2001 IRA DISTRIBUTION PLANNING
USC INSTITUTE ON FEDERAL TAXATION

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I. Scope of Presentation

A. This presentation will focus on distributions from regular Individual Retirement Accounts with substantial balances.
B. We will not discuss distributions from Roth IRAs or Education IRAs; but this presentation will cover distributions from ordinary deductible IRAs, rollover IRAs and spousal rollover IRAs. Notwithstanding this, the cases studies will consider the economics of converting a regular IRA to a Roth IRA.
C. We will not discuss distributions from qualified retirement plans, such as 401(k) plans, Keogh plans, Defined Benefit Pension Plans, Defined Contribution Pension Plans (such as Money Purchase Pension Plans and Profit Sharing Plans), 403(b) annuity plans, or other comparable plans. While many of the issues are identical to both IRA distributions and distributions from qualified retirement plans, there are some significant differences, including the effect of the Retirement Equity Act, the decision in *Boggs* affecting community property interests of a non-participant spouse, and the fact that certain rank and file employees may defer commencement of benefits until they actually retire instead of at age 70-1/2.

D. On January 12, 2001, the Service announced that it will issue today, January 17, 2001, revised Proposed Regulations on Section 401(a)(9), governing distributions from IRAs, qualified plans, Section 403(b) annuities, and Section 457 plans. These rules massively overhaul the rules governing minimum distributions from these plans, effective for 2002 and optionally available for 2001. These new proposed regulations are incorporated in the text of the outline and referred to as "New Prop. Reg.", while the proposed regulations issued in 1987 governing section 401(a)(9) are referred to as "Old Prop. Reg."

II. Description of the New Prop. Regs.

A. While the new Proposed Regulations are discussed in place below, given the likely strong interest in these Regulations, the following is a brief summary of their provisions.

B. The New Prop. Regs. must be used to calculated minimum distributions for distributions for calendar years beginning on or after January 1, 2002. However, for distributions for the 2001 calendar year, IRA owners are permitted to use either the Old Prop. Reg. rules or the New Prop. Reg. rules. Qualified Plan sponsors have been provided with a model amendment, contained in the preamble to the Proposed Regulations, which, if adopted as part of a plan qualification submission, will not require a further qualification submission after final regulations are adopted. IRAs should not be amended to comply with the new rules until after the final regulations are adopted.

C. After a participant attains his or her Required Beginning Date, during the participant's lifetime, distributions must be made on the basis of either (1) if the participant's spouse is the sole beneficiary and the spouse is more than 10 years younger than the participant, based on the joint life expectancies of the participant and the spouse, or (2) in any other case, a uniform table, which is based on the current MDIB table with the participant recalculating life expectancy. (Despite changes in mortality since 1987, no change was made in the mortality tables.) This rule applies even if the participant does not have a Designated Beneficiary. It thus eliminates the need to (1) determine a beneficiary by the Required Beginning Date ("RBD"), (2) decide on whether to recalculate life expectancies, and (3) satisfy the MDIB rules if the Designated Beneficiary is more than 10 years younger than the participant.

D. With respect to post-death distributions, the Designated Beneficiary is not determined until the end of the year following the year of death. Thus, post death actions, such as partial distributions made before that date, and disclaimers, will be taken into account in determining if the participant has a Designated Beneficiary after death. The rules regarding separate shares, or using the oldest beneficiary where there are multiple beneficiaries, remain in place.

E. If there is no Designated Beneficiary at the end of the year following the year of the participant's death, then distributions can still come out over the balance of the participant's life expectancy (determined for the year of death) on a non-recalculated basis.

F. Testamentary trusts work in the same manner as living trusts; but the prior problems that we understood to exist where a trust is a beneficiary (such as where a charity is a contingent beneficiary) are confirmed to still be a problem.

G. The administrator of a qualified plan or custodian or trustee of an IRA must report to the IRS the amount of the minimum distribution required to be made. However, if the participant maintains more than one IRA, the distribution can still be made from any IRA. In many cases, this won't be a problem, but you can expect that problems will arise where (1) the participant's spouse is more than 10 years younger than the participant (since the IRA custodian will undoubtedly report using the default rule), or (2) a payment

is to be made to a trust, since the IRA custodian will now demand to review the trust and closely scrutinize its provisions.

III. Deferral Makes Sense in Almost All Cases.

A. Distributions from IRAs are subject to federal and state income taxes, and the remaining balance in the IRA is subject to estate taxes on the participant's death. Of course, in some cases, these taxes may not actually be payable. For example, the participant may have losses or deductions which could offset (in whole or in part) the taxable income, such as net operating losses or charitable deduction carryovers, that otherwise would not be used. Similarly, the participant may not be subject to estate taxes on the IRA because the estate is too small, or it is being left to the spouse or to charity.

B. In the worst situations (such as with an estate subject to the 5% surtax, bringing the top estate tax marginal rate to 60%, or where the distributions are subject to generation skipping transfer tax as well as estate tax), the combined tax rates may exceed 88%. For high bracket estates and beneficiaries, the tax calculations might look like this (California rates and rules):

Current IRA balance		2,000,000
Federal income tax rate		39.6%
State income tax rate		9.3%
Federal estate tax rate		55.0%
State "pick up" tax rate		16.0%
Taxable estate (Including IRA)	25,000,000	
IRA balance		2,000,000
State income tax rate		9.3%
State income tax		186,000.00
IRA balance		2,000,000
Marginal state "pick up" tax rate		16.0%
State "pick up" tax		320,000
IRA balance		2,000,000
Estate tax rate		55.0%
Gross federal estate tax		1,100,000
Less: State "pick up" tax		(320,000)
Federal estate tax		780,000
IRA balance		2,000,000
Less: State income tax		(186,000)

Less: Federal estate tax	(780,000)	
Net taxable amount	1,034,000	
Federal income tax rate	39.6%	
Federal income tax	409,464	
State income tax	186,000	9.30%
State "pick up" tax	320,000	16.00%
Federal estate tax	780,000	39.00%
Federal income tax	409,464	20.47%
Total taxes	1,695,464	84.77%

C. Thus, some people have questioned the desirability of deferring taxes by minimizing IRA withdrawals, and have suggested that it may make more sense to withdraw the funds and pay taxes.

