

## **IRA Planning Primer**

Every time you establish a new Individual Retirement Account (IRA) or review an existing account, you need to ask yourself : 1) Who should I name as my IRA beneficiary? 2) When should I take distributions from my IRA? and 3) How much should I take? The following can serve as a guide to making these determinations.

### **Who Should You Name as Beneficiary?**

**Spouse.** If you name your spouse as the beneficiary of your IRA upon your death, your spouse will have several options. One is to roll over the IRA benefits into his or her own IRA. This will allow your spouse to defer taking distributions until he or she reaches age 70½. (Your spouse also will designate a new IRA beneficiary, potentially allowing for further deferral after his or her death.) If your spouse is older, he or she also can elect to retain your IRA and defer taxable distributions until you would have reached age 70½. Naming your spouse as beneficiary not only allows for possible tax advantages but also allows for the use of the marital deduction for estate tax purposes. However, if you do not want your spouse to have full control over the IRA benefits on your death, then you must consider other alternatives.

**Nonspouse.** If you name someone other than your spouse as the beneficiary of your IRA, he or she will not be able to roll over the IRA benefits because the tax deferral rollover option is available only to your spouse. A nonspouse beneficiary can receive your IRA benefits over his or her life expectancy, thereby allowing for some income tax deferral, especially if he or she is younger than you. However, this deferral will not be available if you were over age 70½ when you named the beneficiary and had elected to recalculate your life expectancy as to benefits you were receiving.

**Revocable Trust.** Be careful if you name your revocable (living) trust as your IRA beneficiary because you could face an acceleration of IRA income if the trust was still revocable after you reached age 70½. There may still be some deferral opportunity if you have named your revocable trust as beneficiary and have begun taking distributions over your life expectancy (rather than recalculating) because the rules allow the beneficiary to take distributions "at least as rapidly as the account owner was prior to death."

**Credit Shelter Trust.** Consider naming a testamentary or irrevocable lifetime credit shelter trust as beneficiary, especially if the retirement plan is a large part of the estate. Depending on the type of trust or when death occurs, there may be income acceleration, but at least the plan can take advantage of the unified credit equivalent to ultimately save estate taxes.

**Charity.** Naming a qualified charity as IRA beneficiary may offer the best tax results. Upon the IRA owner's death, the account will be subject to federal estate tax in the owner's estate as well as income tax to the IRA recipient. Designating a qualified charity will result in a charitable deduction for federal estate tax purposes. Because the charity is

a tax exempt entity, the distribution of your IRA account balance will escape income taxation. However, your estate would still be liable for the 15% excise tax on excess accumulations, if one is due.

### **When Should You Take Distributions?**

**IRA Owner.** The IRA owner generally cannot take distributions from the IRA until age 59½. Owners who do take distributions before age 59½ face a penalty equal to 10% of the amount distributed. Distributions must start by the required beginning date (RBD), defined as April 1 of the calendar year after which the owner attains age 70½. At the RBD, the owner must irrevocably decide if he or she wishes to take distributions by recalculating life expectancy over a term certain. Deciding when to begin taking distributions may be dependent on the account values as of the date the owner reaches age 59½. In limited circumstances, distributions can begin prior to age 59½ if the distributions are of substantially equal periodic payments. As discussed below, this may be a desirable option if your account values are high and you wish to avoid excess distributions or accumulations. Note that it is possible to receive a double distribution in the first year (April 1 and Dec. 31). This may result in an excess distribution, discussed below, and consideration should be given to taking the first distribution Dec. 31 of the prior year.

**Beneficiary.** After the death of the IRA owner, the designated beneficiary can (and perhaps must) begin taking distributions, but there will be no early withdrawal penalty.

a. The spouse beneficiary can elect to take the IRA benefits out (i) within five years of death, (ii) over the life expectancy of the spouse (if the owner dies before the RBD), and distributions must begin on or before Dec. 31 of the year following the year in which the owner died, unless the spouse makes a special election to defer taking distributions until the owner would have reached age 70½, (iii) as the spouse's own, or (iv) at least as rapidly as the owner was taking during life (if the owner dies after the RBD).

b. The nonspouse beneficiary can take distributions (i) within five years of the owner's death or (ii) over the life expectancy of the beneficiary (if the owner dies before the RBD), or (iii) at least as rapidly as the owner was taking during life (if the owner dies after the RBD). The special election to defer distributions until the owner would have reached age 70½ is not available to a nonspouse beneficiary. If the life expectancy option is available and elected, then distribution must begin by Dec. 31 of the year after the year in which the owner died.

### **What Distributions Should You Take?**

**Minimum Required Distribution (MRD).** Upon the IRA owner attaining the RBD, the Internal Revenue Code sets forth a formula to determine the minimum amount required to be distributed on an annual basis. The MRD is based on the account value divided by a factor that is based on the owner's life expectancy. The election to recalculate or take

distributions over a term certain will determine life expectancy after the first year. For example, assume Joe has a \$750,000 IRA. At age 70 $\frac{1}{2}$ , the Internal Revenue Service tables indicate Joe's life expectancy is 16 years. Joe's MRD for the first year will be \$46,875. Alternatively, the MRD can be based on the joint life and last survivor expectancy of the owner and a designated beneficiary. Note, there is a 50% penalty imposed on any deficiency in the amount distributed.

***Excess Distributions.*** If the MRD is greater than \$160,000 (the threshold for 1997, increased for inflation annually), then the excess distribution is subject to a penalty for excess accumulations. As a result, an individual who, at age 59 $\frac{1}{2}$ , has a qualified plan or plans containing substantial assets may wish to consider taking distributions to begin reducing the account value, or at a minimum, to prevent additional growth. Additionally, the owner may wish to cease making additional contributions to the plan. Finally, the owner may wish to begin distributions even earlier than age 59 $\frac{1}{2}$  and qualify under the substantially equal periodic payment exception to the early distribution payment. Note that there will be no excess distribution penalties for withdrawals during 1997, 1998 and 1999.

***Excess Accumulations.*** If, upon death, an account owner holds an IRA (or other qualified retirement plan or plans) and the plan is deemed to have excess accumulations, then the owner's estate will be subject to an additional tax on death equal to 15% of the excess. An excess accumulation is defined as the excess of the account value (or aggregate account values) on death over the present value of an annuity producing \$160,000 (the 1997 threshold) annually, based on the life expectancy of the owner immediately prior to death. Note that this tax may be imposed even if no estate tax is due. If a spouse is named as the beneficiary, the spouse can elect to defer the excess accumulations tax. If the spouse lives long enough, then perhaps the penalty will be avoided.

### **Consider All of the IRA Options**

We have discussed some of the complex issues and choices that generally are applicable. However, there may be other possible beneficiaries and election options available. All options and elections should be discussed with a skilled estate planning advisor before taking any final action. We would be pleased to assist you in making these decisions.