Required Minimum Distributions

# What is It?

The primary benefit of qualified retirement plans and IRAs is the tax-deferred nature of these accounts. Basically, the qualified plan and IRA provisions of the Internal Revenue Code were enacted so as to provide a major incentive for a taxpayer to save for retirement and to have those funds grow in a tax-deferred environment during the taxpayer’s working years. However, the tax law does not allow this delay in taxation to continue indefinitely. Accordingly, the law requires that funds must be distributed from a qualified plan or IRA upon the occurrence of certain events, such as the plan participant or IRA owner attaining a certain age or following the plan participant or IRA owner’s death. The policy reason for these distribution requirements is to assure that previously untaxed retirement funds will be taxed at some point. In this chapter, the general rules surrounding required minimum distributions (RMDs) and the various exceptions to these rules will be discussed.

# When is the Use of Such a Device Indicated?

Planning for required minimum distributions (RMDs) is important whenever the client has qualified plan or IRA assets. Even though required minimum distributions may not have to begin before age 70½ (or retirement, if later, in the case of a qualified plan) or death, planning should start before age 70½ or death. It is important to have a designated beneficiary to insure that the right beneficiary is named and that distributions are stretched and tax is deferred as long as possible.

In general, RMDs must be considered:

1. When a plan participant or IRA owner reaches age 70½ (but RMD doesn’t apply to Roth IRA until after the death of the IRA owner).

2. When a plan participant retires, if that is later than age 70½.

3. After a plan participant or IRA owner dies.

# Advantages

1. Planning for RMDs enables a plan participant or IRA owner to stretch distributions over as long a period as possible while deferring tax on amounts that have not been distributed.

2. Planning for RMDs should be coordinated with overall retirement, financial, and estate planning.

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# Disadvantages

1. Failure to make a RMD results in a 50% penalty tax to the extent the RMD is not made. Therefore, it is important that the RMDs be made in compliance with the RMD rules.

2. Failure to plan for RMDs may require that distributions be made sooner than otherwise required, and tax deferral shortened.

# What are the Tax Implications?

1. Failure to make RMDs results in a 50% penalty tax to the extent the RMD is not made. The RMD rules are discussed in detail below.

2. Having to make a RMD generally ends the tax deferral in the tax advantaged retirement account for the amount distributed.

# Required Minimum Distributions – General

In an attempt to prevent taxpayers from using qualified retirement plans and IRAs to circumvent the income tax system, the required minimum distribution (RMD) rules were enacted and generally apply to a plan participant or IRA owner who is age 70½ or older during the current year.[[1]](#endnote-1) In the case of an employer qualified plan (but not an IRA), distributions do not have to begin until the plan participant (other than a five-percent owner) retires from that employer if that is later than age 70½. In the case of a Roth IRA (does not include Roth 401(k) or Roth 403(b)), distributions are not required during the Roth IRA owner’s lifetime. The RMD rules also apply to post-death distributions from qualified plans and IRAs.

**Important Point.** In the case of a qualified plan, methods of distribution may be fixed by the plan. The methods must satisfy the required minimum distribution rules. However, the rules for defined benefit plans and annuity contracts may differ from those discussed here.

In the case where a plan participant (where the retirement exception does not apply) or an IRA owner (other than a Roth IRA) has reached age 70½ in the current year, the plan participant or IRA owner must receive a RMD from his IRA by April 1 of the following year. This is known as the required beginning date (RBD). Every year after the RBD (including the year containing the RBD), the plan participant or IRA owner must withdraw the current year's RMD by December 31.

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*Example*:Ron turned age 70 on May 1, 2007. In this case, Ron will need to take his first RMD from his traditional IRA no later than April 1, 2008 in that Ron attains age 70½ during 2007 (on November 1, 2007). In addition, during 2008, Ron will need to take another RMD on or before December 31, 2008. Every year thereafter, Ron will have to take an RMD from his IRA by December 31.

*Example*: Same facts as above, except that Ron turned age 70 on August 15, 2007. Under these facts, Ron will not have to take his first RMD until April 1, 2009 in that Ron does not attain age 70½ until 2008 (on February 15, 2008). In addition, during 2009, Ron will need to take another RMD on or before December 31, 2009. Every year thereafter, Ron will have to take an RMD from his IRA by December 31.