D. Except for a few rare cases where the opportunity for deferral is very limited, it makes economic sense to defer paying income taxes on funds in an IRA and to continue to allow the funds to build on a tax deferred basis, by limiting the amount withdrawn for as long as possible.

E. Cases where it might make sense to accelerate the withdrawal of funds include (a) where the participant is subject to the alternative minimum tax and can use the income to offset otherwise unusable deductions, (b) where the participant has a net operating loss which would otherwise be unused, (c) where the participant does not have enough income to fully utilize his or her lowest income tax brackets, or (d) where there is no other source of cash to fund other tax planning strategies, such as making gift tax free annual exclusion gifts or purchasing needed life insurance. Even in these cases, if a sufficiently long deferral could be achieved (by stretching out the payment for a long life of the participant and the participant's designated beneficiary), deferral is probably a preferable strategy.

F. Under the Old Prop. Regs., the one clear case where acceleration made sense was where the participant was past his or her Required Beginning Date, was expected to die in the very near future, had elected to recalculate his life expectancy, and either the beneficiary was not a Designated Beneficiary or the beneficiary was expected to withdraw the funds in a very short time after the participant's death. Under the New Prop. Regs., a participant's death will not cause the benefits to be forced to be distributed in the year following the participant's death even if the participant had a recalculations election in effect. Rather, the New Prop. Regs. allow the balance to be distributed over the balance of the participant's life expectancy. New Prop. Reg. §1.401(a)(9)-2 Q&A5; New Prop. Reg. §1.401(a)(9)-5 Q&A5. If, notwithstanding the availability of an extended payout, you expect the beneficiary to take an immediate withdrawal from the plan, then an early payout before death may make sense. Using the same assumptions as before, the tax savings of pre-mortem acceleration will equal approximately 10% of the IRA balance:

IRA balance	2,000,000	
State income tax rate	9.3%	
State income tax	186,000	
IRA balance	2,000,000	
Less: State income tax	(186,000)	
Less: Federal income tax	(718,344)	
Net taxable amount	1,095,656	
Marginal state "pick up" tax rate	16.0%	
State "pick up" tax	175,305	
IRA balance	2,000,000	
Less: State income tax	(186,000)	
Less: Federal income tax	(718,344)	
Net taxable amount	1,095,656	
Estate tax rate	55.0%	
Gross federal estate tax	602,611	
Less: State "pick up" tax	(175,305)	
Federal estate tax	427,306	
IRA balance	2,000,000	
Less: State income tax	(186,000)	
Net taxable amount	1,814,000	
Federal income tax rate	39.6%	
Federal income tax	718,344	
State income tax	186,000	9.30%
State "pick up" tax	175,305	8.77%
Federal estate tax	427,306	21.37%
Federal income tax	718,344	35.92%
Total taxes	1,506,955	75.35%

G. A special situation where acceleration is usually beneficial is where the participant qualifies for a Roth IRA conversion. Philosophically, the only thing better than "tax

deferred" is "tax free," assuming the tax free compounding period is sufficiently long enough to justify the tax paid.

H. Deferral may make even more sense today than in previous times, since there is serious consideration being given to reducing income tax rates, and reducing transfer tax rates or eliminating transfer taxes. Thus, deferring taxable distributions may result in the participant (or the participant's beneficiaries) being able to withdraw the funds as lower tax rates than are now applicable.

IV. Distributions Before Age 59-1/2.

A. Distributions before age 59-1/2 are subject to one important rule: Any funds so withdrawn are subject to a 10% tax under Section 72(t)(1), unless an exception applies.
B. The exceptions to the application of the tax are:

1. Distributions after the participant's death or disability. Section 72(t)(2)(A)(ii) and (iii).

2. Distributions as part of a series of substantially equal periodic payments (not less frequently than annually) made over the life (or life expectancy) of the participant or the joint lives (or joint life expectancy) of the participant and the Designated Beneficiary. Section 72(t)(2)(A)(iv)

3. Distributions used to pay medical expenses in excess of 7-1/2% of AGI. Section 72(t)(2)(B).

4. Distributions to pay health insurance premiums with respect to the participant, the participant's spouse and dependents, after the participant has received 12 consecutive weeks of unemployment compensation, in the year in which such compensation is paid (or the following year); but it does not apply to distributions made after the participant is re-employed if the participant has been employed for at least 60 days after the initial separation from service. A self employed person can also qualify for this exception. Section 72(t)(2)(D).

5. Distributions to pay for qualified higher education expenses. Section 72(t)(2)(E).

6. Distributions to pay for first home purchases. Section 72(t)(2)(F).

C. While these exceptions are important in some limited situations, in general the benefits of deferral will cause a taxpayer who can afford to do so to not tax withdrawals until the law requires that he or she do so.

