Harriet is 73 years old. She has been taking required minimum distributions from her IRA since her required beginning date in 1999. Her husband, Harold, age 74, is her beneficiary. Harriet is using a joint life expectancy with double recalculations to figure her required minimum distribution. On December 31, 2000, the value of her IRA was \$420,000. Harriet's goal is to preserve as much of her IRA as possible for her children since she and Harold have ample money for their own use.

The double recalculation method means that Harriet uses the Joint and Last Survivor Life Expectations Table each year to determine the divisor. This enables her to take the lowest possible required minimum distribution. The disadvantage to using this method is that if Harold dies first, the distribution is markedly increased because Harriet has to switch to the single life table.

- Under the old rules, Harriet's \$23,729 required minimum distribution for 2001 is figured:

$$\frac{\$420,000}{17.7} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per Ordinary Joint Life and Last Survivor Table)} \end{array}$$

JOINT AND LAST SURVIVOR LIFE EXPECTANCIES

Ages	65	66	67	68	69	70	71	72	73	74
69	23.4	22.9	22.4	21.9	21.5	21.1	20.7	20.3	20.0	19.6
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6
72	22.5	21.9	21.3	20.8	20.3	19.8	19.4	18.9	18.5	18.2
73	22.2	21.6	21.0	20.5	20.0	19.4	19.0	18.5	18.1	17.7

- Under the new rules, Harriet's \$17,872 required minimum distribution for 2001 is figured:

$$\frac{\$420,000}{23.5} \quad \begin{array}{l} \text{(December 31, 2001 balance)} \\ \text{(per Uniform Table)} \end{array}$$

2001 Workbook

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8

- c. Under the old rules, if Harold died before Harriet, she would be required to use the Single Life Expectancy Table for the rest of her life. Assuming that was the situation as of December 31, 2000, her required minimum distribution would be **\$30,216**.

\$420,000	(December 31, 2000 balance)
13.9	(per Single Life Expectancy Table)

SINGLE LIFE EXPECTANCY

Age	Divisor
71	15.3
72	14.6
73	13.9
74	13.2
75	12.5

- d. Under the new rules, if Harold died before Harriet, she would continue to use the uniform table, and there would be no difference in her required minimum distribution. For 2001, it would still be **\$17,872**.

Conclusion. Harriet's required minimum distribution is considerably less using the new rules because the Uniform Table has a built-in age difference of 10 years, even though she and Harold are only one year apart in age. Since, statistically, the chances are greater that Harold will die first, she is also likely to have to start doing her annual recalculations based on her single life expectancy. In this case, she would be wise to switch to the new rules for her distributions. She will not have to amend her IRA; all she needs to do is inform the trustee or custodian of her IRA.

Case #2. Joint Life Expectancy with Nonrecalculation. Anthony is 73 years old. He has been taking required minimum distributions from his IRA since his required beginning date in 1999. His wife, Angela, age 74, is his beneficiary. Anthony is using a joint life expectancy under the nonrecalculation method to figure his required minimum distributions. On December 31, 2000, the value of his IRA is \$420,000. Anthony's goal is to preserve as much of his IRA as possible for his children, since he and Angela have ample money for their own use.

The nonrecalculation method means that Anthony determines his distribution one time, and it remains a constant amount for his life and for the life of his wife. The disadvantage of the nonrecalculation method for Anthony is that it is possible for him to outlive his IRA.

- a. Under the old rules, Anthony's **\$24,138** required minimum distribution for 2001 is figured:

\$420,000	(December 31, 2000 balance)
23.5	(per Ordinary Joint Life and Last Survivor Table for ages at required beginning date less one for each succeeding year)

2001 Workbook

JOINT AND LAST SURVIVOR LIFE EXPECTANCIES

Ages	65	66	67	68	69	70	71	72	73	74
69	23.4	22.9	22.4	21.9	21.5	21.1	20.7	20.3	20.0	19.6
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6
72	22.5	21.9	21.3	20.8	20.3	19.8	19.4	18.9	18.5	18.2
73	22.2	21.6	21.0	20.5	20.0	19.4	19.0	18.5	18.1	17.7

b. Under the new rules, Anthony's **\$17,872** required minimum distribution for 2001 is figured:

