

NEW PROPOSED MINIMUM DISTRIBUTION REGULATIONS

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I. Background:

- A. The new proposed regulations were issued on January 11, 2001, and are numbered 1.401(a)(9)-0 through 1.401(a)(9)-8; 1.403(b)-2; 1.408-8; and 54.4974-2.
- B. The new proposed regulations completely restate and replace the 1987 proposed regulations, which were never finalized.
- C. The new proposed regulations will become final for calendar years beginning on or after January 1, 2002. IRA owners can start using the new rules right away, but Qualified Plan participants cannot use the new rules until the plan is amended. Therefore, if a particular Qualified Plan has not been amended, participants whose required beginning date is April 1, 2001 must still make elections under the old rules prior to April 1, 2001.
- D. The new proposed regulations apply to qualified retirement plans, traditional IRAs, section 457 and section 403(b) plans. The new proposed regulations do not make any proposed change to the Roth IRA regulations, but they will likely be incorporated by reference into the Roth IRA regulations. Roth IRAs have no lifetime distribution requirements so the impact of the new regulations on Roth IRAs will be far less significant.

II. MAIN CHANGES MADE BY THE NEW RULES:

- A. **LIFETIME DISTRIBUTIONS:** For lifetime distributions, we now have a simplified method for calculating required distributions beginning at and after the Required Beginning Date (April 1st of calendar year following calendar year in which participant/owner turned 70 ½).

1. **CALCULATION OF LIFETIME DISTRIBUTIONS:** The method for calculating the minimum distribution is still based on the account balance (re-valued annually) by a life expectancy factor (called a “divisor”).

Under the old rules, there were seven possible divisors, which depended on elections made prior to the Required Beginning Date (the selection of a particular beneficiary and the manner of calculating life expectancy). Under the new rules, there are only two possible divisors. One for a participant whose sole beneficiary is his or her spouse who is more than 10 years younger, and the other to be used by everyone else.

a) When the designated beneficiary is not a spouse who is more than 10 years younger than the participant: The new uniform table for calculating lifetime distributions is attached as “EXHIBIT A”, which will apply regardless of who is named as beneficiary (even a beneficiary with no life expectancy such as a charity) unless the sole beneficiary is spouse who is more than 10 years younger. The new uniform table represents the actual age of the participant (age 70 or older), and a beneficiary who is 10 years younger. This table used to be known as the MDIB table, which applied to required lifetime distributions whenever the participant named a beneficiary who was more than 10 years younger.

Note under the new uniform table that the divisor does not go down by one every year meaning that the divisor is re-determined annually. Also, note that the divisor never goes below 1.8 (age 115 and older), which means that the account will never go to zero no matter how long the participant lives. In other words, distributions during the lifetime of the participant are similar to distributions under the recalculation method under the old regulations. Unlike recalculation under the old rules, however, the life expectancy of the deceased person does not drop to zero at death. Now, if the participant dies after the required beginning date, the benefits are distributed over the life expectancy of the beneficiary OR, if there is no designated beneficiary, over the remaining **FIXED** term life expectancy of the participant as it existed on his or her birthday in the year of death.

b) When the sole beneficiary is the spouse who is more than 10 years younger than the participant: If the participant names a spouse who is more than 10 years younger as his or her sole beneficiary, the actual ages of both the participant and beneficiary spouse are taken into consideration using a true joint and survivor life expectancy table. The spouse is the sole beneficiary for purposes of determining the minimum distribution amount in a particular year if the spouse is the sole beneficiary of the entire interest at all times during the distribution calendar year. In the event of divorce, or if the spouse

predeceases the participant, the new rules appear to say that the participant would go back to the uniform table shown in Exhibit A. It also appears that a participant who marries a much younger spouse after the required beginning date could switch from the Uniform table to the true joint and survivor life expectancy.

2. SIMPLE CALCULATION: To determine the minimum distribution amount when the beneficiary is not a spouse who is more than 10 years younger, you must first determine the participant's age on his or her birthday in the applicable distribution year. Then divide the prior year end account balance by the divisor in the attached uniform table (EXHIBIT A) that corresponds to that age.

Example: Bob turns 73 on his birthday in 2001. The applicable divisor is 23.5. On December 31, 2000, the value of his IRA was \$750,000. Divide \$750,000 by 23.5 and the minimum distribution amount required in year 2001 is \$31,915.

- This result is the same regardless of whether Bob had a designated beneficiary on his required beginning date.
- This result is the same regardless of whether Bob changed his beneficiary after the required beginning date.
- This result is the same regardless of any elections for determining life expectancy (recalculation vs. non-recalculation).