V. Distributions Before Age 70-1/2.

A. A participant is not required to begin taking distributions until the year in which the participant attains age 70-1/2; and even then, the first year's distributions may be postponed until April 1 of the year following the year in which the participant attains age 70-1/2 (the "Required Beginning Date", or "RBD".) Old Prop. Reg. §1.401(a)(9)-1, Q&A B-1, 2 & 3. New Prop. Reg. §1.401(a)(9)-2 Q&A4; New Prop. Reg. §1.401(a)(9)-5 Q&A1; Prop. Reg. 1.408-8 Q&A3.
B. Distributions before the RBD should be analyzed under the factors discussed above, regarding the benefits of deferral.
C. The main issue to consider for a person who has not yet attained his RBD is the beneficiary designation which will take effect if the participant dies before the RBD. Note that a death after age 70-1/2, but before the RBD, is subject to the "five year payout or life expectancy beginning by the following year" tests discussed in this section of the outline, rather than the "at least as quickly" test discussed in the following section of the outline. PLR 9504045; New Prop. Reg. §1.401(a)(9)-2 Q&A6.
D. If the participant dies before the RBD, then the participant's beneficiaries must take distributions from the IRA under one of two possible methods:

    1. The IRA must be entirely distributed by the end of the fifth year following the year of death (Old Prop. Reg. §1.401-1(a)(9), Q&A C-1 through C-4); New Prop. Reg. §1.401(a)(9)-3 Q&A 1, 2 & 4; or

    2. If, by the end of the year following the year of death, the participant has a Designated Beneficiary **and** distributions commence, then distributions can be taken over the life expectancy of the Designated Beneficiary. (Old Prop. Reg. §1.401-1(a)(9), Q&A C-1 through C-4; New Prop. Reg. §1.401(a)(9)-3 Q&A 1, 3 & 4.)

    3. However, if (as of the end of the year after the participant's death) the only Designated Beneficiary is the participant's spouse, then the spouse may defer taking distributions until the end of the year in which the participant would have attained

age 70-1/2; or if the spouse dies before that time, then the minimum distribution rules apply as if the spouse was the participant. Section 401(a)(9)(B)(iv); New Prop. Reg. §1.401(a)(9)-3 Q&A 3(b). In other words, the five year rule or the alternative of taking distributions over the life of the next successive beneficiary beginning by the end of the year following the year of death, are both tied to the date of death of the spouse; and this rule applies even if the spouse begins to take distributions after the participant's death but before the participant would have attained age 70-1/2. New Prop. Reg. §1.401(a)(9)-3 Q&A 5 & 6. However, a new spouse of the spouse cannot use the deferral rule to postpone beginning distributions until the original spouse would have attained age 70-1/2. Note also that if the spouse dies after the participant and before the end of the year following the participant's year of death, then the participant is not considered to have been survived by a spouse for purposes of determining when distributions are to commence. New Prop. Regs. §1.401(a)(9)-4 Q&A4(a) & (b). Once the spouse begins to take distributions, if the spouse dies while funds remain in the account, the next successive beneficiary can withdraw funds over the successive beneficiary's life expectancy, or if there is no successive designated beneficiary, over the balance of the spouse's life expectancy, on a non-recalculated basis, beginning the year after the year of the spouse's death. New Prop. Regs. §1.401(a)(9)-5 Q&A5(c)(2).

4. Note that there are (at least) four possible situations involving a spouse:

    a. The spouse can be the sole direct beneficiary, in which case the spouse can make a rollover, or elect to treat the IRA as his or her own. It is not possible to qualify for this status if the benefits are payable to a trust; but query if this status can be attained by a distribution to the spouse before the end of the year following the year of death?

    b. The spouse can be the sole beneficiary, which would include a situation where the spouse is the beneficiary of a trust, but where no principal distributed from the plan will ever be accumulated for ultimate distribution to another person.

    c. The spouse can be the oldest beneficiary of several multiple beneficiaries, and thus be the measuring life for purposes of the designated beneficiary rules (i.e., be the "Designated Beneficiary", but not the sole beneficiary. This would be the case if principal distributed from the trust can be accumulated for later distribution to the children; but the funds can't be distributed to a charity. In this case, the special deferral rule (until the participant attains age 70-1/2) and the rule allowing the spouse's life expectancy to be recalculated, won't be available.

    d. The spouse can be one of multiple beneficiaries, but be ignored. For example, if a trust for the spouse allows principal distributed from a trust to be accumulated for ultimate distribution to charity, the spouse would be ignored as a designated beneficiary.

E. If the participant's spouse is the designated beneficiary and is a direct payee (no intervening trust), then the spouse may elect to roll over the funds in the IRA to a new IRA owned by the spouse. Section 408(d)(3)(C). If the spouse is the only designated beneficiary, the spouse can also elect to treat the IRA as the spouse's own IRA (which is

substantially the same thing as a rollover.) New Prop. Regs. §1.408-8 Q&A 5. (Note that if a trust for the spouse is the beneficiary, this option does not exist; but what if the trust distributes the right to receive the IRA distributions to the spouse before the end of the year following the year of the participant's death? The New Prop. Regs. are silent.) A spousal rollover, or treating the IRA as the spouse's own IRA, provides a significant benefit, in that the spouse can then choose new beneficiaries and set a new Designated Beneficiary. Among the factors to consider when deciding whether to make a spousal rollover are:

1. Is the spouse older or younger than the participant? If the spouse is younger, then a rollover will allow the spouse to defer commencement of benefits until the spouse's RBD, which would be later than the RBD which would have applied to the participant if the participant had lived (which would be the maximum period of time to delay commencement of benefits if the participant's IRA is continued.) On the other hand, if the spouse is older than the participant, then a spousal rollover may accelerate the time for commencement of benefits, since the possible delay until the RBD with respect to the participant would not be available.
2. Will the spouse's financial situation be such that he or she will need to take withdrawals before the spouse attains age 59-1/2? If so, a spousal rollover may result in the spouse becoming subject to the 10% tax on early distributions. See New Prop. Regs. §1.408-8 Q&A 5(b)(3).

F. Note that if the Designated Beneficiary is **not** the spouse of the participant, and the Designated Beneficiary begins to take distributions over the Designated Beneficiary's life expectancy, and the Designated Beneficiary dies, then the successive beneficiary can continue to take distributions over the balance of the Designated Beneficiary's original life expectancy, even if the successor beneficiary has a shorter life expectancy (or is not a Designated Beneficiary, such as the participant's estate.) New Prop. Regs. §1.401(a)(9)-5 Q&A7(c).

