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IRA LAWS & YOU

A Newsletter for IRA Owners, Beneficiaries and Professionals Who Advise on IRA Planning.

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NEW IRA RULES PROVIDE AMNESTY FOR MANY CATASTROPHIC TAX TRAPS

(Taxpayers finally reap rewards as the IRS continues the gift giving into the New Year!)

OVERVIEW

At last the IRS has issued Proposed Regulations for IRAs and qualified plans, effective January 1, 2002, which will render considerable tax savings to taxpayers who may have failed to make important, previously irrevocable decisions regarding their IRAs. These new rules impact the required distribution laws that have created controversy and ambiguity over the years. Many professionals have refused to advise clients on IRAs because of the complexities inherent in these rules.

In our future editions of this newsletter, we will discuss how the changes in these new Proposed Regulations can affect IRA owners and beneficiaries. Although effective next January 1st, 2002, IRA owners are permitted and may rely on these proposed rules retroactively to January 1st , 2001 for 2001 distributions. The White House issued a 60-day moratorium on January 24th in the Federal Registry so that Bush could determine the ramifications of the retroactive application.

UNIFORM DISTRIBUTION PERIOD (UDP) TABLE

OLD RULE: Multiple Tables (Joint and Survivor, Single, MDIB)

CHANGE IN RULES:

You may now use the Uniform Distribution Period (UDP) Table to determine your life expectancy, if your beneficiary is the following:

1. **A non-spouse beneficiary;**
2. **A spouse who is less than ten (10) years younger than you, the owner.**

If your spouse is more than ten (10) years younger, it would be more beneficial to continue to use the Joint and Survivor Tables for *minimum* distributions. The former MDIB Table is now the UDP Table of which a significant portion is set out below.

The advantage of this table is that it adds years to your life expectancy. This fact allows the IRA owner to withdraw less IRA annually, which lessens the tax burden and allows more appreciation in the IRA funds. If we check the Single Life Table for the life expectancy of a 70 year-old we determine sixteen (16) years. However, a 70 year-old under the UDP Table has 26.2 years of life expectancy. We have gained 10.2 years of life expectancy under the new rules. Don't you just love those IRS people? What are they up to now? O.K., we've got an IRA owner-friendly table, what other gifts did the IRS bring us?

UDP TABLE

IRA Owner Age	Divisor	IRA Owner Age	Divisor	IRA Owner Age	Divisor
70	26.2	77	20.1	84	14.5
71	25.3	78	19.2	85	13.8
72	24.4	79	18.4	86	13.1
73	23.5	80	17.6	87	12.4
74	22.7	81	16.8	88	11.8
75	21.8	82	16.0	89	11.1
76	20.9	83	15.3	90	10.5

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BENEFICIARY DESIGNATIONS

OLD RULE: Required by RBD

If you forgot to designate a beneficiary by your Required Beginning Date (RBD), (April 1st the year after you turn 70 1/2), or you previously named your living trust as beneficiary, help has arrived. These catastrophic mistakes could have cost you a bundle but it's now all okay. Why? Because Santa IRS has given you the opportunity to change your beneficiary without affecting your distributions. In fact, under the new rules the beneficiary doesn't have to be determined until the end of the year following the year of the IRA owner's death. What? That's right. It would be nice and prudent if you designate a beneficiary as soon as possible but you need not do it by the RBD. Under our former rules, a beneficiary's age is important in determining life expectancy for distributions. For instance, if you designate your brother who is age 65 when you turn 70 1/2, your life expectancy under the Joint and Survivor Tables is 23.1 years. We would need to know the age of the beneficiary to determine this number for the Minimum Required Distribution (MRD).

CHANGE IN RULES:

Under the new rules, we don't need to have a beneficiary's age to determine our life expectancy. A 70 year-old would check the MDIB Tables and see 26.2 years. This number is then divided into the IRA account balance as of December 31st of the prior year. Just like that, we have our MRD for this year. For that reason, we do not need to designate a beneficiary for IRA *distribution* purposes. However, we do need a beneficiary to determine life expectancy during the period after an owner's death. That leads us to the new date of death rules.

