

# The Estate Planner

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By *Lewis J. Saret*

## Retirement Benefits in the Context of Estate Planning—Part I: Minimum Required Distributions

### Introduction

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#### Generally

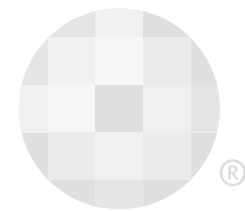
Qualified retirement plans and individual retirement accounts (hereinafter jointly referred to as “QRPs”) typically represent a significant amount of most individuals’ net worth. To illustrate, one study reported that at the end of 2008, individual retirement accounts (IRAs) alone represented 25.4 percent of total U.S. retirement wealth and 8.5 percent of U.S. household financial assets.<sup>1</sup> In addition, QRPs often pass outside of an estate by means of beneficiary designations, which name the beneficiary of QRPs upon the death of the participant of the qualified retirement plan or the account owner of the IRA (hereinafter both participants of qualified retirement plans and account owners of IRAs will be referred to as “participants” for the purpose of convenience). This necessitates that QRP beneficiary designations be coordinated with the overall estate plan to effectuate the testamentary intent of the participant.

This is the first of several columns that will address retirement benefits in the estate planning context. This column focuses on the minimum required distribution (MRD) rules that apply to QRPs because an understanding of the MRD rules is essential in order to incorporate QRPs into an estate plan. Future articles will discuss the income taxation of QRPs; tax issues associated with naming trusts as beneficiaries of QRPs, including both the application of the MRD rules as they apply to trusts named as beneficiaries of QRPs and the income taxation of trusts that receive QRP benefits; and Roth IRAs.

#### MRDs Generally

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Congress intended QRPs to serve as retirement vehicles and not as estate planning wealth transfer



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vehicles. To accomplish this goal and prevent the infinite deferral of income accumulated in QRPs, Congress enacted the MRD rules in the form of Code Sec. 401(a)(9). As discussed below, the penalties for violating the MRD rules are severe, generally (1) a penalty of 50 percent of the amount of the MRD that is not distributed by the required due date, which is imposed on beneficiaries of QRPs, and (2) the disqualification of qualified retirement plans. Therefore, it is important to ensure compliance with the MRD rules.

In addition, upon the participant's death, the beneficiary to whom the benefits are paid will determine the MRD amounts, which in turn determines the period of time during which QRP benefits may grow tax-free. Therefore, an understanding of the MRD rules is essential for incorporating QRPs into an estate plan. Failure to understand these rules can result in QRP benefits not meshing well with an estate plan and, in turn, a significant increase in tax exposure with a corresponding decrease in economic value passing to the estate plan beneficiaries.

**Example 1.** Charlotte marries Rochester. Charlotte has two children by a prior marriage, her net worth consists of a \$2 million brokerage account, an \$8 million IRA, no liabilities and no other assets. Rochester is independently wealthy, and Charlotte's intent is to leave her entire estate to her children. However, when she moves her IRA to another financial service provider, the provider fills out the forms and accidentally names Rochester as Charlotte's designated beneficiary. When Charlotte's estate lawyer, Jane, updates Charlotte's estate plan to reflect her marriage, Jane forgets to look at Charlotte's IRA beneficiary designation. Here, although Charlotte's will leaves everything to Charlotte's children, her IRA, which represents 80 percent of her net worth, passes to Rochester. Therefore, by failing to coordinate Charlotte's IRA beneficiary designation with Charlotte's estate plan, Jane has failed to effectuate Charlotte's testamentary intent.

**Example 2.** Same facts as Example 1 except that Charlotte's beneficiary designation names her estate as her DB. Here the children receive the \$8 million IRA through Charlotte's estate but the entire IRA balance must be distributed on or before December 31 of the year containing the fifth anniversary of Charlotte's death. Therefore,

the children effectively lose the benefit of the IRA income tax deferral.

**Note.** There are two basic types of MRDs: (1) lifetime MRDs, and (2) post-death MRDs. Lifetime MRDs are the rules that apply to participants during their lifetimes. Post-death MRDs are the MRD rules that apply to QRP benefits after the participant's death.

**Caution.** This column does not discuss the MRD rules that apply to defined benefit plans. Reg. §1.401(a)(9)-6 sets out the MRD rules that apply to defined benefit plans, which generally do not apply to defined contribution plans, such as 401(k) plans and IRAs. However, under some circumstances, these rules may apply to defined contribution plans. To illustrate, if a defined contribution plan beneficiary purchases an annuity within the plan, the defined benefit plan MRDs may apply. In such cases, advisors must familiarize themselves with these rules. This column also does not discuss the MRD rules as they apply to trusts. This subject will be the subject of a future column devoted solely to tax issues associated with naming trusts as beneficiaries of QRPs.