G. What if the beneficiary is **not** the spouse, and the beneficiary dies after the participant but before the end of the year following the participant's year of death, and the beneficiary hasn't begun to take distributions. Can the next successive beneficiary begin to take distributions under the "lifetime payout" exception to the five year rule? There was no clear answer to this question under the Old Prop. Regs. (where the Designated Beneficiary was determined as of the date of death), but it appeared that the next successive beneficiary could take out the distributions over the life expectancy of the original Designated Beneficiary as long as distributions commence before the end of the year following the year of the participant's death. Under the New Prop. Regs., the determination of the Designated Beneficiary won't be made until the end of the year following the year of the participant's death, so the issue doesn't even arise.

H. The Service has refused to allow an extension of time to commence distributions under the "lifetime" exception, even when the Designated Beneficiary was not notified of the death of the participant until after the end of the year following the year of the participant's death (thus forcing distributions under the five year rule.) PLR 9812034. Interestingly, the New Prop. Regs. state that if a participant has a Designated Beneficiary then (unless the plan contains an optional provision requiring the use of the five year rule), the life expectancy rule is to apply; but it provides no guidance for applying the rule when the designated beneficiary can't be located, or there is a dispute (such as a contest over the competence of the participant to name a particular beneficiary) by the end of the year following the year of the participant's death. New Prop. Reg.

§1.401(a)(9)-3 Q&A4. The only "relief" is that under Prop. Reg. §54.4974-2 Q&A8, if the participant dies before his or her RBD, and the full balance is distributed before the end of the fifth year following death, the excise tax on insufficient distributions won't be imposed.

I. If the participant designates multiple or contingent beneficiaries, the person with the shortest life expectancy is generally regarded as the designated beneficiary. Old Prop. Reg. §1.401(a)(9)-1 Q&A E-5; New Prop. Reg. §1.401(a)(9)-4 Q&A1, Q&A4(c); New Prop. Reg §1.401(a)(9)-5 Q&A7.

1. This rule applies only to the extent that there are multiple beneficiaries of a single account where "separate accounting" is not made. It is clear that if you have multiple IRAs, then the test is applied separately to each IRA, although the amount of the minimum required distribution can be taken from any IRA. Old Prop. Reg. §1.401(a)(9)-1 Q&A H-2. Prop. Reg. 1.408-8 Q&A9. The Regulations permit a single defined contribution plan with multiple beneficiaries to be maintained on a "separate share" basis, but there must be a separate accounting and allocation among the accounts. New Prop. Reg. §1.401(a)(9)-8 Q&A 3. It is not entirely clear how this can be accomplished where there is a single IRA which is being managed as a single account, or even if this rule is applicable to an IRA. However, in PLR 9433032, a participant died before his RBD and named five (non-spouse) beneficiaries. Four of the beneficiaries wanted to take lump sum distributions, but one wanted to make a trustee to trustee transfer and maintain the IRA with distributions made over the beneficiary's life expectancy. The Service authorized the division and distribution.

   a. Clearly, maintaining multiple IRAs in order to assure that each child will receive an equal amount with full control in that child is a nuisance, and may preclude the ability to meet investment manager minimums. Further, how can you be certain that each IRA will retain an equal value, when the funds are not invested in exactly the same manner?

   b. It may be possible to form a partnership or co-tenancy arrangement among all of the IRAs, which then invests for all of the accounts. In this manner, the separate accounting rules can be met, while still assuring that the values are maintained in the appropriate ratios.

   c. QUERY IF THE PARTNERSHIP WILL GIVE RISE TO A VALUATION DISCOUNT, DO YOU TAKE THAT DISCOUNT WHEN VALUING THE ASSETS OF THE IRAs FOR MINIMUM DISTRIBUTION PURPOSES? Taking the position that there is a discount is a high risk position if it means that you might violate the minimum distribution rules (and thus incur a 50% penalty). It may, however, allow you to assert a discount for estate tax purposes on the death of the participant. Note that the rules regarding investment partnerships may not be of particular relevance to a partnership consisting entirely of tax exempt entities. See Section 731(c)(3)(C).

   d. When creating an investment partnership using IRAs, be wary of prohibited transaction issues when the other partners are the participant, family members or other disqualified persons. See Sections 4975(c)(1)(D) and (E) and 4975(e)(2)(E)(ii). Prohibited transactions were deemed to not have occurred in Department of Labor Advisory Opinion 2000-10A and in Swanson v. Commissioner 106 TC 76 (1996).

1. IF MULTIPLE BENEFICIARIES ARE NAMED, AND ONE OR MORE ARE NOT INDIVIDUALS, THEN THE PARTICIPANT IS TREATED AS HAVING NO DESIGNATED BENEFICIARY, EVEN THOUGH ONE OR MORE INDIVIDUALS ARE ALSO NAMED. In general, under the New Prop. Regs., this problem could be cleared up before the end of the year following the year of death. Note that if the separate share rule is applicable, then this will create a problem only for the portion of the IRA passing to the non-qualifying beneficiary.
2. If a contingent beneficiary will take only upon the death of a prior beneficiary, then the contingent beneficiary is generally disregarded for purposes of determining the beneficiary with the shortest life expectancy. If there is any other contingency (e.g., remarriage), then the contingent beneficiaries are all considered. Old Prop. Reg. §1.401(a)(9)-1 Q&A E-5; New Prop. Reg. §1.401(a)(9)-5 Q&A 7(b). Note that the Service has applied these rules to trusts in a very restrictive manner which was not apparent when the rules were first adopted. New Prop. Reg. §1.401(a)(9)-5 Q&A7(c) Ex. 2 & 3.
3. If the Plan allows anyone to change beneficiaries after the participant's death, it is considered that there is no designated beneficiary. Old Prop. Reg. Sec. 1.401(a)(9)-1 Q&A E-5; New Prop. Reg. §1.401(a)(9) Q&A 7(d). The New Prop. Regs. state that it is okay that a beneficiary will have the power to select a beneficiary to receive the remainder of the benefits if the beneficiary dies before withdrawing all of the benefits. Also, in the case of a death before the participant's RBD, the surviving spouse can have the power to designate a beneficiary under Section 401(a)(9)(B)(iv)(II) since the rules are applied as if the spouse was the participant. New Prop. Regs. §1.401(a)(9)-4 Q&A4(b).

