REQUIRED MINIMUM DISTRIBUTIONS

A COMEDY IN V ACTS

This is an detailed discussion of some of the more important things people need to know about distributions from retirement plans. In particular:

- If you are age 69, read Act I to learn how to figure out how much money you must soon start taking out of your retirement plans.
- If you are the beneficiary of a retirement plan that belongs to someone other than your spouse, you may find Act II amusing.
- If you are the beneficiary of a retirement plan that belongs to your spouse, you should benefit from reading Act III.
- Act IV fills you in on the concept of a "designated beneficiary" of a retirement plan.
- Act V covers some of the interesting aspects of the Roth IRA.

Warning: the materials presented here could cause brain strain. Also, you should not go to the next page if you are offended by bad jokes.

For more information about distributions from retirement plans:

- The best book for everybody is Slesnick and Suttle, *IRAs, 401(k)s, and other Retirement Plans—Taking Your Money Out*. (8th Ed. 2007) (Nolo Press; more information at www.nolo.com)
- The authoritative resource for tax and estate planning professionals is Choate, *Life and Death Planning for Retirement Benefits* (6th Ed. 2006; more information at www.ataxplan.com)

Good luck, and enjoy the **next 24 pages** coming up!

REQUIRED MINIMUM DISTRIBUTIONS

A Comedy in V Acts by Henry C. McFadyen, Jr.

Dramatis Personae (in order of appearance)

Hank: a tax lawyer
Josh: a neighbor, age 69
Tammy Faye: a neighbor who just inherited two traditional IRAs
Amelia, Betty Boo, Cruella, and Dorothy: widows in the Poker Club
M.P. Moneypenny: President of the Neighborhood Association
Ruth, who will inherit a Roth IRA

Special note: required minimum distributions are suspended for 2009. Act I of this play deals with folks who turn 70 in 2009. They don't have to take money out until 2010 at the earliest. So the suspension doesn't apply to them. But if you turned 70 in the 1st half of 2008, 2009 would be your first distribution calendar year, and you could skip that year's distribution.

ACT I

Josh — Getting Started on Taking It Out

Time: A Sunday evening in August 2009

Place: A backyard in Far North Dallas, Texas

Hank is making ice cream when Josh comes through the back gate. After exchanging pleasantries, Josh says:

"Hank, they say you know about minimum distributions."

"Well, Josh, I guess so. Ask me a question while I make this ice cream."

Q1: I'm 69. My birthday is May 1. I'm retired except for a part-time job. I've got three traditional IRAs, a Roth IRA, and there's a 401(k) where I used to work. I'm single. When do I have to start taking money out of all this?

A1: Well Josh, next year, you will turn 70 on May 1, 2010. You also will turn 70½ on November 1, 2010. So, 2010 will be an important year for you.

- ▷ You can't make a traditional IRA contribution during the year you turn 70½ or later. This is the last year you could make a traditional IRA contribution.
- ▷ You can keep making contributions to the Roth IRA if you keep working, make at least as much as your contribution, and don't have too much income.
- ▷ More important, because it's the year in which you turn 70½, 2010 will be your first distribution calendar year (DCY).
  - – You must take a required minimum distribution (RMD) from each of the traditional IRAs and the 401(k) for your first DCY.

- You will also take a RMD for each DCY after that.
- But you never have to take a distribution from the Roth IRA. However, when you die, your beneficiary will have to take RMDs from the Roth IRA.

Q2: But I thought I could wait to take money out until April 15 of the year after I turn 70½! That would be 2011.

A2: Well, it's April 1, not the 15th! That's your required beginning date (RBD), the absolute deadline to avoid a possible 50% penalty.

Q3: Where does this weird 70½ number come from?

A3: It's a way to give everybody plenty of lead time to think about how to start taking their first RMD. If your birthday is early in year 1, you will be 70½ in year 1, and you get until April 1 of year 2 to take the first distribution. That's at least 9 months of lead time from your 70th birthday. If your birthday is late in year 1, you will be 70½ in year 2, and must take the first distribution by April 1 of year 3. That's at least 15 months of lead time from your 70th birthday.

