BASIC RULES OF REQUIRED DISTRIBUTIONS

Generally, if you own a retirement plan, you can take money out any time you like. You may have to pay a penalty if you take money out too soon, but the money is there for you.

The rules I discuss here are concerned mostly with when the law *requires* you to take the money out. Most of the time, you have to pay income tax on all the money you take out.

Disclaimer: to make these basic rules intelligible, I fudged a few places and broke off some square corners. Please don't make any decisions based on these rules alone—they are designed just to get you started in the right direction. If you find yourself dealing with any of this, seek expert help. These rules are unisex—a widower is treated the same as a widow:

1. **Participant**. A "participant" is the person who earned the retirement account. (If a spouse inherits a retirement account and "rolls over" the account, she is then treated as if she earned the account.)

2. **Designated beneficiary**. When a participant dies, the retirement account goes to some beneficiary. A "designated beneficiary" is a human being (with a life expectancy you can establish). You can have several designated beneficiaries (like "my children"). An estate of a dead person is not a designated beneficiary. Trusts generally fail to qualify as a designated beneficiary. Is some situations, maybe a real simple trust for one human being (a so-called "see-through trust") can be a designated beneficiary.

   The advantage to being a designated beneficiary is that you may be able to get a "stretch-out." Then you may be able to keep the tax shelter of the retirement plan going for your benefit for a long time. A beneficiary not qualified as "designated" will not get a stretch-out and will often have to accept all the retirement account in one payment. This could cause a big "spike" in income tax for the year the inheritance comes in, and there will be no more tax shelter.

3. **Modes of distribution**. A retirement plan is distributed to the participant in one of the following ways:

   (a) In a lump sum

      i. In an annuity over his life (like $2,000 a month until he dies, which leaves no inheritance for children or others)
      ii. In a joint annuity over his life and that of a designated beneficiary (like $1,500 a month until both he and his wife have died, which leaves no inheritance for children)
      iii. In payments over his life expectancy (now there can be money left over to be inherited by children)
      iv. In payments over the joint life expectancy of the participant and a designated beneficiary (here too there can be money left over to be inherited by children)

4. **Required beginning date**. The participant must take the lump sum payment or start a payout by the "required beginning date." This is April 1 (not April 15) following the year in which the participant is age 70 ½.

   (a) However, an employee of a company (that the employee does not control) can delay the required beginning date for retirement plans (other than IRAs) until the time he retires. Participants in government and church plans get a similar break.

   (b) If you hit age 70 and you still have money in retirement plans, you need to be sure you know how all this works. If you fail to take out your required minimum distributions on time, there can be serious penalties (50% of the amount you failed to distribute).

5. **Life expectancy mode**. Most affluent participants will elect to take the required distributions over a life expectancy so as to enhance the prospects of inheritance by children.

   (a) There is a Uniform Lifetime Table ("ULT") that most people, single or married, will use for figuring out their required minimum distributions. This table is surprisingly liberal in favor of participants. The ULT allows participants who can afford it to leave money in the retirement plan longer so as to keep earning money free of income tax. (Most participants, however, have to take fund out faster than the ULT requires because they need the money for living expenses.)

   (b) If you are married and your spouse is more than 10 years younger than you, there is a special table for you to use that is even more liberal than the ULT.

6. **Death before RBD**. If the participant dies before the required beginning date (i.e., a younger participant):

   (a) If the designated beneficiary is a widow, see the special rules below.

   (b) If there is a designated beneficiary who is not a widow, the law allows payments to that designated beneficiary over his single life expectancy. This can allow the beneficiary to keep the tax shelter of the retirement plan working for him for a long time. Some retirement plans (especially IRAs) have this flexibility built in to help relatives (children, grandchildren, etc.) as well as significant others.

   (c) Alas, many retirement plans (especially 401(k)s) don't allow payments over long periods of time to non-spouse beneficiaries (even though the law permits it). But beginning in 2010, these retirement plans must give non-spouse designated beneficiaries the option of transferring their accounts to a special inherited IRA. Then the beneficiary can stretch out the distributions over his life expectancy.

