ESTATE PLANNING TODAY

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New Distribution Rules for Retirement Plans and IRAs

You might have noticed that several of our recent Newsletters have dealt with qualified retirement plans and IRAs. These assets get special attention because the vast majority of our clients participate in one or more qualified plans and/or IRAs. Qualified plans and IRAs are subject to both income tax and estate tax under current law. As a result, estate planning for these assets can be quite complex. The IRS has just announced substantial changes designed to simplify the distribution rules that apply to these plans/IRAs. This Newsletter summarizes these new rules for you.

New IRS Regulations

On January 11, 2001, the IRS issued new proposed treasury regulations governing required minimum distributions that retirees and their beneficiaries are required to take from qualified retirement plans and IRAs. The rules apply to stock bonus, pension, 401(k), profit sharing and other 401(a) plans, 403(b) annuities, "regular" IRAs and IRA rollovers from qualified plans. Although not technically effective until January 1, 2002, participants in IRAs, and their beneficiaries, may use the new distribution rules to compute distributions beginning in calendar year 2001 if they so choose (there are only one or two situations where you would not want to use the new rules this year). Participants in qualified plans can also use the new rules as soon as the plans have been amended by their employers to adopt them. If 2000 was your first distribution year, but you haven't taken that distribution yet (required by April 1, 2001), the old rules still apply to compute that distribution.

For the most part, the new rules simplify the determination of the required minimum distributions, especially for the participant (in this Newsletter, the term "participant" refers to the employee who is participating in an employer sponsored qualified retirement plan or the person who is listed as the "owner" of an IRA or IRA rollover.)

Although retirement plan assets must ultimately be subjected to income taxes, these taxes can, for the most part, be postponed until you reach retirement age. During this deferral period, the benefit of tax-free compound growth continues to make retirement plans an extremely effective and immensely popular way to accumulate wealth. Unfortunately, Congress has the view that retirement plans should be used by the retiree (and the retiree's spouse), and should not be used as a vehicle to pass wealth on to the next generation. To implement this policy, they impose an onerous 50% tax for retired participants (and their beneficiaries) who fail to take "minimum required distributions" from their retirement plans and IRAs. The focus of estate planning for retirement plan participants is to ensure that your retirement plan assets pass to your intended beneficiaries at death, while at the same time reducing "transfer" taxes (i.e., estate, gift, and generation-skipping taxes) and postponing income taxes for as long as possible. This process ensures that you, your spouse, your children, and other descendants have maximum access to retirement funds, while being given an opportunity to defer or avoid taxes to the greatest possible extent.

Remember that so long as you have attained the age of 59 ½ (and in the case of an employer sponsored plan, once you have retired), there is not a limit on the *maximum* amount you can take from your retirement plan/IRA in any year. By the same token, there is no limit on the amount that your beneficiary can withdraw after your death. Congress is happy for you to take money from these accounts (and pay the tax) early. The minimum required distribution rules act only to force you (or your beneficiary)

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to take certain minimum amounts from your plan after you attain 70 ½ (or after your death).

The minimum required distribution ("MRD") rules were first explained in a very complex set of proposed regulations issued in 1987. Interpreting how those rules applied in any given situation was difficult, and for most people, the amount they were required to withdraw was based upon rather arbitrary elections they made (or failed to make) on their "required beginning date" or "RBD". Your required beginning date, under both the old and new regulations, is April 1 of the year after you attain age 70 ½, or (for retirement plans that permit it), if you own less than five percent of the employer sponsoring the plan, the later of April 1 of the year after you attain age 70 ½ or April 1 of the year after you retire. The revised rules issued earlier this month substantially simplify the way in which most taxpayers compute minimum required distributions, and generally lengthen the period over which amounts can be withdrawn by you and your beneficiaries.

What the New Rules Mean to You:

- Under the new rules, minimum required distributions are generally measured using a single uniform table, based upon the joint life expectancies of you and a hypothetical beneficiary who is 10 years younger than you. The actual age of your beneficiary (or even whether you have a beneficiary during your lifetime) is irrelevant.
- If your spouse is your sole beneficiary, and your spouse is more than 10 years younger than you, you may use your actual joint lives instead of the uniform table. This gives retirees with very young spouses even greater deferral.
- You no longer need to elect whether to recalculate life expectancies. The new rules adopt the best of both worlds under the old regulations. You and your spouse's life expectancies are automatically recalculated during your lifetimes. Under the old rules, if both spouses' life expectancies were recalculated and you died in the "wrong" order, your beneficiaries couldn't defer distributions for more that a year after your deaths. Under the new rules, after your death, if you have a "designated beneficiary," distributions to non-spouse beneficiaries automatically switch to the favorable fixed-term method (i.e., they can base withdrawals upon their actual life expectancies).
- You don't need to have designated a beneficiary by your required beginning date. Even if you don't have a designated beneficiary during your lifetime, your minimum required distribution is based on the uniform table. In other words, your required beginning date is now just that–the date your distributions are required to begin. It is no longer the date when you must "irrevocably" choose a beneficiary or a recalculation option.
- Changing your beneficiary after the required beginning date no longer shortens your payout period (except if you are changing the beneficiary from your spouse as the sole beneficiary, and your spouse is more than 10 years your junior).
- The new rules are available even for those persons past 70 ½ who didn't have a designated beneficiary on their required beginning date (or whose designated beneficiary has since passed away), and for those persons who previously elected not to recalculate life expectancies.
- Although the required beginning date is no longer a magic deadline for irrevocably choosing a beneficiary, it is still critically important that you make the right choice of a "designated beneficiary" to maximize deferral opportunities available for your retirement plan/IRA beneficiaries after your death. It is also important in many cases to set up post-death planning opportunities while you are living, by including the necessary language in your Will or Living Trust and in your beneficiary designations. These post-death options are discussed further below.

