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Rockland County Estate Planning Council

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BASIC IRA/RETIREMENT PLAN DISTRIBUTION RULES

I. Statutory Basis is IRC 401(a) (9):

401(a)(9) Required Distributions

401(a)(9)(A) In General

A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee—

401(a)(9)(A)(i)

will be distributed to such employee not later than the required beginning date, or

401(a)(9)(A)(ii)

will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

401(a)(9)(B) Required Distribution Where Employee Dies Before Entire Interest Is Distributed

401(a)(9)(B)(i) Where Distributions Have Begun Under Subparagraph (A)(ii)

A trust shall not constitute a qualified trust under this section unless the plan provides that if—

401(a)(9)(B)(i)(I)

the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

401(a)(9)(B)(i)(II)

the employee dies before his entire interest has been distributed to him, the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

401(a)(9)(B)(ii) 5-Year Rule For Other Cases

A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

401(a)(9)(B)(iii) Exception To 5-Year Rule For Certain Amounts Payable Over Life Of Beneficiary

If—

401(a)(9)(B)(iii)(I)

any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

401(a)(9)(B)(iii)(II)

such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

401(a)(9)(B)(iii)(III)

such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe, for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

401(a)(9)(B)(iv) Special Rule For Surviving Spouse Of Employee

If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee—

401(a)(9)(B)(iv)(I)

the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 70-1/2, and

401(a)(9)(B)(iv)(II)

if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

401(a)(9)(C) Required Beginning Date

For purposes of this paragraph—

401(a)(9)(C)(i) In General

The term “required beginning date” means April 1 of the calendar year following the later of—

401(a)(9)(C)(i)(I)

the calendar year in which the employee attains age 70-1/2, or

401(a)(9)(C)(i)(II)

the calendar year in which the employee retires.

401(a)(9)(C)(ii) Exception

Subclause (II) of clause (i) shall not apply—

401(a)(9)(C)(ii)(I)

except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70 1/2, or

401(a)(9)(C)(ii)(II)

for purposes of section 408(a)(6) or (b)(3).

401(a)(9)(C)(iii) Actuarial Adjustment

In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70 1/2, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70 1/2 in which the employee was not receiving any benefits under the plan.

401(a)(9)(C)(iv) Exception For Governmental And Church Plans

Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term “church plan” means a plan maintained by a church for church employees, and the term “church” means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

401(a)(9)(D) Life Expectancy

For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

401(a)(9)(E) Designated Beneficiary

For purposes of this paragraph, the term “designated beneficiary” means any individual designated as a beneficiary by the employee.

401(a)(9)(F) Treatment Of Payments To Children

Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations).

401(a)(9)(G) Treatment Of Incidental Death Benefit Distributions

For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph.

II. Incentive to comply: IRC Section 4974

4974(a) General Rule

If the amount distributed during the taxable year of the payee under any qualified retirement plan or any eligible deferred compensation plan (as defined in section 457(b)) is less than the minimum required distribution for such taxable year, there is hereby imposed a tax equal to 50 percent of the amount by which such minimum required distribution exceeds the actual amount distributed during the taxable year. The tax imposed by this section shall be paid by the payee.

III. Goal: Achieve slowest possible payout without incurring penalties

Two effects: income tax now on withdrawn portion, and income tax deferral on the unwithdrawn portion.

Except for the very old, the unwithdrawn portion is much larger than the portion that must be withdrawn. Planners tend to focus on the current income tax and not the income tax deferral.

Rational distribution rules would require 100% to be withdrawn and income taxed during your retirement, but law allows two lives.

Obvious planning opportunity is to take advantage of the "bonus" second life expectancy.

IV. Distributions permitted, not required

Under age 59.5, 10% penalty for premature distribution, in addition to your having to pay the regular income tax.

Exception to 10% penalty for series of equal annual installments.

After age 59.5 no penalty, but the regular income tax serves as a sufficient disincentive. Not only do you pay income tax prematurely, but the dollars withdrawn no longer are eligible for income tax deferral.