Generally, the MRD rules provide that by a participant's required beginning date (RBD), discussed below, either (1) the entire QRP benefit must be distributed to the participant, or (2) the distribution of the QRP must commence and be made over one of the following periods:<sup>2</sup>

- The life of the participant
- The joint lives of the participant and a designated beneficiary
- A period not extending beyond the life expectancy of the participant
- A period not extending beyond the joint and survivor life expectancy of the participant and the designated beneficiary

If the participant dies before the entire QRP has been distributed, the beneficiary must receive the remaining balance within a time period specified in the Internal Revenue Code and regulations thereunder.<sup>3</sup>

## MRDs and the Economics of Tax Deferral<sup>4</sup>

The primary economic benefit of a QRP is the economic benefit that results from the ability to defer

Chart 1.

| EXAMPLE 3 |      |          |        |                  |            |                 | EXAMPLE 4                  |                      |                |             |                     |
|-----------|------|----------|--------|------------------|------------|-----------------|----------------------------|----------------------|----------------|-------------|---------------------|
| year      | Year | Tax Rate | Growth | Beg. Balance IRA | Growth IRA | End Balance IRA |                            | Beg. Balance Non-IRA | Growth Non-IRA | Tax         | End Balance Non-IRA |
|           |      |          |        |                  |            |                 | Compensation               | \$16,000.00          |                |             |                     |
|           |      |          |        |                  |            |                 | Less Taxes on Compensation | \$5,600.00           |                |             |                     |
|           |      |          |        |                  |            |                 | Net Investment             | \$10,400.00          |                |             |                     |
|           |      |          |        |                  |            |                 |                            | \$10,400.00          | \$520.00       | \$182.00    | \$10,738.00         |
| 1         | 2011 | 0.35     | 0.05   | \$16,000.00      | \$800.00   | \$16,800.00     |                            | \$10,738.00          | \$536.90       | \$187.92    | \$11,086.99         |
| 2         | 2012 | 0.35     | 0.05   | \$16,800.00      | \$840.00   | \$17,640.00     |                            | \$11,086.99          | \$554.35       | \$194.02    | \$11,447.31         |
| 3         | 2013 | 0.35     | 0.05   | \$17,640.00      | \$882.00   | \$18,522.00     |                            | \$11,447.31          | \$572.37       | \$200.33    | \$11,819.35         |
| 4         | 2014 | 0.35     | 0.05   | \$18,522.00      | \$926.10   | \$19,448.10     |                            | \$11,819.35          | \$590.97       | \$206.84    | \$12,203.48         |
| 5         | 2015 | 0.35     | 0.05   | \$19,448.10      | \$972.41   | \$20,420.51     |                            | \$12,203.48          | \$610.17       | \$213.56    | \$12,600.09         |
| 6         | 2016 | 0.35     | 0.05   | \$20,420.51      | \$1,021.03 | \$21,441.53     |                            | \$12,600.09          | \$630.00       | \$220.50    | \$13,009.59         |
| 7         | 2017 | 0.35     | 0.05   | \$21,441.53      | \$1,072.08 | \$22,513.61     |                            | \$13,009.59          | \$650.48       | \$227.67    | \$13,432.41         |
| 8         | 2018 | 0.35     | 0.05   | \$22,513.61      | \$1,125.68 | \$23,639.29     |                            | \$13,432.41          | \$671.62       | \$235.07    | \$13,868.96         |
| 9         | 2019 | 0.35     | 0.05   | \$23,639.29      | \$1,181.96 | \$24,821.25     |                            | \$13,868.96          | \$693.45       | \$242.71    | \$14,319.70         |
| 10        | 2020 | 0.35     | 0.05   | \$24,821.25      | \$1,241.06 | \$26,062.31     |                            | \$14,319.70          | \$715.99       | \$250.59    | \$14,785.09         |
| 11        | 2021 | 0.35     | 0.05   | \$26,062.31      | \$1,303.12 | \$27,365.43     |                            | \$14,785.09          | \$739.25       | \$258.74    | \$15,265.61         |
| 12        | 2022 | 0.35     | 0.05   | \$27,365.43      | \$1,368.27 | \$28,733.70     |                            | \$15,265.61          | \$763.28       | \$267.15    | \$15,761.74         |
| 13        | 2023 | 0.35     | 0.05   | \$28,733.70      | \$1,436.69 | \$30,170.39     |                            | \$15,761.74          | \$788.09       | \$275.83    | \$16,274.00         |
| 14        | 2024 | 0.35     | 0.05   | \$30,170.39      | \$1,508.52 | \$31,678.91     |                            | \$16,274.00          | \$813.70       | \$284.79    | \$16,802.90         |
| 15        | 2025 | 0.35     | 0.05   | \$31,678.91      | \$1,583.95 | \$33,262.85     |                            | \$16,802.90          | \$840.15       | \$294.05    | \$17,348.99         |
| 16        | 2026 | 0.35     | 0.05   | \$33,262.85      | \$1,663.14 | \$34,925.99     |                            | \$17,348.99          | \$867.45       | \$303.61    | \$17,912.84         |
| 17        | 2027 | 0.35     | 0.05   | \$34,925.99      | \$1,746.30 | \$36,672.29     |                            | \$17,912.84          | \$895.64       | \$313.47    | \$18,495.00         |
| 18        | 2028 | 0.35     | 0.05   | \$36,672.29      | \$1,833.61 | \$38,505.91     |                            | \$18,495.00          | \$924.75       | \$323.66    | \$19,096.09         |
| 19        | 2029 | 0.35     | 0.05   | \$38,505.91      | \$1,925.30 | \$40,431.20     |                            | \$19,096.09          | \$954.80       | \$334.18    | \$19,716.71         |
| 20        | 2030 | 0.35     | 0.05   | \$40,431.20      | \$2,021.56 | \$42,452.76     |                            | \$19,716.71          | \$985.84       | \$345.04    | \$20,357.51         |
| 21        | 2031 | 0.35     | 0.05   | \$42,452.76      | \$2,122.64 | \$44,575.40     |                            |                      |                |             |                     |
|           |      |          |        |                  |            |                 | Less Tax                   |                      |                | \$15,601.39 |                     |
|           |      |          |        |                  |            |                 | Net                        |                      |                |             | \$28,974.01         |