Note: Under the old rules, the distribution amount would have depended on all of the above. If Bob had no beneficiary as of the required beginning date, or if he had named a charity as beneficiary, distributions would be based solely on Bob's life expectancy. Bob's life expectancy would vary depending on whether he chose to recalculate or not recalculate his life expectancy. If Bob had a beneficiary as of his required beginning date, the beneficiary's age would have been taken into consideration for purposes of determining the minimum distribution amount. The ages used to calculate the distribution amount would have been fixed as of Bob's required beginning date unless Bob changed to an older beneficiary after his required beginning date, in which case the age of the older beneficiary would have been used for the purposes of calculating the minimum distributions.

3. NO ELECTIONS MUST BE MADE BY THE REQUIRED BEGINNING DATE. Therefore, the debate about which is the best

method of determining life expectancy appears to be over (fixed term, joint recalculation or split method recalculation). Lifetime distributions automatically receive the benefit of recalculation (distributions stretch out over the entire lifetime since the participant can never run out of life expectancy under the recalculation method) but post death distributions to non-spouse, non-charitable beneficiaries convert automatically to non-recalculation/fixed term method based on the life expectancy of the beneficiary. This is the best of both worlds.

4. REPORTING REQUIREMENTS: It will now be necessary for IRA providers to report annually not only the year-end account value of each IRA (as they already do), but also the amount of the minimum required distribution for the year in question. This will make it easier for the IRS to total up required minimum distributions for all taxpayers and make sure that the taxpayer reports the correct amount of income on his or her tax return.
5. MINIMUM REQUIRED DISTRIBUTIONS FOR ALL IRAs CAN BE TAKEN FROM A SINGLE IRA.

B. POST-DEATH DISTRIBUTIONS: The applicable distribution period will be the life expectancy of the designated beneficiary determined as of December 31 of the calendar year following the year of death (not the beneficiary who was named as of the earlier of the date of death or the required beginning date, as required by the old rules).

1. Period for finalizing the beneficiary: The identity of the post-death designated beneficiary is not finalized until December 31st of the calendar year following the year of death. The participant's beneficiary designations are carved in stone as of the moment of death, but there is an opportunity to clean things up post mortem. As a result, the emphasis will now be POST MORTEM PLANNING. Under the new rules, there are now 3 types of post-death actions that can result in a more favorable choice of the designated beneficiary.

- a) Disclaimer: Where an older beneficiary is named as the primary beneficiary and a younger beneficiary such as a child is named as the contingent beneficiary, the new rules allow time for the older beneficiary to disclaim the benefits (a disclaimer must be filed within 9 months of a participant's death to be a valid disclaimer). Now, the younger contingent beneficiary can receive the benefits

over his or her actual life expectancy. It is critical that contingent beneficiaries be named in order for the disclaimer to work.

- b) Establishment of Separate Accounts. Where charitable and non-charitable beneficiaries are named, the old rules gave the beneficiaries a zero life expectancy. This is because the beneficiaries were finalized as of date of death for purposes of determining whose life expectancy measured the minimum distributions. Charities have a zero life expectancy for distribution purposes. Under the new rules, it is possible to establish separate accounts for the charitable and non-charitable beneficiaries no later than December 31 of the calendar year following year of death. The minimum distribution computations for the non-charitable beneficiary from his or her separate account will be made based on his or her life expectancy. It appears that separate accounts could also be established for older and younger individual beneficiaries within the stated time period.

- c) Eliminating Beneficiaries by Distribution. Under the old rules, when an account designated multiple beneficiaries, the age of the oldest trust beneficiary would be used to determine the minimum distribution amounts. If a charity was one of the designated beneficiaries, there would be no life expectancy attributed to the beneficiaries. Under the new rules, the applicable date for determining the beneficiaries (December 31 of the year following the year of death) affords time to cure this problem by distributing the charity's share, or the share of an older beneficiary. After this payout to the older or charitable beneficiary, only the remaining (younger and individual beneficiary) will still have an interest in the account as of the date for determining beneficiaries. The life expectancy of the remaining beneficiary would then be used for determining the minimum distributions.

NOTE: It is not entirely clear whether beneficiaries can be eliminated for purposes of determining the minimum distribution amounts by distributing out a particular beneficiary's share where an estate or non-qualified trust is named as the beneficiary. The new rules imply that an executor, or Trustee of a non-qualified trust, could distribute out the shares to a charitable or older, individual beneficiary in order to use the life expectancy of a younger beneficiary named in a Will or non-qualified trust. On

the other hand, the IRS has stated that an estate (and presumably a non-qualified trust) CANNOT be a designated beneficiary. Does this mean that an estate or non-qualified trust has a zero life expectancy even if the Executor or Trustee has time after the participant's death to cash out the share of a certain beneficiary?

2. Computing distributions when the participant dies BEFORE the Required Beginning Date (April 1 following calendar year in which participant turned 70 ½): With exception of the extended time period to finalize the beneficiaries as described above, the rules here are mostly unchanged from the old rules.