J. What if a trust is designated as the beneficiary? See the section entitled "Trusts as Beneficiaries."

K. The amount of the minimum distribution is based on the value of the IRA assets on the last day of the preceding year, divided by the appropriate age factor. Old Prop. Regs. §1.401(a)(9)-1 Q&A E-3 and E-4; New Prop. Regs. §1.401(a)(9)-5 Q&A3 and §1.408-8 Q&A6; See also New Prop. Reg. §1.401(a)(9)-7 and 1.408-8 Q&A8 regarding the valuation of a plan receiving a rollover or transfer. The Service gives you a wonderful benefit if the plan assets crash in value after the valuation date: the minimum distribution amount need never exceed the value of assets in the plan!

VI. Distributions After the RBD

A. Under the Old Prop. Regs., when the participant attains the RBD, distributions must begin to be taken over the life expectancy of the participant or, if the participant has a Designated Beneficiary, the distributions can be taken over the joint life expectancies of the participant and Designated Beneficiary (subject to the MDIB rule discussed below.) Under the New Prop. Regs., after a participant attains his or her Required Beginning Date, during the participant's lifetime, distributions must be made on the basis of either (1) if the participant's spouse is the sole beneficiary based on the joint life expectancies of the participant and the spouse, or (2) in any other case, a uniform table, which is based on the current MDIB table with the participant recalculating life expectancy. New Prop. Regs. §1.401(a)(9)-2; §1.408-8 Q&A1. The spouse would have to be more than 10 years younger than the participant at the RBD in order for the uniform table to be less advantageous, because the uniform table recalculates life expectancies for the participant and the beneficiary.

B. Under both the Old Prop. Regs. and the New Prop. Regs., if the participant dies before the benefits have been completely withdrawn, then the balance of the benefits must be withdrawn at least as fast as under the method of withdrawal in effect at the date of death. New Prop. Regs. §1.401(a)(9)-2 Q&A 5. However, there is a significant difference where there is no designated beneficiary.

1. Under the New Prop. Regs., even if the participant has no designated beneficiary and elected recalculation, the benefits can be withdrawn over the balance of the participant's unrecalculated life expectancy in the year of death. New Prop. Reg. §1.401(a)(9)-5 Q&A 5(a)(2) & (c)(3). Note that if the designated beneficiary is older than the participant, it may be best to arrange your affairs so that there is no designated beneficiary (e.g., leave the benefits to a trust for the beneficiary and give the beneficiary an inter-vivos limited power of appointment in favor or charity) so that you can use the balance of the participant's life expectancy instead of the beneficiary's life expectancy. Note also that the situation involving a participant with no designated beneficiary is better if he or she dies before his or her RBD than after his or her RBD, since in the former case the funds must be withdrawn within five years, but in the latter case the funds can be withdrawn over the balance of the participant's life expectancy (which may well be in excess of five years.)

2. Under the Old Prop. Regs., you could have a situation where the participant (after his or her RBD) had no designated beneficiary, and had elected to recalculate life expectancies. In that case, the entire remaining benefit would have to be distributed by the end of the year following the participant's death.

C. Under the Old Prop. Regs., the life expectancy of the participant and the participant's spouse can either be computed on a recalculation method or a non-recalculation method. Section 401(a)(9)(D). Old Prop. Reg. §1.401(a)(9)-1, Q&A E-6 to E-8. Under the New Prop. Regs., the life expectancy for the participant and the spouse is always recalculated during their joint and respective lifetimes. See New Prop. Regs. §1.401(a)(9)-5 Q&A 4(b) & 5(c)(2).

D. Under the Old Prop. Regs., when a recalculation election is in effect and the person whose life is being recalculated dies, the life expectancy for that person goes to zero. Generally, where the spouse was the Designated Beneficiary, it made sense to elect to recalculate the life expectancy of the participant, and not to recalculate the life expectancy of the spouse. Thus, if the spouse predeceased the participant, the participant could continue to take into account the original life expectancy of the spouse (even though the spouse was now dead); while if the participant predeceased the spouse, the spouse could make a spousal rollover and reset the minimum distribution schedule using a new Designated Beneficiary. This analysis is no longer needed under the New Prop. Regs., since the recalculation or non-recalculation analysis is no longer made.

E. Under the Old Prop. Regs., if a beneficiary was changed by the participant after the RBD, the original Designated Beneficiary's life expectancy was used unless the new beneficiary had a shorter life expectancy than the original beneficiary. An estate or charity is not a Designated Beneficiary, so it was (and still is) deemed to have a zero life expectancy. Old Prop. Reg. § 1.401(a)(9)-1, Q&A D-2A. Thus, if the participant rolled over his IRA to a new institution and failed to designate a beneficiary, and the default provisions of the institution provided that the participant's estate was the default beneficiary, then the participant would thereafter not be able to use a life expectancy other than the single life expectancy of the participant. PLR 9712032. On the other hand, if (after the participant's RBD) the original Designated Beneficiary died before the participant, and the successor

beneficiary had a shorter life expectancy than the original beneficiary, then the life expectancy of the original beneficiary could continue to be used. Old Prop. Regs. §1.401(a)(9)-1 Q&A E-5(e)(2). Under the New Prop. Regs., this analysis is no longer relevant. During the participant's life, you always use the MDIB (or the joint life expectancy of the participant and the participant's spouse if the spouse is the sole beneficiary at all times during the year) even if there is no Designated Beneficiary. Note the risk that the spouse may die in late December, and you may wind up taking too little from the plan for the year if you had been taking only the joint spousal amount. New Prop. Regs. §1.401(a)(9)-5 Q&A 4(b).

