# New IRA Rules 2001
# Workbook

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# YEAR 2001
# NEW IRA DISTRIBUTION & ELECTION RULES

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## INTRODUCTION

**IRA BENEFITS ARE SUBJECT TO BOTH ESTATE AND INCOME TAXES.**

The new regulations do not change the fact that the full fair market value of the IRA is subject to federal death taxes at the death of the Plan Participant and the IRA proceeds will be subject to income taxes, at the ordinary income tax rate, upon receipt by the Designated Beneficiary. What has changed dramatically with the promulgation of the new IRA distribution and beneficiary rules is when the Plan Participant must make his or her elections and the required distributions period for both the Plan Participant and the Beneficiary.

This video and workbook focus on the income tax consequences of the new elections available for January 1, 2001. Decreasing estate taxes, including your IRA, are the subject of separate videos and workbooks. Please check our Product Section at www.VideoLaw.com for further information.

## WHAT ELECTIONS ARE AVAILABLE UNDER NEW RULES? HOW DO THEY DIFFER FROM OLD RULES?

### BASICS AND DEFINITIONS

**We need to begin our lesson with FOUR definitions.**

**1. Plan Participant:**
The owner of the IRA is still called the Plan Participant. This has not changed under the new rules.

**2. Required Beginning Date** (RBD):
Withdrawals must still begin by April 1 of the year after the Plan Participant reaches age 70 1/2 . However, how the Plan Participant may take his or her withdrawals has dramatically changed.

**3. Beneficiary Designation:**
The person (or trust) that will receive the IRA distributions after the Plan Participant's death. A Plan Participant still may make a Beneficiary Designation, but the effect of that election has changed dramatically.

**4. Required Minimum Distribution:**
The required Minimum Distribution is the amount that must be paid to the Plan Participant commencing April 1 of the year after the Plan Participant reaches age 70 1/2. The new rules significantly change the amount of the Required Minimum Distributions to both the Plan Participant and the Designated Beneficiary.

## **WHEN ARE THE NEW REGULATIONS “EFFECTIVE?”**

The effective date is tricky! The new regulations are proposed to be effective for distributions for calendar years beginning on or after January 1, 2002. However, the proposed regulations state, “For distributions for the 2001 calendar year, IRA owners are permitted, but not required, to follow these proposed regulations, notwithstanding the terms of the IRA documents. IRA owners may therefore rely on these proposed regulations for distributions for the 2001 calendar year.”

The regulations further state that IRA sponsors should not amend their IRA documents to conform their IRAs to the changes in the proposed regulations before publication of the final regulations. The hearing on the final regulations is scheduled for June 1, 2001.

In English, this means the Plan Participant may take advantage of the new rules, regardless of the fact that the distribution he or she takes may be contrary to his or her Plan Sponsor’s document!

## WHAT HAPPENS WHEN A PERSON REACHES 701/2?

By April 1 of the year after a person turns age 70 1/2 the **Plan Participant must begin taking payments** from his or her IRA. Under the new rules, the election is no longer irrevocable. Prior to promulgation of the new regulations, the Plan Participant made **an irrevocable election** based upon one of the following **three** options:

- **A Single Life Annuit**y;
- **A Qualified Joint and Survivor Annuity; or**
- **Installment Payment**s.

There were different rules for a single life annuity, a qualified joint and survivor annuity, and the installment elections, which included choices for a single life payment or various forms of joint and survivor installment options. The "old rules" were extraordinarily complex!. Under the **old rule**s, if the Plan Participant chose an option that provided benefits for the rest of his or her life, commonly known as a single life installment option with recalculation, this often meant the Designated Beneficiary would have to report the entire balance of the IRA into income within 12 months after the year of death of the Plan Participant. And, under the old rules there were a myriad of choices for the surviving spouse, even if the Plan Participant chose a single life with recalculation.

