

New Proposed Regulations on Required Minimum Distributions

Introduction

On January 11th of 2001 the Treasury Department (IRS) issued new proposed regulations under Internal Revenue Code (IRC) Section 401(a)(9). The purpose of IRC Section 401 (a)(9) is to force distributions from IRAs and retirement plans, which Congress feels is appropriate given that the benefit of tax deferral was granted for the express purpose of encouraging retirement savings. Regulations under IRC Section 401(a)(9) were first proposed on July 27, 1987., and were slightly amended on December 30, 1997, to create new rules for trusts.

The new proposed regulations create two ways of calculating required minimum distributions (RMDs) at one's required beginning date (RBD), regardless of whether the IRA owner has named a beneficiary or who that beneficiary may be. In addition, the rules for calculating RMDs after the IRA owner has died are greatly simplified.

For calendar year 2001 RMDs, IRA owners may either continue to use the distribution rules established in 1987 (the "Old Rules") or the New Rules. Beginning in 2002, however, all IRA owners must comply with the New Rules.

Death before RBD (Old Rules still apply).

The Old Rules will apply when the IRA owner dies before age 70-1/2. The Old Rules are as follows:

A. 5-Year Payout. The IRA must be distributed to the beneficiary no later than the December 31st of the fifth year following the IRA owner's death.

B. Life Expectancy Payments. In the alternative, payments can be made to the beneficiary over his or her life expectancy. These payments must begin no later than the December 31st of the year following the IRA owner's death. Payments will be non-recalculated, that is, reduced by one each year, unless the beneficiary is the surviving spouse, in which case either method of calculation (recalculation or non-recalculation) can be used. Under the New Rules, the default in case of death before the RBD is the life expectancy method when there is a designated beneficiary (under the Old Rules, the default was the 5-year payout).

C. Surviving Spouse Options. A surviving spouse beneficiary has the 5-year payout options, plus two additional options:

- 1) he or she can leave the IRA as is (sometimes referred to as a "deceased IRA") and start taking RMDs when the deceased IRA owner would have reached age 70-1/2; or
- 2) he or she can roll the IRA over into his or her own IRA, then start taking RMDs when he or she reaches age 70-1/2.

Summary of New Rules at RBD

A. General Rule. Under the New Rules, reaching age 70-1/2 is no longer a traumatic event; now, with one exception, the required minimum distributions are automatically computed based on the life expectancy figures from the following table:

| <u>Age</u> | <u>Life Expectancy Divisor</u> | <u>Age</u> | <u>Life Expectancy Divisor</u> |
|------------|--------------------------------|------------|--------------------------------|
| 70 | 26.2 | 85 | 13.8 |
| 71 | 25.3 | 86 | 13.1 |
| 72 | 24.4 | 87 | 12.4 |
| 73 | 23.5 | 88 | 11.8 |
| 74 | 22.7 | 89 | 11.1 |
| 75 | 21.8 | 90 | 10.5 |
| 76 | 20.9 | 91 | 9.9 |
| 77 | 20.1 | 92 | 9.4 |
| 78 | 19.2 | 93 | 8.8 |
| 79 | 18.4 | 94 | 8.3 |
| 80 | 17.6 | 95 | 7.8 |
| 81 | 16.8 | 96 | 7.3 |
| 82 | 16.0 | 97 | 6.9 |
| 83 | 15.3 | 98 | 6.5 |
| 84 | 14.5 | 99 | 6.1 |

The above table is the minimum death incidental benefit (MDIB) life expectancy table, which is the joint life expectancy of the IRA owner and a hypothetical individual whose age is ten years younger than the IRA owner.

This life expectancy table is used regardless of whether or not the IRA owner has designated a beneficiary, and regardless of the health of the IRA owner. Each year, the life expectancy divisor is used, so in effect RMDs are recalculated each year.

Note that the New Rules did not change the timing requirement of when distributions had to begin. RMDs have to be made by April 1 of the year following the calendar year when the IRA owner turns age 70-1/2. Of course, if the IRA owner waits until April 11 of the next year to take the 70-1/2 year distributions, two years' worth of distributions will have to be made that year.

B. The Exception. An exception exists for IRA owners whose sole beneficiary is a spouse who is younger by a difference of more than 10 years. These IRA owners may still choose to calculate RMDs based on their joint life expectancies with their spouses and in so doing will obtain a lower RMD than is available based on the MDIB table.

Summary of New Rules at death after RBD

A. Death with Designated Beneficiary

1. Nonspousal Designated Beneficiary. After an IRA owner dies, RMDs to designated beneficiaries will be based upon the beneficiary's individual life expectancy, starting no later than the December 31st of the year following the year of death. Each RMD thereafter is based on the beneficiary's life expectancy reduced by one.