F. Under the Old Prop. Regs, there was no clear way of determining whether a participant or the participant's spouse elected to recalculate life expectancies; the determination is not readily available from any particular form, since it needn't be filed with the IRS. (Note, however, that in the preamble to the proposed regulations issued in December 1997 regarding delivery of documentation to the plan administrator in the case of a trust beneficiary, the preamble requires delivery to the "plan administrator, IRA trustee, custodian or issuer", while the proposed regulations only talk in terms of the plan administrator. The New Prop. Regs end the issue: Prop. Reg. §1.408-8 Q&A1(b) states that in applying the New Prop. Regs. under Section 401(a)(9), the term "plan administrator" means the IRA trustee, custodian or issuer.) If the decision can't be ascertained from the plan or from the plan administrator, it may be necessary to try to reconstruct the payout percentage. This may be difficult, since the participant is always free to take out more than the minimum amount. Again, the New Prop. Regs. end the importance of this inquiry.

In PLR 9726033, the Decedent had four IRAs, a "WF" (Wells Fargo?), a "DW" (Dean Witter?), an "ML" (Merrill Lynch?) and a "KP" (Kidder Peabody?). The KP IRA said that "Unless otherwise elected by the Customer by the time distributions are to commence", the recalculation method would be used. The DW IRA said that life expectancies "may be recalculated." The ML IRA said that life expectancies "can be redetermined . . . annually." The WF IRA said that life expectancies would not be recalculated.

In 1991, the participant attained his RBD, and decided not to use the recalculation method for himself or his spouse. He prepared a worksheet computing the minimum distribution, and noted on it "joint life expectancies -- IRS no recalculation." The KP IRA had a place on the beneficiary designation form to indicate whether a recalculation election would be made, and he indicated no, but the other forms had no place to make an election. The participant attached a statement to his 1991 income tax return indicating that he would not recalculate his or his wife's life expectancy, and in fact took just the minimum non-recalculated amount for 1991 through 1995. In 1995, the participant's wife died, and he wanted to continue to use the joint non-recalculation method, instead of basing distributions on his single life expectancy (which would have been the result if his wife's life expectancy had been recalculated, since it would have dropped to zero.)

The IRS held that since each IRA allowed, or at least did not preclude, a non-recalculation approach, and since the participant took steps to make his irrevocable election clear (such as by attaching a statement to his return), the non-recalculation approach would be respected. Query what would have been the result if there were no such indicators of his intent?

G. Under the Old Prop. Regs., for purposes of determining life expectancy, life expectancy tables (Tables I and II, and a Table for Determining Applicable Divisor for

MDIB) are found in Appendix E of Publication 590. Table I shows single life expectancies, while Table II shows joint and survivor life expectancies. Table I must be used if there is no Designated Beneficiary. Table II must be used if there is a Designated Beneficiary, unless the beneficiary is not a spouse and is less than 10 years younger than the participant. The MDIB Table must be used if there is a Designated Beneficiary (other than the participant's spouse) who is less than 10 years younger than the beneficiary, since in that case during the lifetime of the participant, the beneficiary's life expectancy must not be based on an age younger than 10 years younger than the participant. However, after the death of the participant, the MDIB rules no longer apply, and the actual life expectancy of the Designated Beneficiary is used to calculate the minimum distribution amount.

H. Under the New Prop. Regs., you always use the table in New Prop. Regs §1.401(a)(9)-5 Q&A5, unless the participant wants to use the spouse's life expectancy, in which case you must use Tables V and VI of §1.72-9. New Prop Regs. §1.401(a)(9)-5 Q&A6.

I. Case studies

Last week, you met with Herb and Phoebe Client. They are both 70 years old and have a $25 million estate. They have a son, Cliff, who is 40 years old. Herb has a $2 million IRA. They want to know what they should do with the IRA. You consult the actuarial tables and see that the first spouse is supposed to die in 9.4 years and the surviving spouse is supposed to die in 18.4 years. You assume Phoebe will roll over the IRA if Herb predeceases her. You run scenarios based on the eight possible results focusing on the future value of funds when Cliff is 82 and has deferred IRA withdrawals as long as possible:

Option #	**Option**	**First Death**	
		Participant	**Spouse**
1	Both recalculate	14,900,000	
2	Both recalculate		10,900,000
3	Both term certain	14,700,000	
4	Both term certain		11,000,000
5	Participant term certain, spouse recalculates	14,700,000	
6	Participant term certain, spouse recalculates		11,000,000
7	Participant recalculates, spouse term certain	14,700,000	
8	Participant recalculates, spouse term certain		10,900,000

Herb and Phoebe look pretty confused, so you suggest they think about their options and come back in a week. They return this week and you tell them about the new Proposed Regulations. You show them one more option:

Option #	**Option**	**First Death**	
		Participant	**Spouse**
9	Prop. Reg. § 1.401(a)(9)-5, A-4(a)(2)(i) Table	15,600,000	15,600,000

Herb and Phoebe look relieved, and ask if there are any other options they should consider. You show them five more options:

Option #	Option	Spouse or Participant
9a	Gift after-tax (including gift tax) minimum distributions to an irrevocable trust	18,000,000
10a	Liquidate IRA over 18.4 years to fund after-tax (including gift tax) IT-owned investments	13,400,000
10b	Liquidate IRA over 18.4 years to fund after-tax (including gift tax) ILIT-owned life insurance (Standard risk)	19,100,000
11	Pre-70 Roth IRA conversion	23,800,000
9b	Invest IRA funds in an FLP (assuming a 25% valuation discount for distribution and estate tax purposes)	20,000,000

VII. Trusts as Designated Beneficiaries

A. The beneficiaries of a trust will be treated as Designated Beneficiaries if the beneficiaries are individuals and the trust meets certain tests (New Prop. Regs §1.401(a)(9)-4 Q&A5 & 6):

1. The Trust must be valid under state law, or would be valid under state law but for the absence of a trust res. (The New Prop. Regs. clarify that a testamentary trust will meet this test, at least if the participant dies before his RBD. New Prop. Regs. §1.401(a)(9)-5 Q&A 7(c)(3) Ex.2. The preamble also seems to indicate that a testamentary trust should be okay, but it does not provide an example where the participant reaches his RBD and has a testamentary trust named as the sole beneficiary, and wants to use his more than 10 years younger spouse (who is the sole beneficiary of the trust) as a designated beneficiary.)