Q4: Well, exactly when is best for me to take the first RMD?

A4: Depends. Your first RMD has to be based on the value of the accounts on December 31, 2010. That's why they give you 90 days slack for your first DCY. You can't figure the distribution correctly for sure until after the end of the year.

One strategy would be to make an estimated distribution toward the end of 2010. You can probably get real close to the exact amount. Of course, most distributions from retirement plans are ordinary income. The income tax you have to pay will be for 2010. In 2011 you can make another small distribution before April 1 if you didn't distribute enough in 2010. One advantage of this is you reduce the risk of missing the deadline later and a possible 50% penalty on inadequate distribution. The disadvantage is you are paying an income tax before you have to.

The other strategy is to wait until March of 2011 to make the distribution for 2010. This defers some income tax for a year. But there are also disadvantages. First, you will run a greater risk of missing the deadline. Second, don't forget you must also make a distribution for 2011 in 2011. This will bunch up two distributions in one year, which could throw you into a higher tax bracket. Third, the RMDs for both 2010 and 2011 will be figured on the account balance at the end of 2010, un-reduced by the distribution you made in 2011 on account of year 2010. So you have to take out a bit more for 2011 than would be the case if you made a distribution in 2010.

Finally, your other income and deductions for 2010 and 2011 could influence your decision. You have to run the numbers on your situation. I guess I like the idea of starting early rather than waiting until the last minute on this.

Q5: Don't I get until April 1 each year?

A5: No! The 90 days slack is only for the first DCY. After that you take your RMD each year by December 31. You base the distribution on the value of the account at the end of the prior year.

Q6: I’ve got 3 traditional IRAs. How do I handle that?

A6: You have to figure the RMD for each one. Add ’em up. Then you can take the total from any IRA. But you can’t aggregate your 401(k) plan with the IRAs. So you will need to take at least one distribution for the IRAs and another for the 401(k). For people with different kinds of retirement plans, this can be tricky.

Q7: Sounds tricky, I agree. How does the IRS keep track of all this?

A7: Well, your 401(k) is a qualified retirement plan. The administrator of the 401(k) plan must follow the rules about minimum distributions or the whole plan might be disqualified and the administrator would get fired for sure. The folks who provide your IRAs don’t really care when you take the money out. But they make information reports to the IRS every year. The IRS has the data they would need to aggressively audit. However, it appears the IRS in recent years has not been auditing required minimum distributions. Maybe the risk of getting caught with an error is small, but the stakes are big with that 50% penalty.

Q8: But how much do I have to take out? Remember, I’m not married.

A8: Go to the Uniform Lifetime Table (ULT). The ULT is just one page long. I just happen to have an example here. Let’s suppose you have an IRA of $100,000. For purposes of this illustration, let’s assume the IRA doesn’t make anything or lose anything. Here’s what you will take out over the years. (See Scenario 1a on page 6.)

Q9: Can I start earlier than my first DCY?

A9: You can take your money out anytime. Since the time you were 59½ there was no penalty for withdrawal. You can start on regular distributions early and take out whatever you want. But once age 70½ kicks in, you must distribute the required amounts each year. You don’t get any credit for what you distributed earlier.

Q10: H’m. I’m looking at this illustration. So each year I get less money?

A10: Yes. This illustration ignores market gains and losses. The ULT tends to give you less each year but it keeps at least something in the pipeline for you until you’re 115.

Q11: Hey, could I run out of money?

A11: Only if your IRA investments became worthless. But it really hurts if your investments go south. For example, if the market keeps going down 5% a year, the distributions over the years would look like this. (See Scenario 1b on page 7.) By the time you are 90, the wolf will be at the door.

Q12: Oh. That’s ugly. If the IRA loses money, can I hold up on a distribution?