DEATH OF OWNER

OLD RULE: Five Year Rule

Under our former rules, if an IRA owner died prior to the RBD, the Five Year Rule normally came into play for a non-spouse beneficiary. If not affirmatively elected out of this rule, the non-spouse beneficiary must withdraw the entire IRA within five (5) years. If, however, an election out is accomplished, the beneficiary can withdraw the IRA fund over his/her life expectancy. If the IRA owner dies after the RBD, the non-spouse beneficiary can normally take distribution over his/her lifetime depending on how distributions were being taken during the life of the IRA owner. The Five Year Rule does not apply if the owner dies after the RBD.

CHANGE IN RULES:

The Five Year Rule is no longer applied unless the IRA owner dies prior to the RBD *and* the beneficiary formally elects to take distribution under this rule. Otherwise, the IRA will be distributed over the life expectancy of the beneficiary. Thus, the burden of electing out of the Five Year Rule has been abandoned by a kinder, gentler IRS.

Example: Jed dies at age 65 leaving IRA funds to his nephew, Jethro. Jethro may begin taking distribution by December 31st of the year following the year of death based on his actual life expectancy without notifying the IRA Custodian of an election out of the Five Year Rule.

q&a Section

QUESTION: **I have heard that if my estate pays federal estate tax, a portion can be subsequently deducted from income tax owed by my IRA beneficiary. Is there such a deduction and how does it work?**

JEFF GIBSON, ROCKPORT, TX

ANSWER: *The deduction is allowed under IRC Sec. 691(c) if an IRA or other retirement funds are includable in your estate which incurs federal estate tax. A percentage of every subsequent distribution is entitled to an income tax deduction based on the value of the IRA and the amount of federal estate tax assessed. For example, if the IRA is valued at $600,000 and the federal estate tax attributable to the IRA was $240,000, 40% of the federal estate tax is applied to the IRA ($240,000 / $600,000 = 40%). The estate tax deduction would be equal to approximately 40% of every distribution limited to a maximum of $240,000.*

IRA Alert

If your non-owner spouse died in the year 2000 and you were recalculating both life expectancies, the new laws offer you a window of opportunity for distribution purposes. You may now elect out of Recalculation and base your distributions on the UDP Table. Additionally, you are free to change your IRA beneficiaries without impacting your Minimum Required Distributions (MRD).

Avoid The Following IRA Tax Trap

ROTH IRA DISTRIBUTIONS TO BENEFICIARIES

Remember Roth distributions are required to be withdrawn by the non-spouse beneficiary after the death of the IRA owner. If you are a non-spouse beneficiary you must begin such distributions by December 31st of the year following the year of the owner's death. Although no tax may be required if the distribution is qualified, a 50% penalty may apply if you fail to take the required distributions.

MULTIPLE BENEFICIARIES

OLD RULE: "Shortest Life Expectancy" Rule

What happens if there are multiple beneficiaries? Which life expectancy must we utilize for distribution? Under our former rules, the age of the oldest beneficiary was required to be utilized, otherwise known as the "shortest life expectancy" rule.

CHANGE IN RULES:

Under the new rules, if the beneficiaries have separate accounts or shares by the end of the year following the year of death of the owner, each beneficiary may utilize their individual life expectancy for distribution purposes.

AFTER DEATH DETERMINATION OF BENEFICIARY

OLD RULE: Beneficiary determined by RBD

The new law provides that an IRA beneficiary may be determined after the death of an IRA owner. What circumstances might exist for this to make sense?

DISCLAIMER

The law provides that an IRA beneficiary may disclaim (reject) IRA proceeds which will cause a re-determination of the IRA beneficiary.

Example: Archie names his wife, Edith, as his primary IRA beneficiary and designates their daughter, Gloria, as the contingent beneficiary. Archie hits the lottery before his death and leaves Edith a bundle. Since the IRA will only increase her estate for federal estate tax, Edith disclaims the IRA funds. Under most laws a disclaimer treats the person disclaiming as predeceasing the IRA owner, thus, Gloria receives the IRA proceeds as the contingent beneficiary based on her individual life expectancy. Since the disclaimer may be exercised up to nine (9) months after the owner's death, we may not determine the IRA beneficiary for a significant time after the occurrence.

CASHED-OUT BENEFICIARY

If one beneficiary cashes out his/her share, the remaining beneficiary can take distributions based on his/her own life expectancy.