2. The Trust must have ascertainable beneficiaries.

3. The Trust must be irrevocable no later than the death of the participant. Note that if the trust is fully revocable by the beneficiary, the trust should be ignored and the beneficiary should be treated as the designated beneficiary (see Section 678), but there is no provision in the New Prop. Regs. to recognize that approach.

4. Certain substantiation rules must be complied with. According to the preamble to the New Prop. Regs., generally these must be complied with by the end of the year following the year of death; but if the participant wants to take minimum distributions after the RBD using the joint life expectancy of the participant and a spouse (where the result is more favorable than under the default table) and a trust is the beneficiary, you must provide the information by an earlier (currently unspecified) date. The New Prop Regs say that the requirements must be met "if, during any period during which required

minimum distributions are being determined by treating the beneficiaries of the trust as designated beneficiaries of the employee" the documentation "has been provided to the administrator." Arguably, for the entire "first distribution year" (the year you actually attain age 70-1/2), the information must be in the hands of the administrator; but it would seem more reasonable that the information just be provided by the RBD. The New Prop. Regs., at first glace, seem to require that these rules be complied with at the RBD (or possibly an earlier date) in all cases, but a careful reading of New Prop. Reg. §1.401(a)(9)-4 Q&A5(b) shows that this is not the case, since if you are not using a joint life expectancy of the spouse, the minimum distributions are not being determined by treating the beneficiaries of the trust as designated beneficiaries.

a. The first way of meeting the rules is to provide a copy of the trust and, if the trust is revocable, an agreement that the employee will provide to the administrator a copy of any amendment within a reasonable time after adoption of the amendment. By the last day of the year following the year of death, the trustee must provide a final trust or comply with the requirements discussed below.

b. The second way of complying with the rules is to provide the administrator with a list of all beneficiaries of the trust (including contingent and remainder beneficiaries with a description of the conditions on their entitlement), and a certification that the list is correct and complete and that the other requirements for the beneficiary to be treated as designated beneficiaries are satisfied. Also, the employee must agree to provide a corrected certification if changes occur, and must agree to provide a copy of the trust instrument to the plan administrator on demand. A copy of the trust or a final certification (with agreement to provide a copy of the trust on demand) must be provided to the administrator by the end of the year following the year of the employee's death.

B. Will a trust for the benefit of a spouse be treated as a spouse for purposes of the rule allowing a spouse of a participant who dies before his RBD to defer commencement of distributions until the participant would have attained age 70-1/2? Under New Prop. Regs. 1.401(a)(9)-3 Q&A 3(b), "if the sole designated beneficiary is the employee's surviving spouse", then the distribution can be delayed. Under New Prop. Regs. §1.401(a)(9)-5 Q&A7(c) Ex. 2 & 3 make it clear that if no principal can be accumulated in the trust for later distribution to a beneficiary other than the spouse, then the spouse will be treated as the sole beneficiary. Pursuant to the Old Prop. Regs., in PLR 9710028, the participant named an irrevocable trust as the beneficiary of his pension plan. The participant's spouse was named as the beneficiary, entitled to all income plus principal as needed for her support and maintenance. On the spouse's death, the balance is subject to a testamentary power of appointment. The Service held that not only could the trust take distributions over the spouse's life expectancy, the trustee could defer commencement of payment of benefits until the year that the decedent would have attained age 70½. See also PLR 9623056. Presumably, these rulings would not be issued today, and a result today would be consistent

with PLR 9847022, which holds to the contrary, and Rev. Rul. 2000-2 (2000-3 IRB 305) which assumes without expressly holding that a trust of which the spouse is the sole income beneficiary for life would not so qualify.

C. When will a trust be treated as having only individual beneficiaries?

1. Confirming a trend shown in recent Private Letter Rulings, the New Prop. Regs. clearly state that where any distributions are made to a trust, and the distributions can be accumulated for future distribution to a remainder beneficiary, then the remainder beneficiaries must be included in the determination of whether the trust has multiple beneficiaries. New Prop. Regs §1.401(a)(9)-5 Q&A 7(c)(3) Ex. 2 & 3.

   In Example 2, a married participant of a defined contribution plan dies before his RBD leaving a younger spouse. The beneficiary is a testamentary trust, and the documentation requirements are met by the end of the year following the year of death. The trust provides that all income is payable annually to the spouse, and no one has the power to appoint principal of the trust to anyone other than the participant's children, all of whom are younger than the spouse and who are the (presumably outright) remainder beneficiaries of the trust. The trust requires the distribution of all trust income; the Trustee elects to receive the greater of the income or the minimum required distribution each year. Because some part of the distributions could be accumulated in the trust for ultimate distribution to the children, the trust is treated as having multiple beneficiaries, and does not qualify for the provision allowing a deferral until the participant would have attained age 70-1/2, but rather distributions must begin by the end of the year following the participant's death. Since the only persons who can receive trust principal are the spouse and the younger children, the spouse's age is the measuring life. Query, however, if the spouse is the "sole" beneficiary for this purpose. Under New Prop. Regs. §1.401(a)(9)-5 Q&A5(c)(2), a spouse's recalculated life expectancy (rather than a non-spouse's non-recalculated life expectancy) can be used only if the spouse is the employee's "sole beneficiary." Based on the multiple beneficiary rule, it would appear that even though the spouse's life is the measuring life, you can't use the spouse's recalculated life expectancy, but rather must use only the spouse's non-recalculated life expectancy.