A12: No. It’s not called “required” for nothing.

Q13: I'll need to fix my roof soon. If I take out a bunch of money in, say, 2012, can that apply to 2013 and 2014 also?

A13: Nope. No carryovers.

Q14: What if I make money in the IRA? People sometimes make money on investments, I think.

A14: I have an example of that too. (See Scenario 1c on page 8.) If the IRA makes 5%, the fund grows until you are 78 and the annual distribution grows until you are 93. There's also a good chance somebody else will eventually inherit quite a lot from the IRA.

Q15: Boy, this really is dicey! Can I get a level flow of payments?

A15: Sure, you can buy an immediate lifetime annuity from an insurance company with your $100,000. Hand me that box of salt. If the 10 year treasury note is yielding about 4% when you buy your annuity, it will pay you about $775 a month or $9,300 a year for the rest of your life. But if you die in a year, the money is gone and your survivors get nothing. You can buy different kinds of annuities that provide for an inheritance to eventually go to your survivors, but then your monthly payment would be reduced. You have to shop around.

Q16: I'm looking at the ULT now and it says I have 27.4 years at age 70. Do they think I'm going to live that long?

A16: No, your life expectancy (per the IRS) at age 70 is only 17 years. The ULT is like a sock where one size fits all. It's designed to include a participant who is married to a spouse who is 10 years younger. It then tries to spread the money out over the life of the participant and the spouse too. It even recalculates the life expectancies of the spouses to stretch the payments out pretty far. But you get to use the same table even though you are single.

Q17: I'm thinking about getting married . . . there are these two sisters who live across the street. One is 62.

A17: If you marry her, you use the ULT exactly the same as we talked about. She's only 8 years younger than you.

Q18: The other sister is 48.

A18: Oh! Marry the young one! Then you can have even smaller RMDs. There's a special table for you if your wife is more than 10 years younger—the Joint and Last Survivor Table. Here's a copy. It's 14 pages long. Let's see, if you are 70 next year and your wife is 49, your first distribution is based on 35.9 years or only 2.78%. Then in the following year you will be 71, she will be 50, and the factor will be 35 years or only 2.85%. Now that's a stretch-out!

Q19: Right now my IRA beneficiary is my son. If I get married, do I have to name my wife as beneficiary instead of my son?

A19: Josh, the ice cream is almost finished, and I'm too tired to talk about marital property law. Let's just say that your new bride signs a marital property agreement and doesn't want any of the IRA. Now we can focus again on RMDs.

If you marry the sister who is 62, you can use the ULT because everybody can use it. So you can keep your son as beneficiary. But if you marry the sister who is 48, you will have to name her as beneficiary if you want to use the Joint and Last Survivor Table. You could still name you son as beneficiary, but you would be stuck with the ULT.

Q20: Why is this Joint and Last Survivor Table so long?

A20: Because it figures the combined life expectancy of the couple at every combination of ages. You get to re-figure this each year to help you avoid running short of money as you get older. The ULT is short because the recalculation is built in.

Q21: I have to show this to my cousin. He was born in the same year as me . . . even if he's 3 months younger.

A21: No, Josh! He will be 70 in August, 2010. He will be 70½ in 2011, not 2010! So he can wait a year longer than you. His first DCY will be 2011, and his RBD will be April 1, 2012. On the other hand, in his first DCY he will turn 71, so his first distribution will be a little bigger than yours percentage wise. He will start with age 71 on the ULT.

Q22: I forgot to mention I have a small defined benefit pension also.

A22: Everything we said so far applies to your IRA and the 401(k). But the pension is easy. The pension office will just send you a check every month.

Q23: My best friend says he had 2 RBDs. How can that be?

A23: Easy. He was an employee of a company where he was not a major, or 5%, owner. He kept working past age 70 and adding to his 401(k). But he also had an IRA. After 70½, he hit his RBD for his IRA and had to start taking money out. When he finally retired from the company, he had a different RBD for the 401(k). He has to keep track of all this separately.