There were dozens of payment schedules to choose from under the "old rules." And, the election a person made on April 1 in the Year after he or she turned age 70 1/2 was **irrevocable!**

## WHAT HAS CHANGED?

**The Election a Plan Participant makes by April 1 of the Year after he or she turns age 70 1/2 is no longer irrevocable.** The Plan Participant may change his or her election at any time. As a matter of fact, the new regulations allow a change to be made even after the Plan Participant's death. *(I will cover more on this later in the video.)*

**Payment Schedule.** *THIS IS A DRAMATIC CHANGE!* The Plan Participant may now use one uniform distribution period or schedule to calculate his or her lifetime payments. On Page 18 I have attached the new schedule. This schedule is actually the old Minimum Distribution Incidental Benefit Table originally prescribed in regulation section 1.401(a)(9)-2. The table is calculated on the basis of a joint life expectancy of a Plan Participant and a spouse 10 years younger. This creates a longer payout schedule than most options available under the "old rules."

The beauty of this new schedule is that it makes calculating the annual distributions much easier.

**Example *(under the new rules)*:**
A Plan Participant who is 71 must withdraw 1 divided by 25.3, or 3.95257% of the balance of his or her entire IRA balance that year. *(See page 18)*

When the Plan Participant turns 72, he or she must withdraw 1 divided by 24.4, or 4.09836% of his or her remaining IRA balance. *(See page 18)*

When the Plan Participant is 93 years old, he or she must withdraw 1 divided by 8.8, or 11.36364% of the remaining IRA balance. *(See page 18)*

The IRA balance will never be exhausted under the new required distribution schedule.

## ARE THERE OTHER OPTIONS AVAILABLE?

If the Designated Beneficiary is the Plan Participant's spouse, and the spouse is more than 10 years younger than the Plan Participant, the Plan Participant may elect a joint and survivor life expectancy with his or her spouse to compute his or her Required Distributions. If the spouse is more than 10 years younger than the Plan Participant, this will result in a lower or smaller annual distribution. If a Plan Participant is considering a joint and survivor options with a spouse more than 10 years younger, the Plan Participant should work with his or her professional to calculate the distribution payments, and to discuss the ramifications of that choice after the death of the second spouse.

**Designated Beneficiary.** How does the new Minimum Distribution Schedule affect the Beneficiary? THIS IS ANOTHER DRAMATIC CHANGE FROM THE "OLD RULES."

Under the new rules, the Designated Beneficiary will be determined as of the end of the year following the year of the Plan Participant's death, unless a joint and survivor annuity has been chosen with a spouse more than 10 years younger than the Plan Participant.

The age of the beneficiary will be determined as of the end of the year following the year of death. The IRA benefits will then be paid to the Designated Beneficiary over the single life expectancy of the beneficiary. I have included at Pages 19 & 20 a copy of the Single Life Expectancy Chart.

**Example:**
Assume the Plan Participant is 82 years old. He has been using the new table for his Required Minimum Distribution. Assume the Plan Participant named his child as the Designated Beneficiary. Now assume the Plan Participant was 82 in the Year of his death. He would have taken a distribution of 1 divided by 16, or 6.25% of his or her remaining plan balance during that year. *(See page 18 for the divisor for a person 82 years old.)*

The child, the Designated Beneficiary is age 59 in the year after the Plan Participant's death. The beneficiary will take 1 divided by 25 or 4% of the balance of the plan in the year after the Plan Participant's death. (See page19 for the divisor for a single life, age 59) The child will then take the distributions by reducing the fraction by one for each year thereafter. For instance, if the Beneficiary was 59 in the year following the death of the Plan Participant, creating a fraction measured by 1 divided by 25, the next year the fraction will be 1 divided by 24, then 1 divided by 23 and so on for the remaining 22 years.

What if we assume the Plan Participant is still 82 years old when he died, but he named his spouse as beneficiary. Please note, he did not elect a joint and survivor annuity with his spouse because the spouse was not more than 10 years his junior, or if she was, he did not elect the joint and survivor annuity. Then, commencing with the Year after the deceased Plan Participant's death, the spouse's life expectancy is used to calculate the annual distributions.

Let's assume the Plan Participant's spouse was 80 in the year after the Plan Participant died. Then, the surviving spouse's life expectancy in the year after the Plan Participant's death is 9.5. Therefore, the surviving spouse will take 1 divided by 9.5 or 10.52632% of the balance the first year after the Plan Participant's death, and will reduce the fraction each year thereafter– 1 divided by 8.5 the second year following the death of the Plan Participant, then 1 divided by 7.5 in the third year, and so on.

## WHAT HAPPENS AFTER THE DEATH OF THE SURVIVING SPOUSE?

The distribution period will be the spouse's life expectancy calculated in the year of her death, and then will be reduced by one for each year thereafter.