\$420,000	(December 31, 2000 balance)
23.5	(per Uniform Table)

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8

- c. Under the old rules, if Angela died before Anthony, he would continue to receive the same payment for the rest of his life. Assuming that was the situation as of December 31, 2000, his required minimum distribution would still be **\$24,138**.
- d. Under the new rules, if Angela died before Anthony, he would continue to use the Uniform Table, and there would be no difference in his required minimum distribution. For 2001, it would still be **\$17,872**. In subsequent years, he would continue to figure the required minimum distribution in the same fashion.

Conclusion. If Anthony changes to the new rules, he will have a much lower required minimum distribution and his IRA monies will last longer. He will be required to refigure the amount each year, unlike his choice under the old rules, but his IRA trustee or custodian will inform him of his required minimum distribution each year. Taking the lower required distributions each year reduces the risk that he and Angela will outlive their retirement money, although that is not a concern in their case. More importantly for them, it ensures that there will be more money in the account for their heirs.

Case #3. Changing the Beneficiary. Olive is 73 years old. She has been taking required minimum distributions from her IRA since her required beginning date in 1999. Her beneficiary is her 45-year-old daughter, Olivia. Olive is using a joint life expectancy under the minimum distribution incidental benefit (MDIB) rules to figure her required minimum distribution. She is concerned that her 74-year-old brother, Oscar, does not have any means of support other than social security, so she decides to add him as a beneficiary. On December 31, 2000, the value of her IRA is \$420,000. Olive's primary concern is the preservation of her IRA for her beneficiaries, since she has ample income without it.

Under the old rules, Olive's required minimum distribution must be revised because of the addition of her brother. Joint lives must be figured over the shortest life span.

2001 Workbook

With Olivia only, the required minimum distribution for 2001 is **\$18,026**:

$$\frac{\$420,000}{23.3} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per MDIB Table less one year for each year since starting, or two years)} \end{array}$$

Practitioner Note. This is the *old* MDIB table, which is now the Uniform Table.

By adding Oscar, the required minimum distribution for 2001 becomes **\$23,729**:

$$\frac{\$420,000}{17.7} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per Joint and Last Survivor Table, ages 73 and 74)} \end{array}$$

JOINT AND LAST SURVIVOR LIFE EXPECTANCIES

Ages	65	66	67	68	69	70	71	72	73	74
69	23.4	22.9	22.4	21.9	21.5	21.1	20.7	20.3	20.0	19.6
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6
72	22.5	21.9	21.3	20.8	20.3	19.8	19.4	18.9	18.5	18.2
73	22.2	21.6	21.0	20.5	20.0	19.4	19.0	18.5	18.1	17.7

b. Under the new rules, Olive's **\$17,872** required minimum distribution for 2001 is figured:

$$\frac{\$420,000}{17.7} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per Uniform Table)} \end{array}$$

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8

Conclusion. Changing the beneficiary does not affect the required minimum distribution during the lifetime of the owner under the new rules. Since the calculation of the required minimum distribution is not dependent upon the beneficiary, changes can be made at any time. If a person is planning on making changes to the beneficiaries in 2001, it definitely makes sense to use the new rules.

Case #4. Single Life Expectancy; Nonrecalculated; Non-spouse Beneficiary. Vern is 78 years old and single. His beneficiary is his sister, Veronica, age 65. He has been receiving his required distributions over the nonrecalculated joint lives of himself and his sister. Because his beneficiary is not his wife, he does not qualify for double recalculation. As of December 31, 2000, the value of his account is \$185,000. His goal is to conserve as much of his IRA as possible for his sister's benefit since he does not need the money for his normal living expenses.

Vern had only two options for figuring his distribution. The one he did not choose, the hybrid method, would have let him recalculate his own life expectancy while using a set payment for his sister. It offers a lower required distribution while ensuring that he is not overly penalized if his sister dies first.