Q24: Well, I see the ice cream is ready. I'll say that the subject of RMD is pretty complicated. Can I bring our neighbor Tammy Faye to see you? Her father and her uncle just died.

A24: We didn't cover it all, Josh. If you worked for a government, a church, or a non-profit there are yet more rules. And we haven't touched on how you handle an inherited retirement account; I guess that might be Tammy Faye's problem. Here's the first scoop for you!

Scenario 1a:
IRA Participant is age 70
Uniform Lifetime Table used
Distribution at beginning of each year
0% growth after taxes and expenses

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending IRA Balance
70	27.4	3.65%	100,000	(3,650)	96,350	0	96,350
71	26.5	3.77%	96,350	(3,636)	92,714	0	92,714
72	25.6	3.91%	92,714	(3,622)	89,092	0	89,092
73	24.7	4.05%	89,092	(3,607)	85,485	0	85,485
74	23.8	4.20%	85,485	(3,592)	81,893	0	81,893
75	22.9	4.37%	81,893	(3,576)	78,317	0	78,317
76	22.0	4.55%	78,317	(3,560)	74,757	0	74,757
77	21.2	4.72%	74,757	(3,526)	71,231	0	71,231
78	20.3	4.93%	71,231	(3,509)	67,722	0	67,722
79	19.5	5.13%	67,722	(3,473)	64,249	0	64,249
80	18.7	5.35%	64,249	(3,436)	60,813	0	60,813
81	17.9	5.59%	60,813	(3,397)	57,416	0	57,416
82	17.1	5.85%	57,416	(3,358)	54,058	0	54,058
83	16.3	6.13%	54,058	(3,316)	50,742	0	50,742
84	15.5	6.45%	50,742	(3,274)	47,468	0	47,468
85	14.8	6.76%	47,468	(3,207)	44,261	0	44,261
86	14.1	7.09%	44,261	(3,139)	41,122	0	41,122
87	13.4	7.46%	41,122	(3,069)	38,053	0	38,053
88	12.7	7.87%	38,053	(2,996)	35,057	0	35,057
89	12.0	8.33%	35,057	(2,921)	32,136	0	32,136
90	11.4	8.77%	32,136	(2,819)	29,317	0	29,317
91	10.8	9.26%	29,317	(2,715)	26,602	0	26,602
92	10.2	9.80%	26,602	(2,608)	23,994	0	23,994
93	9.6	10.42%	23,994	(2,499)	21,495	0	21,495
94	9.1	10.99%	21,495	(2,362)	19,133	0	19,133
95	8.6	11.63%	19,133	(2,225)	16,908	0	16,908
96	8.1	12.35%	16,908	(2,087)	14,821	0	14,821
97	7.6	13.16%	14,821	(1,950)	12,871	0	12,871
98	7.1	14.08%	12,871	(1,813)	11,058	0	11,058
99	6.7	14.93%	11,058	(1,650)	9,408	0	9,408
100	6.3	15.87%	9,408	(1,493)	7,915	0	7,915
101	5.9	16.95%	7,915	(1,342)	6,573	0	6,573
102	5.5	18.18%	6,573	(1,195)	5,378	0	5,378
103	5.2	19.23%	5,378	(1,034)	4,344	0	4,344
104	4.9	20.41%	4,344	(887)	3,457	0	3,457
105	4.5	22.22%	3,457	(768)	2,689	0	2,689
106	4.2	23.81%	2,689	(640)	2,049	0	2,049
107	3.9	25.64%	2,049	(525)	1,524	0	1,524
108	3.7	27.03%	1,524	(412)	1,112	0	1,112
109	3.4	29.41%	1,112	(327)	785	0	785
110	3.1	32.26%	785	(253)	532	0	532
111	2.9	34.48%	532	(183)	349	0	349
112	2.6	38.46%	349	(134)	215	0	215
113	2.4	41.67%	215	(90)	125	0	125
114	2.1	47.62%	125	(60)	65	0	65
115	1.9	52.63%	65	(34)	31	0	31