It is important to note that the failure to take the RMD in the current year triggers an additional excise tax equal to 50% of the difference between the actual amount distributed and the RMD amount.[[2]](#endnote-2)

*Example*: During 2007, Jane's RMD was $15,000. However, Jane only withdrew $10,000 from her IRA that year. As a result, Jane will need to pay $2,500 in excise tax [($15,000 - $10,000) x 50%) for 2007 in that she failed to take her RMD.

In determining the current year's RMD while the plan participant or IRA owner (other than a Roth IRA) is alive, the amount to be distributed is calculated using the account balance as of December 31 of the prior year and then dividing this amount by an RMD factor (i.e., applicable divisor). While the plan participant or IRA owner is alive, an RMD factor based on the age of the participant or owner from the RMD Uniform Lifetime Table (see Appendix E) is generally used. However, if the designated beneficiary is the spouse of the participant or owner and the spouse is more than 10 years younger than the participant or owner, an RMD factor from the RMD Joint and Survivor Table (see Appendix E) can be used.[[3]](#endnote-3)

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*Example*: Carl, age 72 as of December 31, 2007, had a traditional IRA balance of $256,000 as of December 31, 2006. Carl's RMD factor is 25.6. As a result, Carl's RMD for the 2007 tax year would be $10,000 ($256,000 / 25.6). Each year going forward, Carl's RMDs would be as follows (assuming a 6% return and that RMDs are taken at year-end):

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2007 | 72 | $256,000 | 25.6 | $10,000 |
| 2008 | 73 | $261,360 | 24.7 | $10,581 |
| 2009 | 74 | $266,460 | 23.8 | $11,196 |
| 2010 | 75 | $271,252 | 22.9 | $11,845 |
| 2011 | 76 | $275,682 | 22.0 | $12,531 |
| 2012 | 77 | $279,692 | 21.2 | $13,193 |
| 2013 | 78 | $283,281 | 20.3 | $13,955 |

**Planning Point:** Contributions and distributions made after December 31 of the calendar year are disregarded for purposes of determining the minimum distribution for the following year. Thus, a plan participant or an IRA owner who delayed the first year distribution until the following April 1 does not have to adjust his prior December 31 account balance by adding back the April 1 distribution. The only exceptions are rollover amounts and recharacterized conversion contributions that are not in any account on December 31 of a year; the account balance must be adjusted for these.

The RMD Uniform Lifetime Table factor is the life expectancy of the participant or owner and a person 10 years younger than the participant or owner. The use of Uniform Lifetime Table provides simplification to taxpayers and greater deferrals of distributions than if the IRA owner’s single life expectancy were used.

If the participant or owner's spouse is the sole designated beneficiary and the differences in age between the participant or owner and his spouse is greater than ten years, the actual joint life expectancy of the participant or owner and his spouse may be used. In order for the spouse to be the sole designated beneficiary for a given distribution year, the spouse must be the sole beneficiary for the participant or owner's entire interest at all time during the applicable year.[[4]](#endnote-4) For lifetime distributions, the marital status of the IRA owner is determined on January 1 of each year. Divorce or death after that date is disregarded until the next year.[[5]](#endnote-5)

Post-death RMDs are computed in a similar way under a fixed-term method, rather than the annual recalculation method used during the IRA owner's life, unless the surviving spouse is the sole beneficiary of the IRA. (The method of calculating these RMDs is discussed below.)

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# Designated Beneficiaries

Overview

By designating an individual as a beneficiary of a qualified plan or an IRA, the plan participant or IRA owner effectively extends the payment of the RMDs over the beneficiary's lifetime. The distribution period varies depending on whether a qualified designated beneficiary has been named.

**Important Point.** In the case of a qualified plan, a married participant generally cannot name a beneficiary other than his spouse without the written permission of the other spouse. This may also apply with regard to a former spouse.

In general, the plan participant or IRA owner must actually designate an individual to be the beneficiary in order to qualify as a designated beneficiary. For post-death distributions, the beneficiary needs to have been designated as of the date of the participant or owner’s death, although actual determination of the designated beneficiary can occur as late as September 30 of the year after the year of death.