   (d) If there is no designated beneficiary, payments can be made over five years to whomever gets the money (often the estate of the participant) if the plan allows that. Otherwise, the beneficiary may be stuck with taking a lump sum.

   (e) Generally, the beneficiary gets sufficient time to deal with the details of his inherited retirement. But don't run the risk of missing a deadline. Get started on this as soon as possible.

7. **Death after RBD**. If the participant dies after the required beginning date (i.e., an older participant) then payments out of the plan to the participant are already underway:

   (a) If the designated beneficiary is a widow, see the special rules below.

   (b) If there is a designated beneficiary who is not a widow, the law allows payments over the longer of the single life expectancy of the beneficiary or the single life expectancy of the participant. This can allow the beneficiary to keep the tax shelter of the retirement plan working for him for a long time. Some retirement plans (especially IRAs) have this flexibility built in to help relatives (children, grandchildren, etc.) as well as significant others.

   (c) Alas, many retirement plans (especially 401(k)s) don't allow payments over long periods of time to non-spouse beneficiaries (even though the law permits it). But beginning in 2010, these retirement plans must give non-spouse designated beneficiaries the option of transferring their accounts to a special inherited IRA. Then the beneficiary can stretch out the distributions over the longer of the single life expectancy of the beneficiary or the single life expectancy of the participant.

   (d) If there is no designated beneficiary, whoever gets the money can stretch out receipt of the funds over the single life expectancy of the participant (if the plan permits this).

   (e) Because the participant is already taking distributions in this situation, the beneficiary should undertake to deal with this immediately. There must be a distribution for the year of death and each year thereafter (there is no hiatus as in the situation when the participant dies before the RBD).

8. **Widow remains beneficiary**. If the designated beneficiary is the participant's spouse, she can continue to treat herself as the beneficiary of the participant's IRA and doesn't have to take anything until the participant would have been 70 ½.

   (a) This is not a rollover. This is probably a better choice than a rollover for younger widows of moderate means who will need to spend money from the participant's plan for living expenses. Under this approach, she will not be burdened with a 10% tax on any distributions prior to the time she is 59 ½.

   (b) The widow doesn't have to do anything to get this treatment. Remaining a beneficiary is the default.

9. **Widow rolls over**. The widow also has the right to rollover the account to her own IRA. Once rolled over, the account is treated as if the widow were the participant who earned the funds. If she needs money from the IRA before age 59 ½, this can expose her to a 10% tax which probably could have been avoided. Most older widows will want to rollover. This "fresh start" has 3 big advantages:

   (a) It can delay in many cases the required beginning date for the widow to start taking distributions.

   (b) Once the required beginning date arrives, the widow will have use of the liberal ULT.

(c) The designated beneficiaries of the widow can, when they inherit from her, withdraw funds over their life expectancies.

10. **Roth IRA.** Generally, retirement plans were designed to provide retirement security and not to be vehicles for inheritance by others. Roth IRAs provide both retirement security and an excellent way to leave an inheritance. Distributions (after an initial holding period) are always free of income tax to the participant. The participant never has to take money out. When the participant dies, the beneficiary can take all the money out immediately with no income tax.

    Can the beneficiary also leave money in the plan for a stretch-out of the tax shelter? Yes. But the beneficiary is limited to the same minimum distribution rules that apply to a traditional IRA when the participant dies before his RBD—the life expectancy of the beneficiary (if he happens to fit the definition of a designated beneficiary) or the five-year rule.

11. **2009 special tax break.** After the dramatic stock market decline late in 2008, Congress quickly passed a special law that suspends required distributions to participants and beneficiaries from most retirement plans for 2009 (only). The idea is to not force folks to sell stocks when they are down in order to raise money to make a distribution. Sounds simple, but according to an article in the *Wall Street Journal* on February 11, 2009, this law has proved to be "perplexing" in many situations. If you're interested in this, get in touch with your plan administrator right away.

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