income taxation of (1) compensation contributed to the QRP, and (2) earnings on such contributions. Ultimately, the key economic benefit of a QRP is the ability to earn investment income on assets that would otherwise have been paid in taxes. This is important because it means that a key objective of estate planners is to stretch out the distribution period over as long a time period as possible in order to obtain the maximum tax deferral; hence the necessity of understanding the MRD rules.

**Example 3.** Dickens contributes \$16,000 in 2011 to his 401(k) plan and leaves this contribution in the plan for 21 years. Dickens properly deducts this contribution on his income tax return, which is the only contribution that he makes to the plan. Dickens withdraws the entire 401(k) plan balance in 2031. Dur-

ing this entire time period, Dickens' marginal income tax rate is 35 percent and Dickens earns a five-percent annual rate of return on all investments. At the end of 2031, Dickens 401(k) plan account holds \$44,574.40. When he withdraws this amount Dickens pays a \$15,601.39 income tax, leaving a net amount of \$28,974.01. See Chart 1 for a spreadsheet showing the annual calculations.

**Example 4.** Same facts as Example 3 except that Dickens does not contribute \$16,000 to a 401(k) plan but instead invests it in a taxable brokerage account. Unlike Example 3, he does not take a \$16,000 deduction for 2011 for a contribution to the 401(k) plan. As a result, Dickens pays \$5,600 of income tax on the compensation that he earned and is only able to put \$10,400 (i.e., \$16,000 less \$5,600) into the investment

account. On the other hand, however, when Dickens withdraws the full amount in 2031, he does not pay any income tax on the amount withdrawn, as he must do in Example 1. In addition, because this account is not a QRP, Dickens must pay tax at a 35-percent income tax rate on all investment earnings each year. See Chart 1 for a spreadsheet showing the annual calculations.

Here, when Dickens cashes out his brokerage account at the end of 2031 he has \$20,357.57 in his brokerage account. Therefore, he has earned 8,616.50 less, after taxes, than in Example 3, where he invested through a QRP, earning the same investment return and with the same tax rate. See Exhibit 1 for a spreadsheet showing the annual calculations.

Therefore, although these examples are very simple, they illustrate the key benefit of QRPs, which is the ability to earn income on assets that would otherwise have been paid in taxes (*i.e.*, in the case of Example 3, earnings on taxes that Dickens saved by (1) the deduction claimed for the QRP contribution in 2011, and (2) taxes that were not required to be paid on earnings realized on the QRP investments each year between 2011 and 2031).

Finally, although Congress intended QRPs to not serve as wealth transfer vehicles, the economic benefits of income tax deferral may continue after the participant's death. The reason is that the participant may designate a successor beneficiary who succeeds to the participant's interest in the QRP upon the participant's death ("Designated Beneficiary"), and the income tax deferral may then continue past the participant's death.

### The Required Beginning Date

The MRD rules require QRPs to distribute or begin to distribute QRP assets no later than the required beginning date ("RBD"). RBD means April 1 of the calendar year following the later of (1) the calendar year that the employee attains age 70 1/2,<sup>5</sup> or (2) the calendar year that the employee retires from employment with the employer maintaining the plan.<sup>6</sup> However, for IRA owners<sup>7</sup> and employees who are five-percent owners,<sup>8</sup> the term "RBD" means April 1 of the calendar year following the calendar year in which the employee attains age 70 1/2. For this purpose, a five-percent owner is an employee who is a five-percent owner<sup>9</sup> with respect to the plan year

ending in the calendar year in which the employee attains age 70 1/2.