What is a "Designated Beneficiary"?

After your death, the new MRD rules provide additional deferral for your retirement plan/IRA beneficiaries, but substantial deferral opportunities will be lost unless you have a "designated beneficiary" to receive your benefits. The term "designated beneficiary" means an individual named as a retirement plan or IRA beneficiary, but not estates, charities, or entities. The term also includes an individual who is named as a beneficiary of certain trusts which are named as retirement plan or IRA beneficiaries (including trusts in Wills and revocable trusts that become irrevocable at your death), so long as a copy of the Will or trust is delivered to the plan administrator by December 31 of the year after your death. If there are multiple individual beneficiaries of a single account, the oldest beneficiary is treated as your "designated beneficiary."

What the New Rules Mean to Your Family After Your Death:

- Your "designated beneficiary" for purposes of measuring minimum required distributions after your death is determined on December 31 of the year after your death.
- This means that even if you name beneficiaries without a life expectancy (such as a charity), payouts to that beneficiary before the end of the calendar year following your death will enable other beneficiaries to use their life expectancies to determine minimum required distributions.
- In addition, if one or more of your beneficiaries "disclaims" (declines to accept) benefits within nine months after your death, and as a result, the benefits pass to a younger family member, the younger life would be used to measure minimum required distributions, thus further deferring income taxes.
- So long as you have a "designated beneficiary" by the end of the calendar year following your death, minimum required distributions will be based upon the life expectancy of that beneficiary (or if you name multiple beneficiaries of a single account, on the life expectancy of the oldest beneficiary).
- Special rules apply if your spouse is your sole beneficiary:
  - After your death he or she may (i) defer commencing distributions until the later of December 31 of the year you would have attained age 70 ½ , or December 31 of the year following your death or (ii) roll the benefits into a new IRA rollover account, and select new beneficiaries to maximize tax deferral after your spouse's death;
  - If the account isn't rolled over to a spousal IRA, your spouse may take distributions after your death over his or her recalculated life expectancy;
  - If the account isn't rolled over into a spousal IRA, then for calendar years *after* your spouse's death (if your spouse had already begun taking distributions), minimum required distributions are based upon your spouse's non-recalculated life expectancy, using your spouse's age in the calendar year of your spouse's death. If you die before age 70½ and your spouse survives you, but dies before taking required distributions, minimum required distributions are based upon the non-recalculated life expectancy of the beneficiary named by your spouse.
- These rules place a premium on advice that your family receives in the days and weeks following your death. Actions that they take before consulting with qualified estate planning counsel can foreclose valuable tax saving strategies.

Who Needs to Take Immediate Action?

You should contact us immediately to schedule a consultation before taking your minimum required distribution for 2001, to see if the more favorable new rules give you an opportunity for additional tax deferral. This evaluation will be especially important if:

- You have already begun taking minimum required distributions from you retirement plans or IRAs.
- You are a participant in retirement plans or IRAs and are nearing your required beginning date (that is, if your birthday is between July 1, 1929 and June 30, 1931).
- You have inherited amounts from a retirement plan or IRA which is still in the decedent's name (that is, has not been entirely withdrawn or rolled over)-- especially if you inherited those assets from someone who died on or after January 1, 2000.

For a more detailed discussion of the new rules, please visit our web site at www.drjg.com. Click on the "Learn More" tab and go to the section called "*Basics Memos.*" The memo entitled, "Designating Retirement Plan Beneficiaries," contains a detailed discussion of these important rules, including copies of the relevant life expectancy tables. If you don't have access to the internet, please feel free to call our office and ask for a copy of the memo. We'll be happy to put one in the mail to you.

Post-Death Planning

The new rules give your family an unprecedented grace period to fine tune estate and tax matters in the months following your death. As previously noted in our *Estate Planning Alert!* (December 29, 2000), the opportunity to undertake this post-death estate planning, and the potential tax cost of failing to do so, makes it extremely important that your spouse and other family members consult with us or other qualified tax and estate planning professionals immediately after your death. For example, disclaimers can be used to "rearrange" the beneficiaries of the participant's plan/IRA. In order to be a "qualified" disclaimer, the disclaimer must be completed within nine months of the participant's date of death and must be done before the intended beneficiary "accepts" the gift. Thus, the surviving spouse should **not** do a spousal IRA rollover of the participant's plans/IRAs, which would foreclose other post-death planning options, prior to obtaining qualified tax and estate planning advice. It is also important that beneficiaries that do not qualify as "designated beneficiaries" (e.g., charities) be "cashed out" before the end of the calendar year following the year of your death.

The new rules mean that a lot of post-death estate planning will involve the use of disclaimers. Therefore, it is important that the disclaimer option be planned for in advance, in both the beneficiary designation for your plan/IRA and in your Will or Living Trust. In order to maintain maximum flexibility, you should review your current beneficiary designations and Will or Living Trust Agreement with us or with another qualified tax and estate planning professional.

If you would like to discuss your situation with one of the attorneys at our firm, we can usually review your situation and advise you during the course of a one hour consultation. Our fee for this type of consultation is typically $250. To make this meeting productive, you must bring accurate copies of all of your current beneficiary designations and a copy of your current Will or Living Trust Agreement (unless we already have it in our file). Please give us a call to schedule a time to come by and discuss your situation.

Special Kudos:

We are very excited to announce that Carol Rusciano has joined the ranks of attorneys at our firm that are Board Certified in Estate Planning and Probate Law by the Texas Board of Legal Specialization. Congratulations, Carol!

Contact Us:

Feel free to contact us at the address and phone number shown below. You can also reach us by e-mail addressed to:

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