After age 70.5 you can withdraw more than the required minimums without penalty, but once again you are paying accelerated tax and losing future income tax deferral.

All of the foregoing assumes that the withdrawals are permitted under the terms of the qualified plan or IRA.

V. Distributions required during lifetime

Employee who is not a 5% owner of a business can defer the start of distributions until actually retiring. Otherwise, first distribution is for calendar year in which you attain age 70.5.

That distribution can be deferred until the "Required Beginning Date": the April 1 of the following calendar year. In practice, the first distribution usually is taken in the fall of the calendar year of attaining 70.5, so as to avoid taking the first two distributions in the same calendar year and putting yourself into a higher income tax bracket.

Uniform Table bases the required distribution on the combined life expectancies of yourself and a hypothetical person 10 years younger. It doesn't matter who is your beneficiary.

Melania exception: Your sole beneficiary is your spouse who is more than 10 years younger than you, or a trust of which your young spouse is the sole beneficiary.

The lifetime distribution rules continue to apply through the calendar year of your death. If you die on January 1, 2016, then a distribution for 2016 is required , because you were alive for part of the year. The calculation is the same as if you had lived for the entire year. The distribution is not made to you, because you are dead. It is made to your beneficiary (not to your estate). Clients run into this rule when, shortly after one spouse's death, the survivor tries to roll the entire death benefit into a spousal IRA. All that can be rolled is the amount that remains after the required distribution because "you can't roll a required distribution."

VI. Designated Beneficiary

As discussed below, the distributions required after your death depend on whether you have a designated beneficiary.

Only an individual can be a DB. In particular, an estate cannot be, and a charity cannot be. If you have multiple beneficiaries, then the DB is the oldest one (the one with the shortest life expectancy). A trust cannot be a DB, but if it is properly structured you can look through the trust and use the life expectancy of the trust beneficiary with the shortest life expectancy.

Remaindermen can count as trust beneficiaries. For example, a client leaves her $1,000,000 IRA in trust for her husband, with the remainder as follows: $10,000 to the Halitosis Foundation, and the rest to relatives. The charity counts as a beneficiary because the husband will not necessarily receive 100% of the death benefit.

Whether you have a DB is determined as of the "determination date": September 30 of the calendar year following the calendar year of death. There can be 9 months to 21 months between your death and the determination date. During that time you can take action to affect whether there is a DB.

A beneficiary who disclaims is disregarded. A qualified disclaimer under IRC Section 2518 must be made within 9 months of the date of death, so it will have been completed by the determination date.

A beneficiary who is paid is disregarded. For example, your beneficiary form leaves $1,000 to the Hangnail Foundation and the rest to your daughter. If you pay the charity by September 30 of the year following death, then your daughter is considered the only beneficiary and is a designated beneficiary.

A beneficiary who dies is *not* disregarded.

A distribution from an estate to a beneficiary is *not* disregarded. For example, your estate is your beneficiary, and your estate is left to your grandchild. You cannot get the use of the grandchild's life expectancy by distributing, from the estate to the child, the right to receive the death benefit.

VII. Distributions required after death

Remember that the rules depend on what the plan provides. Yeshiva University's plan will not pay installments to a trust, so if a trust is the beneficiary, it must take a lump sum. The following assumes that the plan in question is as flexible as the regulations

The required distributions depend on whether you die before or after your Required Beginning Date, which is the April 1 of the calendar year following the calendar year in which you attain age 70.5.

Death before RBD	Death after RBD
No designated beneficiary	
"Five year rule": entire death benefit must be withdrawn by fifth anniversary of your death.	Your remaining life expectancy (ignoring the fact that you are dead).
You have a designated beneficiary (other than your spouse)	
Beneficiary's life expectancy.	Whichever is longer, your life expectancy or the beneficiary's life expectancy.
Spouse is your sole designated beneficiary	
Spouse's life expectancy.	Whichever is longer, your life expectancy or your spouse's life expectancy.

In practice your spouse would roll to a spousal IRA and name children or others as beneficiaries, so as to be able to take lifetime distributions under the Uniform Table. But your spouse should not roll if under 59.5 and may need to take distributions.

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