2001 Workbook

a. Under the old rules, Vern's \$9,635 required minimum distribution for 2001 is figured:

$$\frac{\$185,000}{19.2} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per MDIB table for Vern's age at required beginning} \\ \text{date less one for each succeeding year)} \end{array}$$

Practitioner Note. This is the *old* MDIB table, which is now the Uniform Table.

b. Under the new rules, Vern's \$9,635 required minimum distribution for 2001 is figured:

$$\frac{\$185,000}{19.2} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per Uniform Table)} \end{array}$$

Age of the Employee	Distribution Period
70	26.2 (Part A)
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8
76	20.9
77	20.1
78	19.2 (Part B)
79	18.4

- c. Under the old rules, if Veronica dies before Vern, he will continue to receive the same \$9,635 each year (assuming there is no growth in the account).
- d. Under the new rules, if Veronica dies before Vern, he will need to use the Uniform Table each year to determine his required minimum distribution.

Conclusion. Since Vern is more than 10 years older than Veronica, he was required to use the minimum distribution incidental benefit (MDIB) table when he selected the joint life option. The MDIB table is now the Uniform Table, so there would be no difference under the new rules for this year. In subsequent years, he will look up his current age each year and divide the balance in his account by that amount. Under the old rules, in 2002 Vern's divisor would be 18.2, but with the Uniform Table it will be 18.4. He will be able to reduce his required minimum distribution under the new rules beginning next year.

Had Vern chosen the hybrid method under the old rules, he would also have seen a decrease in his required minimum distribution under the new rules.

Case #5. After Death Calculation. Vern, from Case #4, dies in 2001, and the IRA goes to his sister, Veronica. Under both the old and the new rules, his final required minimum distribution must be distributed before the transfer to the beneficiary.

- a. Under the old rules, Veronica will continue to receive the distributions at the same rate as Vern. In other words, she will have an annual required minimum distribution of \$9,635 (assuming there is no growth in the account).
- b. Under the new rules, the required minimum distributions are paid out over the life expectancy of the beneficiary using the Single Life Expectancy Table. Veronica's age will be the determining factor as of December 31, 2002. Since she will be 66 that year, her required min-

2001 Workbook

imum distribution for 2002 is figured using a divisor of 19.2; her required minimum distribution will be \$9,134 (based on the value after the final distribution to Vern), providing a small reduction in the required minimum distribution.

SINGLE LIFE EXPECTANCY

Age	Divisor
65	20.0
66	19.2
67	18.4
68	17.6

Conclusion. There is not a substantial difference in the dollar amount of the required minimum distribution after Vern's death. Be wary of assuming the new rules will always provide large decreases in the required distributions. In subsequent years, the divisor will be reduced by one year annually to calculate the required minimum distribution, and the payment will continue to be the same.

Case #6. NonDesignated Beneficiary. Isabelle will turn 70½ on November 6, 2001. She would like to leave her IRA to her church since she doesn't have any close relatives. The balance in her account at December 31, 2000 is \$182,000. She does not need the IRA money for her normal living expenses and would like to conserve as much as possible for the church.

- a. Under the old rules, Isabelle is not considered to have a beneficiary since the church is not an individual. Her only option is to calculate her required distributions using her single life expectancy. Her \$11,375 required minimum distribution for 2001 is figured:

$$\frac{\$182,000}{16.0} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per the Single Life Expectancy Table for age 70)} \end{array}$$

SINGLE LIFE EXPECTANCY

Age	Divisor
67	18.4
68	17.6
69	16.8
70	16.0

- b. Under the new rules, Isabelle still does not have a designated beneficiary, but she uses the uniform table to calculate her required minimum distribution. Her \$6,947 required minimum distribution for 2001 is figured:

$$\frac{\$182,000}{26.2} \quad \begin{array}{l} \text{(December 31, 2000 balance)} \\ \text{(per Uniform Table)} \end{array}$$

Age of the Employee	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5

- c. Under the old rules, Isabelle's death after she begins receiving the distributions means that the church must close out the IRA within 5 years of the year of her death.

2001 Workbook

- d. Under the new rules, the distributions will continue to be made over the remaining years of her life expectancy, reduced by one for each year after her death.