After the first distribution is made on or before the RBD, subsequent MRD distributions must be taken by December 31 of each calendar year.<sup>10</sup>

**Note.** The MRD rules treat IRAs and Roth IRAs differently. For traditional IRAs, the IRA owner must begin taking the minimum distribution upon reaching the age of 70 1/2 regardless of the date of his or her retirement.<sup>11</sup> Conversely, Roth IRA owners are not required to take minimum distributions during the life of the IRA owner.<sup>12</sup> Rather, the MRD Rules for Roth IRAs are not triggered until the Roth IRA owner's death.

### MRDs During Participant's Lifetime

During their lifetimes, participants must begin taking MRDs on or before their RBD. After MRDs start, participants must take annual MRDs for the rest of their life.

A participant's annual MRD is determined by dividing the "account" by the applicable distribution period.<sup>13</sup> For this purpose, the amount of the account is the account balance as of the last valuation date in the calendar year, which is typically December 31, immediately preceding the distribution calendar year.<sup>14</sup>

**Example 5.** William Thackeray turns 70 1/2 in 2011. His IRA has a \$1 million balance at December 31, 2010 and a \$1.1 million balance at December 31, 2011. Here, William must use the \$1 million balance from December 31, 2010, for purposes of determining the amount of his MRD for 2011, which, because this is the first distribution year for William, William can take as late as April 1, 2011 (*i.e.*, William's RBD). In addition, William must use the \$1.1 million balance as of December 31, 2011, for purposes of determining the amount of William's 2012 MRD, which William must take on or before December 31, 2012.

**Caution.** Certain adjustments may be required to the prior year-end account balance for purposes of calculating the MRD amount. To illustrate, such adjustments may include adjustments for rollovers in transit at year-end<sup>15</sup> and recharacterization of Roth IRAs.<sup>16</sup>

For purposes of calculating the MRD for participants during their lifetimes, the “applicable distribution period” is determined using the Uniform Lifetime Table, which is set forth in Reg. 1.401(a)(9)-9, Q&A-2, and which is reprinted in Table 1.<sup>17</sup> This table is used for determining the distribution period for lifetime distributions to participants where either (1) the participant’s spouse is not the sole designated beneficiary (“DB”), or (2) the participant’s spouse is the sole DB and is no more than 10 years younger than the participant.

When a participant is married to a younger spouse, a different applicable distribution period may apply. Specifically, if the sole DB at all times during the year is the participant’s spouse and the spouse is more than 10 years younger than the participant, then the “applicable distribution period” is the longer of (1) the distribution period determined pursuant to the Uniform Lifetime Table, described above, or (2) the joint life expectancy of the participant and the participant’s spouse using their attained ages as of their respective birthdays in the distribution calendar year. The joint and last survivor life expectancy is determined pursuant to the Joint and Last Survivor Table, which is set forth in Reg. §1.401(a)(9)-9, Q&A-3.

The spouse will be treated as the participant’s sole DB if the spouse is the sole beneficiary of the participant’s entire QRP interest at all times during the calendar year.<sup>18</sup>

Because applicable regulations determine marital status as of January 1 of each year, death or divorce during the calendar year will not change the applicable distribution period until the following year.<sup>19</sup>

**Caution.** Although divorce, by itself, does not change the applicable distribution period until the following year, if the participant changes the designated beneficiary during that calendar year, the applicable distribution period would change because the participant’s spouse would no longer be the sole designated beneficiary at all times during the year. Here the participant must use the new designated beneficiary for purposes of determining the applicable distribution period.

**Planning Pointer.** No MRDs are required from Roth IRAs during the account holder’s life. Instead, the RBD for Roth IRAs is December 31 of the calendar year following the calendar year of the account holder’s death.<sup>20</sup>

Distribution amounts taken in excess of the MRD in a single calendar year do not reduce subsequent MRDs, except indirectly by reducing the QRP’s overall account balance. Additionally, the amount of the distribution taken in excess of the MRD cannot be “rolled over” and credited against future MRDs.<sup>21</sup> Similarly, distributions occurring before the Required Beginning Date do not affect MRDs, other than by indirectly decreasing the QRP’s account balance before the Required Beginning Date.<sup>22</sup>

### MRDs When Participant Dies Before RBD

After the participant’s death, the MRD rules apply to the beneficiary who succeeds to the participant’s interest in the QRP. Generally, the participant’s QRP may be paid to a designated beneficiary over that beneficiary’s life expectancy. In other words, the applicable distribution period for MRD purposes is the beneficiary’s life expectancy. As a result, this payout method is sometimes referred to as the “stretch” method because the MRDs for deceased participant’s QRP interests may be stretched out over the designated beneficiary’s lifetime. However, the exact period over which the MRDs may be stretched depends on the person named as the DB and that period can vary dramatically depending on who is named as the DB.