The plan trustee or IRA custodian typically provides forms for this purpose, as authorized by the terms of the plan or IRA agreement or annuity contract. However, if the plan or IRA agreement or annuity contract prescribes that a particular relative or other class of persons will be entitled to the account after the owner's death if no actual designation has been made by the owner (e.g., “in the event no beneficiary has been designated by the owner, the beneficiary shall be the spouse of the owner, if the owner is married”), that person can be a designated beneficiary.[[6]](#endnote-6)

If the following requirements are met, a trust will qualify as a designated beneficiary. When a trust is named as beneficiary, the individual or individuals who are beneficiaries under the terms of the trust will be treated as the designated beneficiaries, if the following four requirements are met:

* The trust must be valid under state law or would be valid except that it lacks a corpus (due to its not being yet funded);
* The trust must be irrevocable or will, by its terms, become irrevocable upon the death of the employee;
* The beneficiaries of the trust must be identifiable; and

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* A copy of certain documentation must be provided to the plan administrator.[[7]](#endnote-7)

In the case of individual accounts, the deadline for providing the beneficiary documentation is October 31 of the year following the year of the taxpayer's death.[[8]](#endnote-8)

Multiple Beneficiaries

If more than one individual has been designated beneficiary by the plan participant or IRA owner, the age of the beneficiary having the shortest life expectancy (i.e., the oldest beneficiary) must be used in determining each year's RMD.[[9]](#endnote-9) However, if separate accounts are maintained with respect to each beneficiary, each beneficiary's life expectancy can be used. The purpose of separate accounts with IRAs is to be able to calculate a separate RMD from each portion of the IRA and to pinpoint where the distribution is coming from so next year's required minimum distribution can be properly calculated.

*Example*: Pete died in 2007, naming his sister, Luann (age 58), and his two daughters, Andrea (age 37) and Amy (Age 35), as equal primary beneficiaries of his IRA. No separate accounts were set up by the beneficiaries and withdrawals are taken from a general account within the IRA. Under these facts, the RMD in the first year after death will be determined by reference to Luann's age in the year following the year of Pete's death (i.e., age 59 in 2008). The RMD factor from the RMD Single Life Table (see Appendix E) for age 59 is 26.1. Every year thereafter, the RMD factor will be reduced by one. This is shown as follows:

|  |  |  |
| --- | --- | --- |
| Year | Age (Luann) | RMD Factor |
| 2008 | 59 | 26.1 |
| 2009 | 60 | 25.1 |
| 2010 | 61 | 24.1 |
| 2011 | 62 | 23.1 |
| 2012 | 63 | 22.1 |

**Planning Point:** A contingent beneficiary is not considered to cause a multiple beneficiary situation for purposes of the rule requiring use of the oldest beneficiary’s life expectancy, unless the contingency is something other than the death of a prior beneficiary (for example, a contingent beneficiary in a trust).

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If separate accounts are established for different beneficiaries, then the separate accounts are not aggregated in determining whether distributions satisfy the RMD rules, but instead, the RMD rules apply separately to each separate account after the death of the IRA owner. In other words, each beneficiary can utilize his or her life expectancy in calculating RMDs rather than using the oldest beneficiary’s life expectancy. However, the applicable distribution period for each separate account is determined independently only if the separate accounts are established on or before December 31 of the year following the year of the IRA owner's death.

*Example*: Same facts as the previous example, except that separate accounts were established for Luann, Andrea, and Amy before December 31, 2008 (i.e., December 31 of the year following the year of Pete's death). In this situation, Luann, Andrea, and Amy would each determine their RMDs separately from each other in the first year by referencing their individual age in the year following the year of death (i.e., Andrea would use her age of 38 in 2008 and Amy would use her age of 36 in 2008). RMD factors from the RMD Single Life Table would be used. Every year thereafter, each beneficiary would reduce the RMD factor by one. This is shown as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Year | Age (Luann) | RMD Factor | Age (Andrea) | RMD Factor | Age (Amy) | RMD Factor |
| 2008 | 59 | 26.1 | 38 | 45.6 | 36 | 47.5 |
| 2009 | 60 | 25.1 | 39 | 44.6 | 37 | 46.5 |
| 2010 | 61 | 24.1 | 40 | 43.6 | 38 | 45.5 |
| 2011 | 62 | 23.1 | 41 | 42.6 | 39 | 44.5 |
| 2012 | 63 | 22.1 | 42 | 41.6 | 40 | 43.5 |

If the designated beneficiary is a class of beneficiaries that is capable of expansion or contraction, care must be taken to comply with the requirement that the beneficiaries must be identifiable by September 30 following the year of the plan participant or IRA owner's death. Beneficiaries in a class that is capable of expansion or contraction (e.g., "all my children") are considered identifiable if it is possible to identify the class member having the shortest life expectancy (i.e., the person who is oldest) by the September 30 date.