Conclusion. Under the new rules, Isabelle will be able to defer more of her IRA and so be able to leave a larger amount to the church. The church will also have the option to take the minimum withdrawals each year and so leave the IRA in place; this would be beneficial if the rates are particularly good. At any rate, the church can do some planning for the distribution instead of having to withdraw the entire amount in 5 years. Obviously, if the church needs larger amounts of money, it can withdraw more than the required minimum distribution amount. Under the old rules, she was penalized by not being able to use the joint life expectancy because she did not have an individual for a beneficiary. Under the new rules, she gets the benefit of a joint life with a 10-year age difference because it is built into the Uniform Table.

Case #7. Combination Beneficiaries. Lois dies at age 75 in 2001. The beneficiaries of her IRA are her two nieces, ages 50 and 52, and her church. Because the church is not an individual, she is treated as having no designated beneficiaries. The balance in her IRA, after her final required distribution, is \$200,000.

- a. Under the old rules, the account would be treated as though there were no beneficiary, and the entire \$200,000 would have to be paid out within 5 years of Lois' death.
- b. Under the new rules, if the church is paid its share before December 31, 2002, it is no longer considered a beneficiary. The nieces then become the designated beneficiaries.

Conclusion. The flexibility of the proposed regulations makes this situation much more beneficial for the nieces. The remaining portion of the IRA, after the church gets its part, can also be divided into shares, and the nieces can each take RMDs based upon their individual life expectancies. Everything must be done before December 31, 2002. Charitable organizations should benefit from this since their inclusion is no longer a handicap for the other beneficiaries.

Case #8. Roth IRA Distributions after Death. Darlene, age 73, converted to a Roth IRA when they were first available. She has no required minimum distribution. She dies November 15, 2001. Her beneficiary is her son Albert, age 50.

- a. Under the old rules, the entire balance in the account must be distributed by the end of the fifth year after her year of death (December 31, 2006) unless the beneficiary elects to take the distributions over his life expectancy. Albert has until December 31, 2002 to make that election.
- b. Under the new rules, the default rule is the lifetime pay out for the beneficiary instead of the 5-year rule.

Conclusion. The Roth has no RMDs until the death of the IRA owner. If the IRA plan does not specify the method of distribution, the default is the lifetime pay out. The key is that it will be tax free *only* if the owner and/or the beneficiary meet the *other* 5-year rule, namely that the account must have been in existence for 5 years .

MISCELLANEOUS QUESTIONS AND ANSWERS

Question 1. Do the new rules affect the substantially equal periodic payments exception for penalty-free withdrawals prior to reaching age 59½?

Answer 1. No. Substantially equal periodic payments are allowed under I.R.C. §72(t)(2)(A)(4) when early distributions are needed by the IRA owner; the distribution is based upon life expectancies. In that case, the goal is normally to receive the *largest* amount possible for a period of 5 years or until the owner reaches age 59½, whichever is later. The uniform table does not even begin until age 70½, the age for required distributions.

2001 Workbook

Question 2. I inherited an IRA from my father several years ago. Can I use the new rules to figure my distributions?

Answer 2. Yes. You do need to be aware that any differences in the required minimum distributions will depend upon the original treatment by your father.

If he used his single life expectancy to figure his required minimum distributions, you are currently finishing out his life expectancy by subtracting one year from his age at the required beginning date. In that case, under the new rules, you could use your age in the year following the year of death, subtract one year for each year since your father died, and see a substantial decrease in the required minimum distribution.

If, on the other hand, your father used the minimum distribution incidental benefit rules to calculate a joint life payment, the old rules already allowed distribution over your remaining single life expectancy.

Question 3. Do all beneficiaries use the Single Life Expectancy Table?

Answer 3. No. A spouse who rolls the IRA over into his or her own name is treated as if the spouse were the original owner, and the spouse can use the new Uniform Table.

Question 4. What if my IRA issuer does not allow all of the options under the new proposed regulations?

Answer 4. The new proposed regulations apply to *your* options, not to the options that plans must offer. If your plan cannot comply with an option that you would like to choose, you will need to consider transferring your IRA to another issuer.