- a) Where one or more individual, non-spouse beneficiaries are named as beneficiaries, you will simply use the non-recalculated life expectancy of the oldest beneficiary to determine the maximum period over which distributions can be taken. Non-recalculation means that you refer to the appropriate life expectancy table in the first year (the age the beneficiary attains the year after the year of the decedent's death) and subtract one from the initial life expectancy number in each subsequent year. The appropriate table for measuring the life expectancy of the beneficiary is attached hereto as EXHIBIT B. Distributions must begin no later than December 31st of the year following the year of the participant's death. Recall that it may be possible to split an IRA into separate account for each beneficiary before December 31 of the year following the year of death. This will allow each beneficiary to use his or her own life expectancy for determining distribution amounts. It is also possible to distribute an older beneficiary's share within this time frame.
- b) If there is no designated beneficiary, or if one of the designated beneficiaries does not have a life expectancy (such as a charity), the account must be distributed no later than December 31st of the 5th year following death. Distributions must begin no later than December 31st of the year following the year of the participant's death. Recall that if there are multiple beneficiaries, the new rules allow for a charity's share to be distributed out or separated from the other beneficiary's share.
- c) If the spouse is the beneficiary, the spouse has the option of rolling over the account or taking distributions based on his or her own recalculated life expectancy. Recalculation means that you refer to the single life expectancy table each year. If the

spouse chooses not to roll over the account, but rather to take distributions based on his or her life expectancy, the beginning date for distributions would be the later of December 31 of the year following the year of the participant's death or December 31 of the year the participant would have attained age 70 ½.

NOTE: A Qualified Trust can be named as a beneficiary, and distributions may be calculated based on the life expectancy of the oldest trust beneficiary. It is important that a qualified attorney draft the trust agreement to ensure that the trust would be treated as a qualified trust under the regulations. A copy of the trust must be received by the IRA custodian or plan administrator by December 31 in the year following the date of death of the IRA owner or plan participant. Under the old rules, it was necessary to provide a copy of the trust to the custodian or administrator before the participant's required beginning date.

3. Computing distributions when the participant dies AFTER the Required Beginning Date:

- a) If the spouse is the beneficiary, the spouse has the option of rolling over the account or taking distributions based on his or her own recalculated life expectancy. If spouse chooses not to roll over the account, but rather to take distributions based on his or her life expectancy, the beginning date for distributions would be December 31 of the year following the year of the decedent's death.

NOTE: Where a spouse elects to roll over an IRA or qualified account from a decedent who died after his or her required beginning date, the new regulations require that the spouse take the minimum required distribution in the year of the decedent's death before rolling over the account. This is the amount the decedent would have been required to take had he or she lived for the entire year.

- b) The general rule for all other beneficiaries is that distributions can be made from the decedent's account over the life expectancy of a person who is the same age that the decedent would have been on the last day of the year in which he or she died. If the beneficiary is younger than the decedent, distributions can be taken over the longer life expectancy of the younger beneficiary. The life expectancy of the designated

beneficiary is determined by using the beneficiary's age as of the beneficiary's birthday in the calendar year immediately following the calendar year of the employee's death. The appropriate table for measuring the remaining life expectancy of either the decedent or the designated beneficiary, whichever is appropriate, is attached hereto as EXHIBIT B. Distributions must begin no later than December 31 of the year following the year of the decedent's death.

- c) If there is no designated beneficiary, you would use the decedent's remaining, non-recalculated life expectancy, if any, for determining the distribution amount. See EXHIBIT B. Distributions must begin no later than December 31 of the year following the year of the decedent's death.

NOTE: A Trust can be named as a beneficiary, and distributions may be calculated based on the life expectancy of the oldest trust beneficiary. It is important that a qualified attorney draft the trust agreement to ensure that the trust would be treated as a qualified trust under the regulations. A copy of the trust must be received by the IRA custodian or plan administrator by December 31 in the year following the date of death of the IRA owner or plan participant.

4. What action should be taken immediately by heirs of deceased participants? Since required distributions may be determined under the new rules starting in 2001, any beneficiaries of inherited IRAs (or other retirement accounts if amended to allow it) should be able to use the new rules for their 2001 and later distributions, although it is not yet 100% clear how much retroactive effect will be given.

The greatest opportunity for action lies with beneficiaries of an employee or IRA owner who died in year 2000. Under the new rules, the designated beneficiary is not finally determined until the end of the year following the year of death. Thus, beneficiaries of an employee or IRA owner who died in year 2000 have until December 31, 2001 to finalize the decedent's choice of designated beneficiary for purposes of determining required distributions (through disclaimers or distributions) regardless of whether that person died before or after his required beginning date.

- C. WHO SHOULD BE THE BENEFICIARY OF AN IRA? While the new regulations have clearly simplified lifetime distributions, and have allowed for significant post mortem flexibility, the decision as to who should be

named as the designated beneficiary is no less complicated. Clearly, the post-mortem flexibility with regard to identifying a beneficiary make the naming of contingent beneficiaries critical to the process. As long as IRAs or other retirement accounts are potentially subject to both estate and income taxes, the selection of the appropriate beneficiary and contingent beneficiary will be an important part of the planning process.