   In Example 3, the facts are the same as Example 2, except that the trust is a "conduit trust" that requires all of the Plan's distributed principal paid out during the spouse's life to be distributed to the spouse. In that case, the spouse is treated as the sole designated beneficiary, distributions need not commence until the participant would have attained age 70-1/2, and (presumably) distributions can be made over the spouse's recalculated life expectancy.

1. Under the Old Prop. Regs., in PLR 9820021, the Decedent was a participant in a profit sharing plan, and named his living trust as the beneficiary. The trust provided that after payment of estate taxes and specific bequests (including a $40,000 trust for his wife's children), the balance would be allocated to two marital deduction trusts for the benefit of the spouse for

life, remainder to four charities. Under the terms of the plan and a distribution election, the trustees were to withdraw from the plan, at a minimum, the income only until the time the participant would have attained age 70½, and thereafter they were to receive at least the greater of all income or the minimum distribution amount. Following the participant's death, they withdrew $300,000 which was used to pay estate taxes, specific bequests, and provide operating capital. They asked for a ruling that the spouse could be treated as the designated beneficiary, since she was the beneficiary of the marital deduction trusts. The Service held that the charities would be treated as beneficiaries as well, and thus the trust would not be treated as a designated beneficiary.

The fact that a material portion of the Plan benefits were not paid to the spouse should have been enough for the Service to rule that the Trust could not use the Spouse as a measuring life. However, the ruling goes far beyond that simple analysis. Instead, it focuses on the fact that funds accumulated in the Trust (in a manner similar to that authorized in Rev. Rul. 2000-2) for the benefit of remainder beneficiaries following the spouse's death, makes those remainder beneficiaries "designated beneficiaries" immediately. In this case, that meant not only could the Trust not defer commencement of benefits until the participant would have attained age 70½, but that the charities must be taken into account as beneficiaries immediately. Thus, since a charity has a zero life expectancy (under the Regulations regarding Designated Beneficiaries), the entire balance had to be distributed within five years of the participant's death.

The ruling states that the Trust "does not provide that [the spouse] must receive all amounts that are distributed from [the Plan] to [the Trust]. Although [the spouse] is entitled to income, and principal subject to a standard, [the Trust] does not require [the spouse] to receive any minimum distribution amount under section 401(a)(9) that has been distributed to [the Trust] if greater than annual income. Further, any larger amounts requested by [the Trust] from [the Plan] that are allowed by [the Trust's] election are not required to be distributed to [the spouse]. Thus, [the Plan] may distribute to [the Trust] an amount greater than [the spouse] is entitled to receive under [the Trust] during [the spouse's] lifetime."

"Because additional amounts that are distributed from [the Plan] could remain in [the Trust] during [the spouse's] lifetime, [the charities] are entitled to benefits while [the spouse] is alive unless the trustee considers the amounts necessary for [the spouse's] health and medical needs, even though access to these amounts may be delayed until after [the spouse's] death. Absent the occurrence of this contingency, the death of [the spouse] affects the timing rather than the availability of their benefits. Thus, the entitlement of the charities is not contingent on the death of [the spouse]. As a result, these beneficiaries are designated beneficiaries, and [the spouse] is not treated as the sole beneficiary."

1. If, on the other hand, all of the IRA distributions received by the trust are required to be distributed currently to the current individual beneficiaries, then only the current individual beneficiaries will be taken into account. In this situation, no IRA funds which are distributed can be accumulated for anyone other than the current beneficiary. See New Prop. Regs. 1.401(a)(9)-5 Q&A 7(c)(3) Q&A 2 & 3.

4. Further, if the trust is revocable by the beneficiary (for example, a Survivor's Trust under a standard California revocable trust), then the assets of the trust should be treated as owned by the person holding the power of revocation and treated as a distribution to that person. This is consistent with Section 678, holding that the assets are treated as owned by the person having the power of withdrawal. However, the New Prop. Regs. don't deal with this issue.

5. If all of the trust assets will be distributed to the beneficiaries if they live to their normal life expectancy, then any remainder beneficiaries after those beneficiaries will be ignored. For example, if the funds are payable to a trust which is to be held for the benefit of child until age 30, but if child dies before then, the funds are to go to charity, then the charitable beneficiary will be ignored (since the child must receive the funds before his actuarial life expectancy.) On the other hand, if the funds are payable to a "Dynasty Trust" for the benefit of children for life, then to grandchildren for life, remainder to great-grandchildren, or if there are none, to charity, then there can be no assurance that the funds will be distributed to the current beneficiaries during their normal life expectancy. Thus, all remainder beneficiaries (including the charity) are to be taken into account, and the trust will be deemed to have a non-individual beneficiary (and thus a zero life expectancy.)

6. A similar problem exists with powers of appointment. If a trust will not necessarily terminate in favor of an individual during the individual's actuarial life expectancy, and on the death of that individual the funds can be paid pursuant to a special power of appointment, then all permissible appointees are considered to be beneficiaries. Thus, for example, if the trust will benefit wife for life, remainder as wife appoints among the descendants of the marriage, or in default of exercise outright to the descendants, then the trust will qualify as a designated beneficiary. But, if the wife could appoint to descendants or charity, or to anyone other than herself, her estate, her creditors or the creditors of her estate, and the trust is not a "conduit trust", then the trust would not qualify as a designated beneficiary. It should be noted that the Proposed Regulations prohibit giving anyone other than the participant the right to change beneficiaries after the RBD, except that a beneficiary may have the power to change beneficiaries as to any undistributed balance in the participant's account remaining after the beneficiary's death. New Prop. Regs. §1.401(a)(9)-5 Q&A7(d). See, e.g., PLR 199903050 and PLR 199918065.

7. If IRA funds distributed to a trust can be used to pay estate taxes, the Service may take the position that the funds are actually payable to the

participant's "estate", and as such the trust is not qualified as a Designated Beneficiary. See PLR 9809059. Unfortunately, this provision is not discussed in the New Prop. Regs., so its impact is still unclear.