Question 5. If I choose the life payout option can I change my mind and withdraw more than required by that option?

Answer 5. Choosing the life payout option does not restrict your choices for the future since you can always withdraw more than the required minimum amount.

Question 6. What's all this fuss about required minimum distribution? I need all I can get from my retirement plan in order to survive.

Answer 6. The required minimum distribution was added to tax law because people with sufficient income to live on wanted to try to conserve their retirement monies for their beneficiaries. IRAs were never intended to be perpetual, nontaxed accounts. In your circumstances, it is not a problem, and you don't need to worry about required minimum distributions.

Question 7. My husband died two years ago when I was 58, and I have taken money from his IRA a couple of times when there was a money crunch. Now that I'm old enough to take penalty-free withdrawals, I'd like to transfer the account to my name. Is it too late?

Answer 7. You can transfer the account to your name. The new proposed regulations state the election to do so can be made "any time after the distribution of the required minimum amount for the account for the calendar year containing the individual's date of death" [Prop. Reg. §1.408-8(5A)].

Question 8. There's a lot of talk about being able to use the new rules in 2001, but what happens in 2002? What if I don't want to change?

Answer 8. According to the preamble to the proposed regulations, the rules become applicable for calendar years beginning on or after January 1, 2002, "for determining required minimum distributions."

2001 Workbook

Beginning in 2002 it is the only option. Since, in most cases, the result will be a lower required distribution, if you keep taking out more than is required, you will not owe the 50% excise tax.

Question 9. What if I change my method of figuring my required minimum distribution and the laws change again? Nothing seems to stay the same.

Answer 9. The preamble to the proposed regulations states: “If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be issued without retroactive effect.”

Question 10. My retirement plan is with a life insurance company that’s in bankruptcy. Does this mean I’ll get a penalty because I’m not withdrawing my required minimum distributions—even though I can’t get to the money?

Answer 10. There is a permitted delay built into the proposed regulations when the payments are reduced or suspended under these circumstances.

Question 11. My retirement is in a simplified employee plan (SEP). Do these distribution rules apply to me?

Answer 11. Yes. SEPs and SIMPLE plans fall under the required minimum distribution rules.

Question 12. Since I have a couple of traditional IRAs and a Roth IRA, wouldn’t it make sense to take my distributions out of the tax-free Roth?

Answer 12. It might seem to make sense to take the money out of the Roth since you would have made the required distribution, but the proposed regulations specifically say that distributions from Roths will *not* satisfy the distribution requirements for traditional IRAs.

Question 13. What’s the deal with people making their beneficiary their estate? What are they thinking?

Answer 13. People sometimes make that choice because they can’t decide whom else to make the beneficiary. It can also happen by default if the IRA is used to pay expenses, debts, or taxes of the estate.

Question 14. Who are the big winners under the new rules?

Answer 14. There are several categories where a switch to the new rules is a good choice for 2001.

It could benefit people who are already beyond the required beginning date for required minimum distribution (normally over age 70½) who

- Haven’t designated a beneficiary
- Are married with less than 10 years age difference between spouses
- Are using joint nonrecalculation (and, if not married, don’t fall under the minimum distribution incidental benefit rules)
- Want to change the beneficiary

It could also benefit anyone who is *not* the sole beneficiary of an IRA owner who died in 2001.

Conclusion

The new distribution rules presented in the proposed regulations are a benefit to people trying to conserve their IRAs for their beneficiaries. They also simplify things for people who must deal with complicated retirement decisions. While many people will not be affected at all because they are receiving monthly

2001 Workbook

income to provide for daily living expenses, it is reassuring to know that the new rules provide solutions for errors in planning under all the circumstances. The regulations simplify the rules for everyone.