**Continuing with our example**:

The surviving spouse was 80 in the year following the Plan Participant's death. Let's assume she took her distribution for that year *(Age 80 - Single Life - See Page 19)* of 1 divided by 9.5 or 10.52632%. Her distribution the following year would be 1 less, or 1 divided by 8.5 or 11.7647%. Then the surviving spouse dies at age 82. The Required Minimum Distribution is then calculated by taking the divisor for her age in the year of death, 1 divided by 8.4 or 11.90476% times the IRA balance.

Then each year thereafter the distributions is made by one year less. For instance, the distribution one year after her death will be 1 divided by 7.4 or 13.5135% time the IRA balance. The next year will be 1 divided 6.4 or 15.625% time the IRA balance– followed each year by 1 divided by 5.4, then 1 divided by 4.4 and so on.

## ARE THERE OTHER OPTIONS AVAILABLE FOR A SURVIVING SPOUSE?

Yes, the surviving spouse still has the election to take a complete distribution of the deceased Plan Participant's IRA, and roll the balance into a new IRA (or an existing IRA) of the surviving spouse. This is a very important election for a surviving spouse! Why? Because the new IRA rules allow a person to change his or her beneficiary, even after turning age 70 1/2. Therefore, if the deceased spouse's IRA is rolled into a new or existing IRA for the surviving spouse, the surviving spouse is now the Plan Participant and she can name a new beneficiary who could then receive the benefits over the Designated Beneficiary's life expectancy, rather than the remaining life expectancy of the surviving spouse.

Alternatively, the surviving spouse may assume the deceased spouse's IRA. In order to assume the IRA, the surviving spouse must be the sole beneficiary of that IRA.

In our previous example, when a Designated Beneficiary is 59 years old, that Designated Beneficiary's life expectancy divisor is 25 years. In contrast, the life expectancy divisor of an 82 year old beneficiary is 8.4 years.

If your plan is to extend the payments for a long period of time to allow tax-free accumulation inside of an IRA, you would clearly rather have the Designated Beneficiary paid over 25 years, rather than 8.4 years.

Please be aware, only surviving spouses may elect to roll the deceased Plan Participant's IRA into his or her own IRA, or assume the IRA as his or hers. In order to have either of these options, the surviving spouse must be the sole beneficiary of the deceased Plan Participant.

## WHAT IF A PLAN PARTICIPANT HAS NOT NAMED A BENEFICIARY?

The new rules have changed! If there is no designated beneficiary as of the end of the year after the employee's death, the distribution period will be the IRA Plan Participant's life expectancy calculated in the year of the Plan Participant's death, reduced by one for each subsequent year. If the Plan Participant was 77 in the year of his death, without naming a beneficiary, his life expectancy divisor was 11.2 in the year of his death. Then the person receiving the IRA benefits will collect 1 divided by 10.2 the year following the Plan Participant's death, then 9.2 the subsequent year, and so on.

## WHAT IF THE PLAN PARTICIPANT HAS MULTIPLE BENEFICIARIES?

If the IRA has not been divided into separate shares for each beneficiary, the beneficiary with the shortest life expectancy is the designated beneficiary whose life expectancy will be used to calculate the remaining payments.

## WHAT HAPPENS TO PRIOR BENEFICIARY DESIGNATIONS?

Because the new rules allow the use of the life expectancy of the Designated Beneficiary in the year after the death of the Plan Participant (with the exception of a joint and survivor annuity for a spouse more than 10 years younger than the Plan Participant), then any prior beneficiary designation is irrelevant for purposes of calculating how quickly the IRA benefits will be paid to the designated beneficiary.

## ARE THERE DIFFERENT RULES FOR PAYMENTS BEFORE VS. AFTER A PLAN PARTICIPANT REACHES HIS REQUIRED BEGINNING DATE?

**NO!** The "old rules" had different payment schedules depending on whether a Plan Participant died before or after his or her Required Beginning Date. Now, (except for a joint life expectancy with a spouse more than 10 years younger than the Plan Participant, or the fact that a surviving spouse may roll an IRA into his or hers), the payment schedule after the death of the Plan Participant will be determined by the age of the Designated Beneficiary in the year after the Plan Participant's death, regardless of when death occurs.