Example: Ozzie, who dies in 2001, leaves his $400,000 IRA in two equal shares to his son, Ricky and the Presbyterian Church. The church takes its share in a lump sum during March of 2002. Ricky, age 50, opts to take distributions over his life expectancy of 33.1 years. As of the end of

recent rulings

MULTIPLE BENEFICIARIES - SEPARATE ACCOUNT TREATMENT PLR2000-52042: DEATH *AFTER* RBD

The IRS allowed each non-spouse IRA beneficiary to use his/her own life expectancy for calculating required distributions on their respective share of the inherited IRA. Previously, the IRS had ruled that the life expectancy of the oldest child must be utilized when the owner dies after the Required Beginning Date (RBD). Also, in previous rulings allowing for separate share treatment, the owner had to die *before* the RBD.

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2002, Ricky is the only present beneficiary of the IRA since the church withdrew its share earlier.

TREATMENT OF TRUSTS

The Proposed Regulations of 1987 were amended in 1997 regarding trusts as beneficiaries. A set of requirements were adopted in order that trusts could qualify the trust beneficiaries as designated beneficiaries of IRAs. If the trust was not properly qualified, the trust beneficiaries could not attain the status as a designated beneficiary (DB) and there could be no additional life expectancy for distribution purposes. As part of the qualification, the former rules require the trust documentation be sent to the IRA Trustee/Custodian during the life of the IRA owner to document the trust beneficiaries and their individual interests in the IRA.

CHANGE IN RULES:

Since the new Proposed Regulations do not require a beneficiary to be determined for *distribution* purposes, the lifetime requirement for trust documentation has been deleted. For this reason, the only requirement remaining for documenting the trust beneficiaries and their interests is by the end of the year following the year of death of the IRA owner.

IRA *Alert*

Although the new Proposed Regulations have provided some favorable changes in the distribtuion rules, there are other areas of the IRA laws that remain unchanged to this date. Penalties for early or less than required withdrawals are still in place. Additionally, under the new Proposed Regulations, the institution acting as Custodian/Trustee of the IRA must report the amount of MRD to the owner or beneficiary and the IRS. It is anticipated that this requirement will result in more IRS penalty assessments.

METHODS OF DISTRIBUTION

OLD RULE: To Recalculate or Not To Recalculate?

This is a question of the past because it really makes no difference now unless you are designating a spouse more than ten (10) years younger. But for the vast majority of IRA owners this decision is now meaningless. Why? Because Recalculation is no longer needed to withdraw an amount annually which is less than a Non-Recalculating distribution commonly known as Term Certain. Under our former rules, Recalculation allows for less withdrawal because our life expectancy is being reduced by less than 1 year annually. Term Certain, or the One Year Reduction Method, provides that we reduce our life expectancy by 1 full year annually. Thus, under Term Certain, more IRA is being distributed faster.

Example: Archie, age 77, and Edith, age 72, are in the eighth year of recalculating their joint lives and determine that they have 17.2 years of life expectancy remaining under the Joint and Survivor Tables. Desi and Lucy, who are the same ages as Archie and Edith, are taking distribution based on Term Certain. They determine they have 16.1 years of life expectancy remaining. Archie and Edith have more than a year remaining of life expectancy because of Recalculation.

CHANGE IN RULES:

The life expectancy of a 77 year-old under the UDP Table with the 10 years added amounts to 20.1. For this reason a decision to recalculate is not necessary because of the life expectancy advantage allowed by the new rules. However, if your spouse is more than 10 years younger, you will realize more life expectancy by recalculating under the Joint Life Tables. For instance, if you are age 77 and your spouse is age 66, you have a life expectancy of 20.7 years under the Joint and Survivor Tables. The life expectancy is greater as the disparity in age increases.

Author & Editor
Jack E. Stephens, J.D., LL.M.
12520 High Bluff Drive,
Suite 150
San Diego, CA 92130
TEL: (858) 481-5254
FAX: (858) 481-8802
www.jackstephens.com
jack@jackstephens.com

Jack Stephens, a practicing attorney in San Diego, California, is the author of the book Avoiding he Tax Traps in Your IRA, which was endorsed by Kiplinger's Retirement Report. He has also been a contributing writer to How To Draft Wills and Trusts in California; Estate Planning for the Terminally Ill; and California Elder Law. Mr. Stephens taught Estate Planning at the University of California, La Jolla campus (U.C.S.D.). He obtained a Juris Doctorate degree from the Baylor School of Law and a Masters of Law (LL.M.) degree in Taxation from the University of San Diego Graduate Law School.

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Next Issue: Estate Planning Opportunities Under The New Rules