APPENDIX

The New "Uniform" Table
Table is Used Annually to Determine the Required Minimum Distribution

APPLICABLE DISTRIBUTION PERIODS

Age of the Employee	Distribution Period	Age of the Employee	Distribution Period
70	26.2	99	6.1
71	25.3	100	5.7
72	24.4	101	5.3
73	23.5	102	5.0
74	22.7	103	4.7
75	21.8	104	4.4
76	20.9	105	4.1
77	20.1	106	3.8
78	19.2	107	3.6
79	17.6	108	3.3
81	16.8	109	3.1
82	16.0	110	2.8
83	15.3	111	2.6
84	14.5	112	2.4
85	13.8	113	2.2
86	13.1	114	2.0
87	12.4	115 and older	1.8
88	11.8		
89	11.1		
90	10.5		
91	9.9		
92	9.4		
93	8.8		
94	8.3		
95	7.8		
96	7.3		
97	6.9		
98	6.5		

2001 Workbook

THE MINIMUM REQUIREMENT INCIDENTAL BENEFIT (MDIB) TABLE TO BE USED FOR DEFINED BENEFIT ANNUITIES WITH NON-SPOUSE BENEFICIARIES

Excess of Age of Employee Over Age of Beneficiary	Applicable Percentage
10 years or less	100
11	96
12	93
13	90
14	87
15	84
16	82
17	79
18	77
19	75
20	73
21	72
22	70
23	68
24	67
25	66
26	64
27	63
28	62
29	61
30	60
31	59
32	59
33	58
34	57
35	56
36	56
37	55
38	55
39	54
40	54
41	53
42	53
43	53
44 and greater	52

Percentage is applied to the payments to be received by the non-spouse beneficiary after the death of the IRA owner or employee. In order for the plan to be in compliance, it must affirm the percentages for the non-spouse beneficiary as of the required beginning date.

2001 Workbook

Single Life Expectancy Table
 Use for Designated Beneficiaries after Death of Owner or Employee or Where There Is No Designated Beneficiary and Deceased Owner's Remaining Life Must Be Calculated

ORDINARY LIFE ANNUITIES ONE LIFE—EXPECTED RETURN MULTIPLES (TREAS. REG. §1.72-9)

Age	Multiple	Age	Multiple
5	76.6	6	75.6
7	74.7	8	73.7
9	72.7	10	71.7
11	70.7	12	69.7
13	68.8	14	67.8
15	66.8	16	65.8
17	64.8	18	63.9
19	62.9	20	61.9
21	60.9	22	59.9
23	59.0	24	58.0
25	57.0	26	56.0
27	55.1	28	54.1
29	53.1	30	52.2
31	51.2	32	50.2
33	49.3	34	48.3
35	47.3	36	46.4
37	45.4	38	44.4
39	43.5	40	42.5
41	41.5	42	40.6
43	39.6	44	38.7
45	37.7	46	36.8
47	35.9	48	34.9
49	34.0	50	33.1
51	32.2	52	31.3
53	30.4	54	29.5
55	28.6	56	27.7
57	26.8	58	25.9
59	25.0	60	24.2
61	23.3	62	22.5
63	21.6	64	20.8
65	20.0	66	19.2
67	18.4	68	17.6
69	16.8	70	16.0
71	15.3	72	14.6
73	13.9	74	13.2
75	12.5	76	11.9
77	11.2	78	10.6
79	10.0	80	9.5
81	8.9	82	8.4
83	7.9	84	7.4
85	6.9	86	6.5
87	6.1	88	5.7
89	5.3	90	5.0
91	4.7	92	4.4
93	4.1	94	3.9
95	3.7	96	3.4
97	3.2	98	3.0
99	2.8	100	2.7

Note: Table was cut short for space reasons. If you need to go beyond age 100, refer to the regulations.

2001 Workbook

Joint Life Expectancy Table Use for Spouses Who Are More than 10 Years Apart in Age

ORDINARY JOINT LIFE AND LAST SURVIVOR ANNUITIES TWO LIVES—EXPECTED RETURN MULTIPLES (TREAS. REG. §1.72-9)