### Nonspouse Is DB

If a participant dies before his/her RBD and either (1)

**Table 1.**

| Age of Employee | Distribution Period |
|-----------------|---------------------|
| 70              | 27.4                |
| 71              | 26.5                |
| 72              | 25.6                |
| 73              | 24.7                |
| 74              | 23.8                |
| 75              | 22.9                |
| 76              | 22.0                |
| 77              | 21.2                |
| 78              | 20.3                |
| 79              | 19.5                |
| 80              | 18.7                |
| 81              | 17.9                |
| 82              | 17.1                |
| 83              | 16.3                |
| 84              | 15.5                |
| 85              | 14.8                |
| 86              | 14.1                |
| 87              | 13.4                |
| 88              | 12.7                |
| 89              | 12.0                |
| 90              | 11.4                |
| 91              | 10.8                |
| 92              | 10.2                |
| 93              | 9.6                 |
| 94              | 9.1                 |
| 95              | 8.6                 |
| 96              | 8.1                 |
| 97              | 7.6                 |
| 98              | 7.1                 |
| 99              | 6.7                 |
| 100             | 6.3                 |
| 101             | 5.9                 |
| 102             | 5.5                 |
| 103             | 5.2                 |
| 104             | 4.9                 |
| 105             | 4.5                 |
| 106             | 4.2                 |
| 107             | 3.9                 |
| 108             | 3.7                 |
| 109             | 3.4                 |
| 110             | 3.1                 |
| 111             | 2.9                 |
| 112             | 2.6                 |
| 113             | 2.4                 |
| 114             | 2.1                 |
| 115+            | 1.9                 |

\* Adapted from Reg. §1.401(a)(9)-9, A-2.

has a DB who is not the participant's spouse, or (2) there is more than one DB, and therefore, if the spouse is a DB, he/she is not the sole DB, the MRD rules provide that the deceased participant's QRP benefits may be distributed over the DB's life expectancy. Here, such distributions must commence on or before the end of the calendar year immediately following the calendar year in which the participant died.<sup>23</sup>

### ***Spouse is Sole DB***

If the participant's sole DB is the participant's spouse, then the distribution must commence on or before the later of (1) the end of the calendar year immediately following the calendar year of the participant's death, or (2) the end of the calendar year in which the participant would have attained age 70 1/2.<sup>24</sup>

**Example 6.** Hamlet, unmarried and age 30, dies on August 1, 2012. Hamlet's DB is his mother, Gertrude, age 50. Here, Gertrude must begin taking MRDs no later than December 31, 2013.

**Example 7.** Same facts as Example 6 except that Hamlet is married to Ophelia, Ophelia is Hamlet's sole DB, and Hamlet's birthday is January 1. Here, Ophelia must begin taking MRD distributions no later than December 31, 2052, which is the year that Hamlet would have attained the age of 70 1/2, had he lived.

**Planning Pointer.** If there are multiple DBs, one of whom is the surviving spouse, the surviving spouse may be able to avail himself/herself of the special rule for surviving spouses described above by establishing a separate account for the portion of the QRP account to which the surviving spouse is entitled and such separate account is established on a date no later than the last day of the year following the calendar year of the participant's death.<sup>25</sup>

### ***Determination of Applicable Distribution Period—Nonspousal DB***

Unless the participant's spouse is the sole DB, the life expectancy (*i.e.*, the "applicable distribution period") is determined by using the beneficiary's age as of the beneficiary's birthday in the calendar year immediately following calendar year of the participant's death. In subsequent years, the

life expectancy is reduced by one year for each calendar year that elapses after the calendar year immediately following the calendar year of the participant's death.<sup>26</sup>

### ***Determination of Applicable Distribution Period—Spousal DB***

If the participant's surviving spouse is the sole DB, the surviving spouse's life expectancy (*i.e.*, the "applicable distribution period"), is determined using the surviving spouse's birthday for each distribution calendar year after the calendar year of the employee's death through the year of the spouse's death.<sup>27</sup> After the spouse's death, the remaining applicable distribution period is the spouse's life expectancy as of the spouse's birthday in the calendar year of his/her death, reduced by one year for each calendar year that has elapsed after the calendar year of the spouse's death.<sup>28</sup>

### ***Determination of Applicable Distribution Period—Multiple DBs***

If there are multiple DBs, the determination of the applicable distribution period depends on whether each DB is treated as the beneficiary of a separate account. If yes, then generally the MRD rules apply to each DB as if that DB were the sole DB of its portion of the QRP.

If separate account rules do not treat each DB as the beneficiary of a separate account, then if all DBs are individuals, the applicable distribution period will generally be the life expectancy of the oldest beneficiary. If all DBs are not individuals or certain types of trust, which are generally referred to as see-through trusts, the participant is treated as not having a DB. Here, the entire QRP balance must be distributed on or before December 31 of the year containing the fifth anniversary of the participant's death.<sup>29</sup> This is generally referred to as the "five-year rule."