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The IRS has issued a number of private letter rulings stating that sub-trusts created pursuant to the terms of a trust do not constitute separate accounts for purposes of allowing each beneficiary to utilize their individual life expectancy.[[10]](#endnote-10) Generally, if separate accounts are properly established, the separate accounts are not aggregated in order to determine whether the distributions from such separate accounts satisfy the RMD requirements. Rather, the RMD rules apply separately to each separate account under the plan. If distributions are made to a trust, even if the trust is a see-through trust, the separate account rules are not available to the trust beneficiaries, and thus each beneficiary must receive the RMDs over the life expectancy of the oldest beneficiary.[[11]](#endnote-11) If, however, separate trust shares are named as separate beneficiaries in the beneficiary designation form and the trust creates separate shares, the trust beneficiaries may be able to utilize their individual life expectancies to calculate RMDs.[[12]](#endnote-12)

Disclaimer by Beneficiary

A beneficiary might wish to disclaim her interest as a beneficiary in a decedent’s qualified plan or IRA in order to pass wealth to another person, avoid income taxes, or for estate tax planning purposes. The most common example is a case where a plan participant or an IRA owner's surviving spouse may wish to disclaim all or a portion of the qualified plan or IRA to reduce the couple's overall estate tax. In this case, the disclaimed amount then passes to the contingent beneficiary.

*Example*: Jack died on November 10, 2007, naming his wife, Vicki, the primary beneficiary of his $1,500,000 IRA and his daughter, Lisa, as secondary beneficiary. For estate tax reasons, Vicki disclaimed her entire interest in Jack's IRA in June 2008. In this case, Lisa will inherit Jack's entire IRA and will take RMDs based on her life expectancy.

Under IRC Section 2518, in order to be a qualified disclaimer, it must meet the following requirements:

* The disclaimer must be in writing
* The disclaimer must be executed within 9 months after the decedent's death
* The person making the disclaimer must not accept any interest or receive any benefit in the property disclaimed
* The disclaimed interest passes without any direction on the part of the person making the disclaimer

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Provided the disclaimer is qualified, the beneficiary who makes the qualified disclaimer is not treated as making a gift and is not subject to income tax on the decedent's disclaimed qualified plan or IRA. Instead, the contingent beneficiary pays the income tax when distributions are made and is subject to the required minimum distribution rules.

*Example*: In 2007, John passed away, naming his wife, Delores, as primary beneficiary and his son, Jake, as contingent beneficiary of his $500,000 IRA. After seeking tax advice, Delores disclaimed her entire interest. In this case, Jake succeeds to Delores' interest in John's IRA and will withdraw RMDs from the IRA using Jake’s life expectancy.

An original beneficiary's disclaimer of a beneficial interest in a decedent's IRA is a qualified disclaimer (if all of the other requirements of that section are met) even though, prior to making the original disclaimer, the beneficiary receives the required minimum distribution for the year of the decedent's death from the IRA.[[13]](#endnote-13)

# Beneficiary Distribution

Surviving Spouse – No Rollover

If an IRA owner’s spouse inherits an IRA and keeps the IRA titled in the deceased IRA owner’s name, the spouse may defer required distributions until the year the owner would have reached age 70½. This would generally also apply to qualified plan benefits inherited by a spouse, unless the plan requires earlier distributions (e.g., immediate annuity distributions). [If the qualified plan permits rollovers, consider whether it might be better to hold the benefits in an IRA. See Chapter 14 regarding rollovers.] In that year, the RMD is calculated based upon the spouse's life expectancy by referencing her attained age for the year of distribution based on the RMD Single Life Table (see Appendix E). For each succeeding year, the surviving spouse references her age under the Single Life Table for that particular year.