Ages	55	56	57	58	59	60	61	62	63	64
55	34.4	33.9	33.5	33.1	32.7	32.3	32.0	31.7	31.4	31.1
56	33.9	33.4	33.0	32.5	32.1	31.7	31.4	31.0	30.7	30.4
57	33.5	33.0	32.5	32.0	31.6	31.2	30.8	30.4	30.1	29.8
58	33.1	32.5	32.0	31.5	31.1	30.6	30.2	29.9	29.5	29.2
59	32.7	32.1	31.6	31.1	30.6	30.1	29.7	29.3	28.9	28.6
60	32.3	31.7	31.2	30.6	30.1	29.7	29.2	28.8	28.4	28.0
61	32.0	31.4	30.8	30.2	29.7	29.2	28.7	28.3	27.8	27.4
62	31.7	31.0	30.4	29.9	29.3	28.8	28.3	27.8	27.3	26.9
63	31.4	30.7	30.1	29.5	28.9	28.4	27.8	27.3	26.9	26.4
64	31.1	30.4	29.8	29.2	28.6	28.0	27.4	26.9	26.4	25.9
65	30.9	30.2	29.5	28.9	28.2	27.6	27.1	26.5	26.0	25.5
66	30.6	29.9	29.2	28.6	27.9	27.3	26.7	26.1	25.6	25.1
67	30.4	29.7	29.0	28.3	27.6	27.0	26.4	25.8	25.2	24.7
68	30.2	29.5	28.8	28.1	27.4	26.7	26.1	25.5	24.9	24.3
69	30.1	29.3	28.6	27.8	27.1	26.5	25.8	25.2	24.6	24.0
70	29.9	29.1	28.4	27.6	26.9	26.2	25.6	24.9	24.3	23.7
71	29.7	29.0	28.2	27.5	26.7	26.0	25.3	24.7	24.0	23.4
72	29.6	28.8	28.1	27.3	26.5	25.8	25.1	24.4	23.8	23.1
73	29.5	28.7	27.9	27.1	26.4	25.6	24.9	24.2	23.5	22.9
74	29.4	28.6	27.8	27.0	26.2	25.5	24.7	24.0	23.3	22.7
75	29.3	28.5	27.7	26.9	26.1	25.3	24.6	23.8	23.1	22.4
76	29.2	28.4	27.6	26.8	26.0	25.2	24.4	23.7	23.0	22.3
77	29.1	28.3	27.5	26.7	25.9	25.1	24.3	23.6	22.8	22.1
78	29.1	28.2	27.4	26.6	25.8	25.0	24.2	23.4	22.7	21.9
79	29.0	28.2	27.3	26.5	25.7	24.9	24.1	23.3	22.6	21.8
80	29.0	28.1	27.3	26.4	25.6	24.8	24.0	23.2	22.4	21.7

Ages	65	66	67	68	69	70	71	72	73	74
65	25.0	24.6	24.2	23.8	23.4	23.1	22.8	22.5	22.2	22.0
66	24.6	24.1	23.7	23.3	22.9	22.5	22.2	21.9	21.6	21.4
67	24.2	23.7	23.2	22.8	22.4	22.0	21.7	21.3	21.0	20.8
68	23.8	23.3	22.8	22.3	21.9	21.5	21.2	20.8	20.5	20.2
69	23.4	22.9	22.4	21.9	21.5	21.1	20.7	20.3	20.0	19.6
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6
72	22.5	21.9	21.3	20.8	20.3	19.8	19.4	18.9	18.5	18.2
73	22.2	21.6	21.0	20.5	20.0	19.4	19.0	18.5	18.1	17.7
74	22.0	21.4	20.8	20.2	19.6	19.1	18.6	18.2	17.7	17.3
75	21.8	21.1	20.5	19.9	19.3	18.8	18.3	17.8	17.3	16.9
76	21.6	20.9	20.3	19.7	19.1	18.5	18.0	17.5	17.0	16.5
77	21.4	20.7	20.1	19.4	18.8	18.3	17.7	17.2	16.7	16.2
78	21.2	20.5	19.9	19.2	18.6	18.0	17.5	16.9	16.4	15.9
79	21.1	20.4	19.7	19.0	18.4	17.8	17.2	16.7	16.1	15.6
80	21.0	20.2	19.5	18.9	18.2	17.6	17.0	16.4	15.9	15.4

Note: Table was cut short for space reasons. If you need to go beyond these parameters, refer to the regulations.