### ***Determination of Applicable Distribution Period—No DB***

If the participant leaves the QRP to his/her estate or another nonindividual beneficiary, other than certain types of trusts, which are generally referred to as "see-through trusts," the participant is treated as having no DB for MRD purposes. Here, the five-year rule applies, and the QRP must be distributed by the end of the fifth calendar year following the calendar year of the participant's death.<sup>30</sup>

**Planning Pointer.** Because the five-year rule is generally unfavorable, advisors should carefully review beneficiary designation forms to ensure that it will not apply to their clients.

## MRDs When Participant Dies After RBD

### *Determination of Applicable Distribution Period—Nonspouse Is DB*

If a participant dies after his/her RBD and has a DB, then the applicable distribution period over which MRDs may be paid is the longer of (1) the DB's life expectancy determined in the year following the participant's death and reduced by one year for each year thereafter,<sup>31</sup> or (2) the participant's remaining life expectancy, determined in the year of the participant's death and reduced by one year for each year thereafter. Such payments must commence by the end of the calendar year following the participant's death.<sup>32</sup> Notwithstanding the foregoing, if the deceased participant did not withdraw his entire MRD in the year of death, the beneficiary must withdraw the remaining amount by the end of that year.<sup>33</sup> In other words, for the year of the participant's death, the MRD must be determined as if the participant had lived throughout the entire year.

### *Determination of Applicable Distribution Period—Spouse Is DB*

If a participant dies after his/her RBD and the participant's spouse is the sole DB, the applicable distribution period is determined using the surviving spouse's life expectancy, using the surviving spouse's birthday for each distribution year after the year of the participant's death through the year of the spouse's death.<sup>34</sup> After the spouse's death, the remaining applicable distribution period is the spouse's life expectancy as of the spouse's birthday in the year of his/her death, reduced by one year for each year that elapses after the year of the spouse's death.<sup>35</sup>

### *Determination of Applicable Distribution Period—No DB*

If the participant leaves the QRP to his/her estate or another nonindividual beneficiary, other than see-through trusts, then the participant is treated as having no DB for MRD purposes, and the applicable

determination period equals the participant's life expectancy in his/her year of death, reduced by one year for each year thereafter.<sup>36</sup>

### *Determination of Applicable Distribution Period—Multiple DBs*

If the participant has multiple DBs, the MRD rules depend on whether each DB is treated as the beneficiary of a separate account pursuant to the separate account rule, which is set out in Reg. §1.401(a)(9)-8(a)(2). If the separate account rule does apply, then each separate account is determined using the MRD rules described above. If the separate account rule does not apply but all DBs are either individuals or see-through trusts, the applicable determination period is the greater of the following: (1) the life expectancy of the oldest DB; or (2) the remaining life expectancy of the participant.<sup>37</sup>

If the separate account rule does not apply and all DBs are not individuals or see-through trusts, the applicable determination period is the participant's remaining life expectancy.<sup>38</sup>

## MRDs Penalties

After a participant's RBD, if the participant fails to take the required MRD, the Internal Revenue Code imposes a penalty equal to 50 percent of the required distribution, which was not distributed.<sup>39</sup> In addition, for qualified retirement plans, failure to make minimum required distributions may result in disqualification of the plan.<sup>40</sup> Because the consequences of failure to comply with the MRD rules are so severe, it is critical that advisors ensure that their clients are MRD compliant.

## Conclusion

This column, which is the first of several that discuss retirement benefits in the context of estate planning, focuses on the MRD rules. Because the consequences of MRD noncompliance can be very high, it is critical for advisors to understand these rules when incorporating retirement benefits into estate plans.

To assist advisors, included below is Appendix 1: Checklist for Determination of MRDs, which summarizes the MRD rules.

Future columns in this series will discuss the income taxation of retirement benefits, tax issues associated with naming trusts as beneficiaries of QRPs and Roth IRAs.

**Appendix 1. Checklist for Determination of MRDs**

| Step No. | Checklist for Determination of MRDs  |
|----------|--|
| 1.       | <p>Is the participant living?</p> <p>A. If no, go to step 7.</p> <p>B. If yes, go to step 2.</p>   |
| 2.       | <p>Has the participant reached or will the participant reach age 70 1/2 during the current calendar year?</p> <p>A. If no, no MRDs are required for the current year.</p> <p>B. If yes, go to Step 3.</p>  |
| 3.       | <p>Determine the amount of the QRP account as of the last valuation date of the immediately preceding calendar year, and then proceed to the next step.</p>  |
| 4.       | <p>Was the participant married at all times during the year and if so, was the participant's spouse both (a) the sole DB during the year, and (b) more than 10 years younger than the participant?</p> <p>A. If yes, determine the applicable distribution period by using the longer of the distribution period determined by using (a) the Uniform Lifetime Table, set forth in Reg. §1.401(a)(9), Q&amp;A-2 and reproduced in Exhibit 2, or (b) the joint life expectancy table for the participant and the participant's spouse pursuant to the Joint and Last Survivor Table, which is set forth in Reg. §1.401(a)(9)-9, Q&amp;A-3. Then go to the next step.</p> <p>B. If no, determine the applicable distribution period by using the Uniform Lifetime Table, set forth in Reg. §1.401(a)(9), Q&amp;A-2 and reproduced in Exhibit 2. Then go to the next step.</p> |
| 5.       | <p>Divide the amount of the QRP account, determined in Step 3, by the applicable distribution period, determined in Step 4. The result equals the MRD for the year. Then go to the next step.</p>  |
| 6.       | <p>Did the participant reach age 70 1/2 during the current calendar year?</p> <p>A. If no, the MRD must be made no later than December 31 of the current calendar year.</p> <p>B. If yes, the participant's required beginning date is April 1 of the next calendar year.</p> <p>C. The analysis is now complete for living participants.</p>  |
| 7.       | <p>Is the participant dead?</p> <p>A. If no, the analysis is complete.</p> <p>B. If yes, did the participant die before the participant's RBD?</p> <p>(1) If yes, go to Step 8.</p> <p>(2) If no, go to Step 9.</p>  |
| 8.       | <p>Was the participant's spouse the sole DB?</p> <p>A. If yes, then:</p> <p>(1) MRDs must commence on/before the later of (a) the end of the calendar year immediately following the calendar year of the participant's death, or (b) the end of the calendar year in which the participant would have attained age 70 1/2; and</p>  |