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*Example*: Tony (born March 5, 1940) died in 2007, naming his wife, Sarah (born January 26, 1950), the primary beneficiary of his IRA and his son, Jim (born February 1, 1970), as secondary beneficiary. In this example, Sarah would not have to begin taking RMDs from Tony's IRA until the year in which he would have been age 70½ (i.e., 2010). In 2010, Sarah's RMD factor for the first distribution would be 25.2 (i.e., the RMD factor for a 60-year-old beneficiary using the Single Life Table). Each year going forward, Sarah would re-determine her RMD factor for the current year by reference to her age using the Single Life Table. This is shown as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Tony’s “Ghost” Age | Sarah’s Age | RMD Factor (Sarah) |
| 2007 | 67 | 57 | - |
| 2008 | 68 | 58 | - |
| 2009 | 69 | 59 | - |
| 2010 | 70 | 60 | 25.2 |
| 2011 | 71 | 61 | 24.4 |
| 2012 | 72 | 62 | 23.5 |

Upon the death of the surviving spouse, the RMD rules provide two different rules, depending on when the surviving spouse dies. If the surviving spouse dies on or after the date on in which the owner would have reached age 70½, an RMD for the current year must be taken. Thereafter, RMDs are calculated based upon the now deceased spouse's life expectancy by reference to her attained age in the year of death by reference to the Single Life Table. For each succeeding year, the factor is reduced by one.

*Example*: Same facts as the previous example, except that Sarah dies in 2025 when she is age 75. In this case, the RMD factor of 13.4 for 2025 will be determined by reference to Sarah's age in the year of death. Every year after the year of death, the RMD factor for Sarah’s beneficiary will be reduced by one (i.e., 12.4 in 2026, 11.4 in 2027, etc).

If the surviving spouse dies prior to the year in which the owner would have reached age 70½, the spouse is deemed to be the owner/participant and the spouse’s beneficiary is determined based on the beneficiaries designated by the spouse as of the spouse’s date of death who remains beneficiaries as of September 30 of the year following the year of death.[[14]](#endnote-14) In the following year, such beneficiary must begin to

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receive RMDs based upon his corresponding life expectancy under the RMD Single Life Table (see Appendix E). For each succeeding year, the factor is reduced by one.

*Example*: Same facts as above, except that Sarah dies in 2008 at the age of 58. Sarah names Jim as beneficiary. Because Sarah died prior to the year in which Tony would have been 70½ (2010), Sarah is now treated as the owner of Tony's IRA and the IRA will pass to Jim (Sarah’s beneficiary). As a result, in the year following the year of Sarah's death (2009), Jim will begin receiving RMDs based on his age (39). Every year thereafter, the original RMD factor from the Single Life Table (44.6) will be reduced by one. This is shown as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Year | Tony’s “Ghost” Age | Sarah’s “Ghost” Age | Jim’s Age | RMD Factor (Jim) |
| 2007 | 67 | 57 | 37 | - |
| 2008 | 68 | 58 | 38 | - |
| 2009 | 69 | 59 | 39 | 44.6 |
| 2010 | 70 | 60 | 40 | 43.6 |
| 2011 | 71 | 61 | 41 | 42.6 |
| 2012 | 72 | 62 | 42 | 41.6 |

Surviving Spouse – Rollover

As an alternative to retaining the IRA in the decedent owner's name, the surviving spouse may roll over all or part of the decedent's IRA into her own IRA. It also may be possible for a surviving spouse to roll over all or part of a qualified plan into her own IRA. (See Chapter 14 regarding rollovers.) In this situation, the RMDs begin the year the surviving spouse reaches age 70½. If the spouse is already age 70½, RMDs begin by December 31 of the year following the rollover. For successive tax years, the RMDs are based upon the surviving spouse's life expectancy factor determined under the RMD Uniform Lifetime Table (see Appendix E).

*Example*: In 2007, Pauline (born July 23, 1941) died, naming her husband, Frank (born February 19, 1944), as primary beneficiary of her IRA. On June 1, 2008, Frank rolled over Pauline's IRA into his own IRA. Under these facts, Frank will not have to begin receiving RMDs from the IRA until April 1 of the year following the year in which he turns 70½ (i.e., April 1, 2015).

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Nonspouse Beneficiary

The first year distribution (year after the year of the IRA owner's death) is determined based upon the corresponding life expectancy factor for the nonspouse beneficiary's age in the year of the first distribution by reference to the Single Life Table (see Appendix E). For succeeding years, this factor is reduced by one.

