MRDelights

Everything you always wanted to know about retirement planning with the newly revised* minimum required distribution rules.

* **IMPORTANT NOTE:** This material covers one of the most epochal changes in the U.S. tax code—certainly when evaluated for its impact on retirees. The revision referred to as "proposed" in this 2001 article was formally implemented on January 1, 2003 pursuant to Treasury Decision 9897 (issued in Internal Revenue Bulletin No. 2002-19, May 13, 2002). The provision remains valid at this writing. However, many other changes have occurred in the tax code. Therefore, consumers should check with a qualified retirement-phase advisor before making important decisions regarding their tax status and exposure.

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By Ed Slott

March 1, 2001- The Internal Revenue Service has created incredible opportunities for financial planners and their clients. On Jan. 11, 2001, the IRS issued proposed new regulations for withdrawals from IRAs and other retirement accounts, including 401(k) and 403(b) plans. The new rules create massive changes that are both taxpayer- and financial adviser-friendly.

For a financial planner, long-term success is dependent upon retention of assets. Retaining retirement account assets was not easy under the old required distribution rules. They were complex and mistakes were costly. In many cases, more than 80% of a client's individual retirement account was confiscated by the combination of estate and income taxes after the death of the IRA owner. This thwarted efforts to retain these assets, and both clients and financial planners lost out.

The IRS has changed all that. The new rules now allow most IRAs to be retained for beneficiaries long after the death of the original owner. Although the new rules are technically "proposed" regulations, they are in effect right now; in fact, they are retroactive to Jan. 1, 2001. (The old rules were also based on proposed regulations that were in effect since July 1987 but never finalized.) For 2001, IRA owners can use either the old rules or new rules, but it would be rare to find anyone who would benefit from the old rules. Plan participants can only use the new rules if their plan is amended to conform to the proposed regulations.

The centerpiece of the new distribution rules is a Uniform Life Expectancy Table (see Figure 1). The table itself is not new, but it now takes center stage. It's actually the old Minimum Distribution Incidental Benefit table, also known as the 10-year table. Under the old rules, this life expectancy table was only used to compute required distributions if your beneficiary was a non-spouse (a child, brother or friend, for example) who was more than 10 years younger than the IRA owner.

Under the new rules most IRA owners and plan participants will use this table to figure required distributions. The only exception is if the beneficiary is a spouse who is more than 10 years younger than the IRA owner or plan participant. In that case -- and only in that case -- the uniform table will not be used. Instead, required distributions will be based on the joint life expectancy using the actual ages of the IRA owner and the spouse. That will produce an even lower annual required

distribution than the uniform table. The bottom line is that most IRA owners and plan participants will benefit from lower annual required distributions during their lifetime. This means immediate tax savings and more retirement money for heirs. The uniform table concept provides two key benefits to IRA owners and their financial advisers. One is simplicity; the other is a longer life expectancy.

The new table really is simple. Since almost everyone will use the uniform table, it will be much easier to figure required withdrawals. That's because the life expectancy factors (in years) from the table are the same for most IRA owners and do not depend on the selection of a particular distribution method or the identity of the beneficiary. There are no more distribution methods to choose from! Remember "recalculation," "term certain" and the "hybrid" methods? Well, they're gone now.

The choice of beneficiary is also of no consequence in computing lifetime required distributions. The uniform table assumes the beneficiary is 10 years younger than the IRA owner or plan participant regardless of his or her actual age. Even people who have no beneficiary will use the same table.

Under the old rules, choices made at the required beginning date (RBD) were generally locked in. Changes in the calculation were based on the distribution method and the choice of beneficiary at the RBD. Poor choices could generally not be corrected, often resulting in complete distribution of the account soon after the owner's death.

Nothing is locked in anymore at a client's RBD. He can keep changing beneficiaries but his required distributions will not change. The only change that can be made to the lifetime required distribution amount is to reduce it, and that can happen only if a spouse who is more than 10 years younger than the IRA owner becomes the beneficiary.

IRA owners who are already past their RBD and taking required distributions can change to the new uniform table in computing their 2001 required distribution. This will most likely result in a lower withdrawal and, in turn, lower taxes. They can also name new beneficiaries.

Here's an example of an immediate lifetime benefit. Mr. Turner is 75 years old in 2001 and has $1 million in his IRA. At 70 1/2 he neglected to name a beneficiary (or named his estate as his beneficiary) and elected the recalculation method. Under the old rules he was stuck with single life/recalculation. His required distribution for this year would have been based on his age using the single life

expectancy table; that factor is 12.5 years. Thus, Mr. Turner's required distribution would have been $80,000 (the $1 million IRA balance 12.5 years = $80,000).

Mr. Turner's financial planner should advise him to switch to the new uniform table immediately. He can do that regardless of who his beneficiary is (or even if he still has not named a beneficiary). The factor from the new uniform table for age 75 is 21.8 years. Instead of having to withdraw $80,000 this year, Mr. Turner can now withdraw only $45,872 ($1 million 21.8 = $45,872). That's $34,128 less that he can withdraw this year. At an estimated combined 35% federal and state income tax rate, that's a tax savings of $11,945! Not too shabby.