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| 8. (cont'd) | <p>(2) The applicable distribution period for the spouse is determined using the surviving spouse's birthday for each distribution calendar year after the calendar year of the employee's death through the year of the spouse's death. After the spouse's death, the remaining applicable distribution period is the spouse's life expectancy as of the spouse's birthday in the calendar year of his/her death, reduced by one year for each calendar year that has elapsed after the calendar year of the spouse's death.</p> <p>B. If no, is the DB one individual? If yes:</p> <p>(1) MRDs must commence on or before the end of the calendar year immediately following the calendar year of the participant's death; and</p> <p>(2) The applicable distribution period for the DB is determined by using the beneficiary's age as of the beneficiary's birthday in the calendar year immediately following calendar year of the participant's death. In subsequent years, the life expectancy is reduced by one year for each calendar year that elapses after the calendar year immediately following the calendar year of the participant's death.</p> <p>C. If the answer to both A and B are no, are there multiple DBs? If yes, is each DB treated as a beneficiary of a separate account? If yes, go to Step 8.D. If no, go to Step 8.E. If there is no DB, go to Step 8.F.</p> <p>D. If each multiple DB is treated as the beneficiary of a separate account, then the MRD rules apply to each DB as if that DB were the sole DB of its portion of the QRP.</p> <p>E. If multiple DBs are not treated as beneficiaries of separate accounts, then:</p> <p>(1) If all DBs are individuals, the applicable distribution period will generally be the life expectancy of the oldest beneficiary.</p> <p>(2) If all DBs are not individuals or see through trusts, the participant is treated as not having a DB. Here the five-year rule applies and the entire QRP balance must be distributed on or before December 31 of the year containing the fifth anniversary of the participant's death.</p> <p>F. If there is no DB, the five-year rule applies and the entire QRP balance must be distributed on or before December 31 of the year containing the fifth anniversary of the participant's death.</p> |
| 9.          | <p>Was the participant's spouse the sole DB?</p> <p>A. If yes, then:</p> <p>(1) MRDs must commence on/before the end of the calendar year immediately following the calendar year of the participant's death; and</p> <p>(2) The applicable distribution period for the spouse is determined using the surviving spouse's birthday for each distribution calendar year after the calendar year of the employee's death through the year of the spouse's death. After the spouse's death, the remaining applicable distribution period is the spouse's life expectancy as of the spouse's birthday in the calendar year of his/her death, reduced by one year for each calendar year that has elapsed after the calendar year of the spouse's death.</p> <p>B. If no, is the DB one individual? If yes,</p> <p>(1) MRDs must commence on or before the end of the calendar year immediately following the calendar year of the participant's death; and</p> <p>(2) The applicable distribution period for the DB is the longer of (1) the DB's life expectancy determined in the year following the participant's death and reduced by one year for each year thereafter,<sup>1</sup> or (2) the participant's remaining life expectancy, determined in the year of the participant's death and reduced by one year for each year thereafter.</p>   |

| Step No.    | Checklist for Determination of MRDs  |
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| 9. (cont'd) | <p>C. If the answer to both A and B are no, are there multiple DBs? If yes, is each DB treated as a beneficiary of a separate account? If yes, go to Step 9.D. If no, go to Step 9.E. If there is no DB, go to Step 9.F.</p> <p>D. If each multiple DB is treated as the beneficiary of a separate account, then the MRD rules apply to each DB as if that DB were the sole DB of its portion of the QRP.</p> <p>E. If multiple DBs are not treated as beneficiaries of separate accounts, then:</p> <p>(1) If all DBs are individuals, the applicable distribution period will generally be the greater of the life expectancy of the oldest beneficiary or the remaining life expectancy of the participant.</p> <p>(2) If all DBs are not individuals or see through trusts, the applicable distribution period is the participant's remaining life expectancy.</p> <p>F. If there is no DB, the applicable distribution period is the participant's remaining life expectancy.</p> |

<sup>1</sup> Reg. §1.401(a)(9)-5, Q&A-5(a)(1)(i), Q&A-5(c).