*Example*: Louise (age 60) died in 2007 naming her son, Nick (age 33), as primary beneficiary of her IRA. For 2008, Nick will need to take a RMD from his mother's IRA. In this case, Nick's RMD factor of 49.4 during 2008 will be based on his age in that year (34) by reference to the Single Life Table. Every year thereafter, the RMD factor will be reduced by one. This is shown as follows:

|  |  |  |
| --- | --- | --- |
| Year | Nick’s Age | RMD Factor (Nick) |
| 2007 | 33 | - |
| 2008 | 34 | 49.4 |
| 2009 | 35 | 48.4 |
| 2010 | 36 | 47.4 |
| 2011 | 37 | 46.4 |

Multiple Individual Beneficiaries

As long as the IRA is divided prior to December 31 of the year following the year of the IRA owner's death, each beneficiary may independently calculate her RMDs. Thus, with respect to each beneficiary, the first year distribution (year after the year of death) is determined based upon the corresponding life expectancy factor for the beneficiary's age in the year of the first distribution by reference to the Single Life Table (see Appendix E). For succeeding years, this factor is reduced by one.

Designated Beneficiary Trust

The first year distribution (i.e., the year after the year of death) is determined based upon the corresponding life expectancy factor for the oldest beneficiary's age in the year of the first distribution by reference to the Single Life Table (see Appendix E). For succeeding years, this factor is reduced by one. If the trust is designed to create one pot for the benefit of multiple beneficiaries, RMDs are based upon the oldest beneficiary's life expectancy.

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However, if the Beneficiary Designation is payable to separate sub-trusts, each separate sub-trust beneficiary may be able to use their respective life expectancies to calculate RMDs. In this situation, consider getting a private letter ruling if separate share treatment is desired.

# Death of the Participant or Owner – Special Rules

Death Prior to the RBD

If the plan participant or IRA owner dies prior to his RBD and does not designate a beneficiary or the beneficiary does not meet the designated beneficiary requirements, the RMD rules require that the account be paid out in full by December 31 of the calendar year containing the fifth anniversary of the taxpayer's death.[[15]](#endnote-15) This is known as the five-year rule.

*Example*: On October 18, 2007, Andrew (age 67) died, naming his estate the primary beneficiary of his IRA. Because the estate is not a qualified designated beneficiary and Andrew died prior to his RBD, the entire balance of the IRA will need to be distributed by December 31, 2012 (i.e., December 31 of the fifth year after the year of Andrew's death).

Death On or After the RBD

If the plan participant or IRA owner dies on or after his RBD and no beneficiary is named or the beneficiary does not qualify as a designated beneficiary, the post-death RMDs are determined by reference to the Single Life Table (see Appendix E) using the participant or owner's age in the year of death. For subsequent distributions beginning in the year after the participant or owner's death, the applicable divisor is determined using that life expectancy reduced by one for each subsequent year (the fixed-term method). The participant or owner’s RMD factor determined in this fashion may also generally be used if the factor is lower than the factor for the beneficiary (other than a spouse who elects to treat the plan or IRA as her own). The RMD for the year of death must be taken based on the decedent’s age in the year of death based on the Uniform Lifetime Table (if not already taken by the decedent during her lifetime).

*Example*: Same facts as the previous example, except that Andrew was age 73 and that he had taken his RMD for 2007 before he died. Under these facts, the RMD factor of 13.8 for 2008 was determined by referencing the RMD factor for Andrew's age in the year of death using the Single Life Table (i.e. 14.8) and reducing that factor by one. Going forward, this factor will continue to be reduced by one (i.e. 12.8 in 2009, 11.8 in 2010, etc).

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Post-Death IRA Rollovers - Non-Spouse Beneficiaries

If a qualified nonspouse beneficiary is named, the tax law permits a nonspouse beneficiary to roll over all or a portion of the decedent's IRA into an inherited IRA. However, care must be taken to ensure that the new inherited IRA is set up in the name of the decedent IRA owner, with the beneficiary being identified in the account title (e.g., “Jeff Smith, deceased, IRA f/b/o Peter Smith”). In this case, the first year RMD for the nonspouse beneficiary will be calculated by reference to the RMD Single Life Table (see Appendix E) using the beneficiary's age in the calendar year immediately following the IRA owner's death. In subsequent calendar years, this RMD factor is reduced by one year for each year following the IRA owner's death.

Prior to PPA 2006, nonspouse beneficiaries of qualified plan benefits were not able to roll over inherited amounts to an IRA. Instead, they had to leave the amounts in the qualified plan or take a taxable distribution. As a result, they were bound by the payout provisions of the plan document.