Obviously a client's tax savings will be directly related to the size of his retirement account and his age. If the IRA owner already named a beneficiary who was more than 10 years his junior, then there will be no reduction of the required distribution and thus no tax savings.

The IRS has given financial planners a wonderful gift, because now they will be able to retain retirement account assets for a longer time, during the life of the client and after his or her death. The buildup of tax-deferred retirement account balances will increase the estates of clients. This signals the need for a review of the client's estate plan. A life insurance review is also in order. An IRA can still be lost to taxes at death if it has to be tapped to pay estate taxes. Life insurance is the most cost-effective way to protect a large IRA from the confiscatory combination of estate and income taxes.

The new rules also provide another essential element needed to retain retirement assets. That magic ingredient is commonly known as the "stretch IRA." The stretch IRA is not a product but a result that is created by allowing an IRA to live on as long as possible after the death of the IRA owner. The new rules practically guarantee this result, because the designated beneficiary can stretch post-death required distributions over his lifetime, regardless of when the IRA owner names him or her as the beneficiary.

The new rules underscore the importance of naming a beneficiary and a contingent beneficiary. A contingent beneficiary comes into play if the primary beneficiary predeceases the IRA owner, or if the primary beneficiary either disclaims his or her interest in the inherited IRA or "cashes out." The new rules introduce a cash-out provision that allows a beneficiary to withdraw his or her inherited share after the death of the IRA owner. Also, the rules state that the designated beneficiary will

not be determined until Dec. 31 of the year following the year of the IRA owner or plan participant's death.

However, this does not mean that new beneficiaries who were not named by the IRA owner can come out of the woodwork. It does mean that a primary beneficiary can either disclaim or withdraw his entire share (cash out) during the period from the death of the IRA owner to Dec. 31 of the following year. This would leave only the contingent beneficiary, who would then be the designated beneficiary and be able to use his life expectancy for required withdrawals.

Also in the new rules is a provision requiring the IRA financial institution (the bank, brokerage or mutual fund company) to report the amount of the IRA owner's or beneficiary's required distribution to the taxpayer and to the IRS to ensure compliance. This reporting appears to be similar to the way interest and dividend income is reported to the IRS for matching and compliance purposes. The amount of the distribution actually withdrawn was always reported on a 1099-R form, but the new rules will include reporting of the amount that was supposed to be withdrawn. (Note: There is still a 50% penalty for not withdrawing the required amount.)

Financial planners could not have asked for more. Your income is now only limited by the time you have to visit with each client. Every client's IRA can now be stretched for decades, regardless of their current age. Can you imagine the value of your practice with 500 stretch IRAs? Better go to a time management seminar -- you'll need every minute!

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FIGURE 1

Uniform Distribution Table for RMDs		
This table is the new life expectancy table to be used by all IRA owners to calculate lifetime distributions (unless your beneficiary is your spouse who is more than 10 years younger than you). In that case, you would not use this table, you would use the actual joint life expectancy of you and your spouse based on the regular joint life expectancy table. These Required Miminimum Distributions are calculted and based on the previous years aggregate year end value of all IRA and Qualified accounts owned by the particular taxpayer and can be withdrawn from any one or any combination of threir accounts so long as the required total dollar amount is withdrawn. The Uniform Distribution Table is not used by IRA beneficiaries to compute required distributions on their inherited IRAs.		
Age of IRA Owner or Plan Participant	**Life Expectancy (in years)**	**Required Min Dist %**
70	27.4	3.65%
71	26.5	3.77%
72	25.6	3.91%
73	24.7	4.05%
74	23.8	4.20%
75	22.9	4.37%
76	22.0	4.55%

77	21.2	4.72%
78	20.3	4.93%
79	19.5	5.13%
80	18.7	5.35%
81	17.9	5.59%
82	17.1	5.85%
83	16.3	6.13%
84	15.5	6.45%
85	14.8	6.76%
86	14.1	7.09%
87	13.4	7.46%
88	12.7	7.87%
89	12.0	8.33%
90	11.4	8.77%
91	10.8	9.26%
92	10.2	9.80%
93	9.6	10.42%
94	9.1	10.99%
95	8.6	11.63%
96	8.1	12.35%
97	7.6	13.16%
98	7.1	14.08%
99	6.7	14.93%
100	6.3	15.87%
101	5.9	16.95%

102	5.5	18.18%
103	5.2	19.23%
104	4.9	20.41%
105	4.5	22.22%
106	4.2	23.81%
107	3.9	25.64%
108	3.7	27.03%
109	3.4	29.41%
110	3.1	32.26%
111	2.9	34.48%
112	2.6	38.46%
113	2.4	41.67%
114	2.1	47.62%
115 and older	1.9	52.63%