ENDNOTES

- <sup>1</sup> Investment Company Institute, *Research Perspective: The Evolving Role of IRAs in U.S. Retirement Planning* (Nov. 2009).
- <sup>2</sup> Code Sec. 401(a)(9); Reg. §1.409(a)(9)-2, Q&A-1.
- <sup>3</sup> Code Sec. 401(a)(9). See also Reg. §§1.401(a)(9)-3, -4.
- <sup>4</sup> For a very detailed analysis of the economic implications of QRPs under various scenarios, see Steven E. Trytten, *Estate Planning for Retirement Accounts*, ALI-ABA, June 2010.
- <sup>5</sup> Reg. §1.401(a)(9)-2, Q&A-3.
- <sup>6</sup> Reg. §1.401(a)(9)-2, Q&A-2.
- <sup>7</sup> Code Secs. 408(a)(6), 401(1)(9)(C)(i)(I), 401(a)(9)(C)(ii)(II).
- <sup>8</sup> Code Sec. 401(a)(9)(C)(ii)(I); Reg. §1.401(a)(9)-2, Q&A-2(c).
- <sup>9</sup> See Code Sec. 416.
- <sup>10</sup> Reg. §1.401(a)(9)-5, A-1. There are certain exceptions to this rule, including the Five-Year Rule; see Reg. §1.401(a)(9)-3, A-2, which mandates the complete withdrawal of all funds in a retirement plan no later than December 31 of the fifth anniversary of the plan participant's death; asset rollovers into new plans, such as a new IRA, see, e.g., LTR 199931049 (May 12, 1999), LTR 200123070 (Mar. 14, 2001); and delays caused by Qualified Domestic Relations Orders and insurance companies .
- <sup>11</sup> Code Sec. 408(a)(6).
- <sup>12</sup> Code Sec. 408A(c)(5).
- <sup>13</sup> Reg. §1.401(a)(9)-5, Q&A-1(a).
- <sup>14</sup> Reg. §1.401(a)(9)-5, Q&A-3(a).
- <sup>15</sup> Reg. §1.401(a)(9)-7, Q&A-2.
- <sup>16</sup> Reg. §§1.401(a)(9)-5, Q&A-3, -8, Q&A-8-(b).
- <sup>17</sup> Reg. §1.401(a)(9)-5, Q&A-4.
- <sup>18</sup> Reg. §1.401(a)(9)-5, Q&A-4(b)(1).
- <sup>19</sup> *Id.*
- <sup>20</sup> Code Sec. 408A(c)(5); Reg. §1.408A-6, Q&A-14.
- <sup>21</sup> Reg. §1.401(a)(9)-5, Q&A-2.
- <sup>22</sup> Reg. §1.401(a)(9)-2, Q&A-6(a).
- <sup>23</sup> Reg. §1.401(a)(9)-3, Q&A-3(a).
- <sup>24</sup> Reg. §1.401(a)(9)-3, Q&A-3(b).
- <sup>25</sup> Reg. §1.401(a)(9)-8, Q&A-2(a)(2).
- <sup>26</sup> Reg. §1.401(a)(9)-5, Q&A 5(c)(1).
- <sup>27</sup> Reg. §1.401(a)(9)-5, Q&A-5(c)(2).
- <sup>28</sup> Reg. §1.401(a)(9)-5, Q&A-5(c)(2).
- <sup>29</sup> Reg. §§1.401(a)(9)-3, Q&A-1(a), 54.4974-2, Q&A-3(c).
- <sup>30</sup> Code Sec. 401(a)(9)(B)(ii).
- <sup>31</sup> Reg. §1.401(a)(9)-5, Q&A-5(a)(1)(i), Q&A-5(c).
- <sup>32</sup> Reg. §1.401(a)(9)-2, Q&A-5.
- <sup>33</sup> Reg. §1.401(a)(9)-5, Q&A-4(a).
- <sup>34</sup> Reg. §1.401(a)(9)-5, Q&A-5(c)(2).
- <sup>35</sup> Reg. §1.401(a)(9)-5, Q&A-5(c)(2).
- <sup>36</sup> Reg. §1.401(a)(9)-5, Q&A-5(a)(2), (c)(3).
- <sup>37</sup> Reg. §1.401(a)(9)-5, Q&A-5(a)(1), Q&A-7(a)(1).
- <sup>38</sup> Reg. §§1.401(a)(9)-4, Q&A-3, -5, Q&A-5(a)(2).
- <sup>39</sup> Code Sec. 4974(a); Reg. §54.4974-1.
- <sup>40</sup> Code Sec. 401.

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