PPA 2006 added a provision that allows nonspouse beneficiaries of qualified plan benefits to roll over inherited amounts to an IRA after 2006.[[16]](#endnote-16) The rollover to an IRA must be done through a trustee-to-trustee transfer to the IRA which must be set up as an inherited IRA. The RMD rules are applied accordingly to the inherited IRA. A plan is not required to offer a direct rollover of a distribution to a nonspouse beneficiary.

If the applicable payout under the qualified plan was for distributions over the beneficiary’s life expectancy and a rollover is made from the plan to an IRA, distributions from the IRA can be made using the beneficiary’s life expectancy. If the applicable payout under the qualified plan was the five-year rule and a rollover is made from the plan to an IRA, distributions from the IRA can be made using the beneficiary’s life expectancy only if the rollover occurs and the life expectancy payments start prior to the end of the year following the year of death. The amount that can be rolled over is reduced by any prior or current year RMDs.[[17]](#endnote-17)

Therefore, not all nonspouse beneficiaries can take advantage of this new rollover rule to stretch payments. However, beneficiaries who inherit a qualified plan no longer have to simply accept an unfavorable plan provision (i.e., the five year rule). Instead, assuming the plan allows it, rolling the plan into an inherited IRA by the end of the year following the year of death in order to start utilizing the life expectancy method should be an option that is seriously considered.

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Plan or IRA Agreement Provisions

A qualified plan or an IRA agreement may specify which method will apply to distributions after a plan participant or IRA owner's death. In the alternative, a plan or IRA agreement may expressly allow the participant or the owner or the beneficiary to elect, individually, whether to apply the five-year rule or one of the statutory exceptions. If so, such an election must be irrevocable and must be made by the earlier of the date that distributions must begin under the five-year rule or the date that distributions must begin under the requirements for the life expectancy rule.

The tax law provides that a qualified plan trustee or an IRA custodian may adopt a provision stating either (a) that the five-year rule will apply to certain distributions after the death of the participant or owner, even if the participant or owner has a designated beneficiary, or (b) that distribution in every case will be made according to the five-year rule.

Also, the plan trustee or IRA custodian may adopt a provision that permits the participant or owner (or beneficiaries) to elect on an individual basis whether the five-year rule or the life expectancy rule applies to distributions after the death of the participant or owner (who has a designated beneficiary). The plan or IRA should specify the method of distribution that applies if an election is not made; the default election will be the life expectancy rule.

1. IRC Sec. 401(a)(9). [↑](#endnote-ref-1)
2. IRC Sec. 4974. [↑](#endnote-ref-2)
3. Treas. Reg. §1.401(a)(9)-5, A-4. [↑](#endnote-ref-3)
4. Treas. Reg. §1.401(a)(9)-5, A-4(b)(1). [↑](#endnote-ref-4)
5. Treas. Reg. §1.401(a)(9)-5, A-4(b)(2). [↑](#endnote-ref-5)
6. Treas. Reg. §1.401(a)(9)-4, A-1. [↑](#endnote-ref-6)
7. Treas. Reg. §1.401(a)(9)-4, A-5. [↑](#endnote-ref-7)
8. Treas. Reg. §1.401(a)(9)-4, A-6(b). [↑](#endnote-ref-8)
9. Treas. Reg. §1.401(a)(9)-5, A-7. [↑](#endnote-ref-9)
10. Let Ruls. 200317041, 200317043, 200317044. [↑](#endnote-ref-10)
11. Let. Ruls. 200410019 to 200410021, 199903050. [↑](#endnote-ref-11)
12. Let. Rul. 200537044. [↑](#endnote-ref-12)
13. Rev. Rul. 2005-36, 2005-26 IRB 1368. [↑](#endnote-ref-13)
14. Treas. Reg. §1.401(a)(9)-4, A-4. [↑](#endnote-ref-14)
15. IRC Secs. 401(a)(9)(B)(ii), 401(a)(9)(B)(iii); Treas. Reg. §1.401(a)(9)-3, A-1. [↑](#endnote-ref-15)
16. IRC Sec. 402(c)(11). [↑](#endnote-ref-16)
17. Notice 2007-7, 2007-5 IRB 395. [↑](#endnote-ref-17)