## WHAT IF A PLAN PARTICIPANT WAS RECALCULATING AT THE TIME OF HIS OR HER DEATH?

The “old rules” would have required that the entire IRA balance be distributed in the year after the Plan Participant’s death. The new rules allow a distribution period equal to the employee’s remaining life expectancy, recalculated according to the charts attached at pages 19 & 20, computed immediately before his or her death.

## HAVE THE RULES CHANGED ON WITHDRAWALS FROM AN IRA BEFORE A PERSON TURNS AGE 59 1/2?

The new rules regarding how to calculate the distribution to a Designated Beneficiary will apply to a named Designated Beneficiary even if the Plan Participant dies before he or she turns age 59 1/2. But, the penalty for early withdrawal (a withdrawal by a Plan Participant before he or she turns age 59 1/2 have not changed.) I am including a summary of the income tax penalty for a withdrawal prior to reaching age 59 1/2 to complete the analysis of IRA distributions.

## PENALTY FOR WITHDRAWALS BEFORE AGE 59 1/2?

**Answer: No.**

**Distributions Before Age 59 1/2:**

A Plan Participant may withdraw from his or her IRA before reaching age 59 1/2 but the Plan Participant will incur a penalty for early withdrawal. The penalty is an additional 10% on top of the Plan Participant’s normal marginal rate *(there are exceptions to the imposition of the 10% penalty).*

## WHAT IS A 10% MARGINAL TAX PENALTY?

Please go to line 39 of your 1040 Form. This is your taxable income. Then check the rate schedule to determine the % of taxes you are paying in that bracket. If your income is taxed at 15%, your IRA withdrawal will be taxed at 25%. If your rate is 28%, your IRA withdrawal will be taxed at 38%.

## ARE THERE ANY EXCEPTIONS TO THIS RULE?

There are ***FIVE*** exceptions to the penalty for a distribution from an IRA prior to reaching age 59 1/2.

**The 10% penalty will not apply when:**

**1**. The distribution is due to the death of the Plan Participant.

**2.** The Plan Participant is disabled.

**3.** The distribution is for a qualified medical expenses that exceed 7.5% of the Plan Participant's adjusted gross income.

**4.** The distribution is for first-time qualified home owners (up to $10,000).

**5.** The distribution is for post-secondary education costs.

## HOW ARE WITHDRAWALS AFTER THE AGE OF 59 1/2 TAXED?

Withdrawals from the Plan Participant's account after reaching age 59 1/2 are subject to ordinary income taxes, ***BUT ARE NOT SUBJECT TO THE ADDITIONAL 10% PENALTY***. In rare cases, the Plan Participant will have basis in his or her IRA, and may spread that basis ratably over the expected period of withdrawals. When a person does have cost basis in their IRA, it is typically low in comparison to the value of the IRA.

## WHAT HAVE WE LEARNED?

**LESSON NUMBER ONE:** IRA proceeds are subject to Federal Death Taxes and Income Taxes.

**LESSON NUMBER TWO:** Withdrawals from an IRA after turning age 70 1/2 are now computed using one uniform schedule (See Page 18), unless the designated beneficiary is a spouse who is more than 10 years younger than the plan participant. Then, the plan participant may use a Joint and Survivor Annuity Schedule using the spouses' actual ages.

**LESSON THREE:** Designated Beneficiary Elections are no longer irrevocable at age 70 1/2 The plan participant may change his or her Designated Beneficiary right up until he or she dies.

**LESSON FOUR:** The IRA will be distributed to the Designated Beneficiary after the death of the plan participant, using the age of the Designated Beneficiary in the year after the Plan Participant's death.

**LESSON FIVE**: If the spouse is the sole Designated Beneficiary, he or she may roll the deceased spouse's IRA into his or her existing IRA, or create a new IRA.

**LESSON SIX:** When a surviving spouse rolls the benefit into a new IRA (or an existing IRA), the surviving spouse can name a new Designated Beneficiary, whose age at the time of the second spouse's death will be used to determine the distribution schedule.

**LESSON SEVEN:** If the spouse does not roll into a new or existing IRA, then after his or her death, the distributions will be made using the surviving spouse's life expectancy at her death, rather than a longer distribution schedule that can be used by naming a younger Designated Beneficiary.