2. Spousal Designated Beneficiary. If the designated beneficiary is the surviving spouse, RMDs are based on the surviving spouse's life expectancy recalculated each year, starting no later than the December 31st of the year following the year of death. In the calendar year after the surviving spouse dies, RMDs are made based on the surviving spouse's remaining life expectancy, reduced by one each calendar year. The surviving spouse may also roll the IRA over into his or her own IRA, assuming the spouse is the sole beneficiary, and then start taking RMDs when he or she reaches age 70-1/2.

B. Death without Designated Beneficiary. In the case of an IRA with no beneficiary, or a beneficiary with no life expectancy (such as an estate, charity, institution, or trusts which do not comply with Regulation Section 1.401(a)(9)-4, Q&A-5(b)), RMDs are calculated using the deceased IRA owner's remaining life expectancy, starting no later than the December 31st of the year following the year of death. Each RMD thereafter is based on the remaining life expectancy reduced by one.

C. Designated Beneficiary Determination. A beneficiary no longer has to be designated by one's required beginning date, as was the case under the Old Rules. Under the New Rules, the designated beneficiary does not have to be determined until distributions to the designated beneficiary must begin, which is the December 31st after the calendar year of death. An IRA owner must designate his or her beneficiary before death.

Special Rules

A. The Separate Share Rule. Under the Old Rules, if any of the designated beneficiaries had no life expectancy (such as a charity), a life expectancy could not be used for any of the beneficiaries in which to calculate IRA payments. This problem was avoided by creating separate shares for each beneficiary. Under the Old Rules, the deadline for setting up the separate accounts was either the required beginning date or the date of death after the RMDs had started.

Under the New Rules, the deadline for setting up separate accounts for after-death distributions is the December 31st of calendar year following the year of death. In the event one of the beneficiaries has no life expectancy (such as a charity), there is enough time to create separate accounts so that beneficiary life expectancies can be used.

B. Spousal Rollovers. Under the New Rules, a surviving spouse is able to roll over an inherited IRA only if the surviving spouse is the sole beneficiary of the account and has an unlimited right to withdrawal from the account. The New Rules also state that the surviving spouse can roll over an inherited IRA if he or she is the sole beneficiary of a trust which is the beneficiary to the IRA. If the surviving spouse is entitled to the entire RMD the surviving spouse is considered to be the sole beneficiary of the IRA, and can either roll over or wait until he or she attains 70-1/2. You may also be able to name other beneficiaries other than the trust since the separate share rules allow the spouse's portion to be treated separately from the other beneficiary's portion (if set up before the following December 31st).

C. Trust Documentation Rule. The actual documentation that has to be provided (in order for the trust to be considered a "designated beneficiary") has not changed. Under the Old Rules, documentation had to be furnished "by the end of the ninth month beginning after the employee's date of death". Under the New Rules, the documentation

must be furnished "by the last day of the calendar year immediately following the calendar year in which the employee died.

Who benefits under New Rules in 2001. As stated, during 2001 IRA owners have the option of operating under either the Old Rules or the New Rules. Those who will benefit under the New Rules include the following:

- those who are over the RBD and have failed to designate a beneficiary (and are thus under a single life expectancy)
- married couples who are close in age (the MDIB table would give them a higher life expectancy divisor)
- those who are taking RMDs from a IRA on a joint non-recalculation basis (the MDIB life expectancies could be higher than this)
- any beneficiaries to IRA wherein the IRA owner died last year, and are either co-beneficiary with a "non-life beneficiary" (such as a charity) or with one or more other beneficiaries who have shorter life expectancies
- anyone who wants to change their designated beneficiary after the RBD

Miscellaneous

The new rules will not affect 72(t) payments. However there may be more stringent reporting requirements.

What to do:

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|------------------------------|--|
| If dies before 70-1/2 | beneficiary may take: |
| with non-spousal beneficiary | either 5 years to cash out or Single non-recalc life expectancy |
| with spousal beneficiary | either 5 years or roll over or leave in spouse's IRA and wait until 70-1/2 |
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|----------------------|---|
| At 70-1/2 | |
| The participant may: | Take under the table above or |
| | Take actual joint life expectancy if spouse is more than 10 years younger |

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| If dies after 70-1/2 | beneficiary may take: |
| Non-spousal beneficiary | single non-recalc life expectancy less one each year |
| Spousal beneficiary | Roll over or take single life expectancy recalculated less one each year |
| No designated beneficiary | Remaining life expectancy of participant reduced by one each year |
| | |

In all of the above cases an inherited IRA beneficiary may take over the remaining life expectancy of the designated beneficiary.