

LOS ANGELES

Daily Journal

— SINCE 1888 —

FRIDAY,
MAY 25, 2001
VOL. 114 NO. 102

Extended Payout

IRS Eases Rules for Retirement-Account Distributions

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Everyone who has an individual retirement account is required to follow the Internal Revenue Service rules in taking money out of that account. While the IRS usually is eager to get taxes due from IRAs, most taxpayers want to defer their IRA payout as long as possible so they can minimize their tax obligations. They also would like to allow their beneficiaries after their death to defer payouts as long as possible.

Although account owners usually can begin withdrawing funds at age 59½ without penalty, they don't have to. But the IRS requires that account owners start distributions once they reach age 70½. It also has rules that determine how and when the account is paid to a beneficiary if the account owner dies before all the money is taken out.

In the past, the intricacies of these rules often perplexed both account owners and their advisors. In January, the IRS made these rules less complex. IRS Regulation 130477. But although the rules have been simplified, they are not simple. So most people still will need a tax or financial advisor to understand the new rules.

■ **New uniform distribution schedule.** Under the new rules, the required minimum distribution from the retirement account for anyone 70½ or older is calculated, in most cases, using one standardized distribution table based on the person's life expectancy. Most people will take smaller distributions than the old rules required. For example, the first required payout at age 70½ equals about 3.8 percent of the total account balance. The required payout at age 80 is about 5.7 percent of the total account balance.

This standardized distribution table applies unless the sole beneficiary is a spouse who is more than 10 years younger than the account owner. In that case, the spouse's true life expectancy is factored in, and even smaller required distributions may be made.

■ **Extended payout period for beneficiaries.** The new rules now protect beneficiaries from being forced to take out the entire balance in the year after the death of the account owner. Imagine that the

account owner dies before he had to take any money out of the account. If the designated beneficiary is the spouse, she has the option of rolling over the IRA into her own IRA. If she can't or doesn't want to do that, she can start taking money out of the IRA based on her own life expectancy beginning the year following the death of the account owner.

If the designated beneficiary is a son, he cannot roll over the account into his own IRA. He can, however, take distributions based on his own life expectancy beginning the year after the account owner died.

But what if distributions have begun? Again, if the spouse is the designated beneficiary, she can have the remaining funds transferred into her own IRA if eligible or continue the distributions based on her own life expectancy. If the designated beneficiary is not a spouse, he must continue the distributions. But he can have them based on his own life expectancy instead of the life expectancy of the original account owner.

If there is no designated beneficiary and disbursements have not begun, then the entire amount must be disbursed within five years to the account owner's heirs.

But what if disbursements have begun and there is no designated beneficiary? Then the remaining amount can be disbursed to the owner's heirs based on how long he would have lived according to the IRS' life-expectancy table. Previously, in such situations, the entire balance sometimes had to be paid by the end of the next year.

The new rules also solve the problem of an accelerated payout if the spouse is the primary beneficiary and he or she predeceases the account owner. Under the old rules, the entire account was sometimes due the year after the account owner died. Under the new rules, regardless of the order of death, the remaining balance can be paid out over a period based on the account owner's life expectancy or the life expectancy of the remaining beneficiaries.

So with proper planning, distributions from a retirement account can last a long time. For example, if a beneficiary is a young child, he can have distributions made on his own life expectancy, which can be a dependable income source. Distributions also can be spread over the lifespans of children and grandchildren if the designation of beneficiaries is properly constructed.

■ **Picking a beneficiary.** The new rules stipulate that by the last day of the calendar year following the year of the account owner's death, one or more beneficiaries must be designated. If the account owner dies in 2002, for example, the designated beneficiaries must be determined by Dec.

31, 2003. Under the old rules, the designated beneficiaries were determined at the time of the account owner's death or, if the owner survived until age 70½, the time when required distributions must begin.

Previously, payouts to heirs were based on the designated beneficiary with the shortest life expectancy. But the new rules allow post-death planning to make sure each beneficiary gets the maximum payout period possible.

What if the account owner, for example, gave 25 percent of an IRA to his same-age spouse and 25 percent to each of their three children? Under the old procedure, the payout period to each beneficiary was based on the life expectancy of the spouse. Under the new rules, the IRA can be subdivided into four separate accounts by the end of the calendar year following the year of the owner's death. Each child then takes his share during his own life expectancy. This will be a much longer period than before.

Here's another example. Assume 20 percent of an IRA went to charity and 80 percent went to the account owner's son. For payout purposes, charities are not considered designated beneficiaries because they do not have life expectancies.

Under the old rules, both the charity and the son had to take everything out immediately. The new rules allow the IRA to be split up and paid to the son and to the charity at different times. The charity can receive its amount before the end of the year after the year of the owner's death. The son can use his own life expectancy for post-death minimum-distribution calculation purposes.

■ **New reporting rules.** When the account owner turns 70½, the custodian of his IRA must report to both him and the IRS the amount of the required distribution for that year. The IRS is receiving comments this year regarding the form and method to facilitate this reporting. There was no such reporting requirement before.

■ **Distributions this year.** The new rules begin Jan. 1, 2002. For distributions in 2001, account owners can use either the old rules or the new ones. As a result, owners who must receive a payout from their retirement accounts in 2001 should get some good advice before taking that distribution. In many situations, it would be advantageous for account owners to use the new distribution rules.

Almost everyone should welcome the new account distribution rules. The extended payout periods allow account owners and their beneficiaries to better allocate these retirement resources.

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