**PLAN PARTICIPANT SCHEDULE**

Table for Determining Applicable Divisor for MDIB

(Minimum Distribution Incidental Benefit)

| AGE | APPLICABLE DIVISOR | AGE | APPLICABLE DIVISOR |
|---|---|---|---|
| 70 | 26.2 | 93 | 8.8 |
| 71 | 25.3 | 94 | 8.3 |
| 72 | 24.4 | 95 | 7.8 |
| 73 | 23.5 | 96 | 7.3 |
| 74 | 22.7 | 97 | 6.9 |
| 75 | 21.8 | 98 | 6.5 |
| 76 | 20.9 | 99 | 6.1 |
| 77 | 20.1 | 100 | 5.7 |
| 78 | 19.2 | 101 | 5.3 |
| 79 | 18.4 | 102 | 5.0 |
| 80 | 17.6 | 103 | 4.7 |
| 81 | 16.8 | 104 | 4.4 |
| 82 | 16.0 | 105 | 4.1 |
| 83 | 15.3 | 106 | 3.8 |
| 84 | 14.5 | 107 | 3.6 |
| 85 | 13.8 | 108 | 3.3 |
| 86 | 13.1 | 109 | 3.1 |
| 87 | 12.4 | 110 | 2.8 |
| 88 | 11.8 | 111 | 2.6 |
| 89 | 11.1 | 112 | 2.4 |
| 90 | 10.5 | 113 | 2.2 |
| 91 | 9.9 | 114 | 2.0 |
| 92 | 9.4 | 115 and older | 1.8 |

**SINGLE LIFE EXPECTANCY**

Table 1

| AGE | DIVISOR | AGE | DIVISOR |
|---|---|---|---|
| 35 | 47.3 | 73 | 13.9 |
| 36 | 46.4 | 74 | 13.2 |
| 37 | 45.4 | 75 | 12.5 |
| 38 | 44.4 | 76 | 11.9 |
| 39 | 43.5 | 77 | 11.2 |
| 40 | 42.5 | 78 | 10.6 |
| 41 | 41.5 | 79 | 10.0 |
| 42 | 40.6 | 80 | 9.5 |
| 43 | 39.6 | 81 | 8.9 |
| 44 | 38.7 | 82 | 8.4 |
| 45 | 37.7 | 83 | 7.9 |
| 46 | 36.8 | 84 | 7.4 |
| 47 | 35.9 | 85 | 6.9 |
| 48 | 34.9 | 86 | 6.5 |
| 49 | 34.0 | 87 | 6.1 |
| 50 | 33.1 | 88 | 5.7 |
| 51 | 32.2 | 89 | 5.3 |
| 52 | 31.3 | 90 | 5.0 |
| 53 | 30.4 | 91 | 4.7 |
| 54 | 29.5 | 92 | 4.4 |
| 55 | 28.6 | 93 | 4.1 |
| 56 | 27.7 | 94 | 3.9 |
| 57 | 26.8 | 95 | 3.7 |
| 58 | 25.9 | 96 | 3.4 |
| 59 | 25.0 | 97 | 3.2 |
| 60 | 24.2 | 98 | 3.0 |
| 61 | 23.3 | 99 | 2.8 |

**SINGLE LIFE EXPECTANCY**

Table 1

- Continued -

| AGE | DIVISOR | AGE | DIVISOR |
|---|---|---|---|
| 62 | 22.5 | 100 | 2.7 |
| 63 | 21.6 | 101 | 2.5 |
| 64 | 20.8 | 102 | 2.3 |
| 65 | 20.0 | 103 | 2.1 |
| 66 | 19.2 | 104 | 1.9 |
| 67 | 18.4 | 105 | 1.8 |
| 68 | 17.6 | 106 | 1.6 |
| 69 | 16.8 | 107 | 1.4 |
| 70 | 16.0 | 108 | 1.3 |
| 71 | 15.3 | 109 | 1.1 |
| 72 | 14.6 | 110 | 1.0 |

Table 1 does not provide for IRA owners younger than 35 years of age. For additional life expectancy tables, see Publication 939.

Publication 939 may be found at:**http://www.irs.gov/forms_pubs/ pubs/p939toc.htm**l OR go to: **www.videolaw.com** Click on **Library**; select **IRS Publications,** and choose **Publication 939**.