Scenario 1b:
IRA Participant is age 70
Uniform Lifetime Table Used
Distribution at beginning of each year
-5% growth after taxes and expenses

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending IRA Balance
70	27.4	3.65%	100,000	(3,650)	96,350	(4,818)	91,532
71	26.5	3.77%	91,532	(3,454)	88,078	(4,404)	83,674
72	25.6	3.91%	83,674	(3,269)	80,405	(4,020)	76,385
73	24.7	4.05%	76,385	(3,093)	73,292	(3,665)	69,627
74	23.8	4.20%	69,627	(2,926)	66,701	(3,335)	63,366
75	22.9	4.37%	63,366	(2,767)	60,599	(3,030)	57,569
76	22.0	4.55%	57,569	(2,617)	54,952	(2,748)	52,204
77	21.2	4.72%	52,204	(2,462)	49,742	(2,487)	47,255
78	20.3	4.93%	47,255	(2,328)	44,927	(2,246)	42,681
79	19.5	5.13%	42,681	(2,189)	40,492	(2,025)	38,467
80	18.7	5.35%	38,467	(2,057)	36,410	(1,821)	34,589
81	17.9	5.59%	34,589	(1,932)	32,657	(1,633)	31,024
82	17.1	5.85%	31,024	(1,814)	29,210	(1,461)	27,749
83	16.3	6.13%	27,749	(1,702)	26,047	(1,302)	24,745
84	15.5	6.45%	24,745	(1,596)	23,149	(1,157)	21,992
85	14.8	6.76%	21,992	(1,486)	20,506	(1,025)	19,481
86	14.1	7.09%	19,481	(1,382)	18,099	(905)	17,194
87	13.4	7.46%	17,194	(1,283)	15,911	(796)	15,115
88	12.7	7.87%	15,115	(1,190)	13,925	(696)	13,229
89	12.0	8.33%	13,229	(1,102)	12,127	(606)	11,521
90	11.4	8.77%	11,521	(1,011)	10,510	(526)	9,984
91	10.8	9.26%	9,984	(924)	9,060	(453)	8,607
92	10.2	9.80%	8,607	(844)	7,763	(388)	7,375
93	9.6	10.42%	7,375	(768)	6,607	(330)	6,277
94	9.1	10.99%	6,277	(690)	5,587	(279)	5,308
95	8.6	11.63%	5,308	(617)	4,691	(235)	4,456
96	8.1	12.35%	4,456	(550)	3,906	(195)	3,711
97	7.6	13.16%	3,711	(488)	3,223	(161)	3,062
98	7.1	14.08%	3,062	(431)	2,631	(132)	2,499
99	6.7	14.93%	2,499	(373)	2,126	(106)	2,020
100	6.3	15.87%	2,020	(321)	1,699	(85)	1,614
101	5.9	16.95%	1,614	(274)	1,340	(67)	1,273
102	5.5	18.18%	1,273	(231)	1,042	(52)	990
103	5.2	19.23%	990	(190)	800	(40)	760
104	4.9	20.41%	760	(155)	605	(30)	575
105	4.5	22.22%	575	(128)	447	(22)	425
106	4.2	23.81%	425	(101)	324	(16)	308
107	3.9	25.64%	308	(79)	229	(11)	218
108	3.7	27.03%	218	(59)	159	(8)	151
109	3.4	29.41%	151	(44)	107	(5)	102
110	3.1	32.26%	102	(33)	69	(3)	66
111	2.9	34.48%	66	(23)	43	(2)	41
112	2.6	38.46%	41	(16)	25	(1)	24
113	2.4	41.67%	24	(10)	14	(1)	13
114	2.1	47.62%	13	(6)	7	0	7
115	1.9	52.63%	7	(4)	3	0	3

Scenario 1c:
IRA Participant is age 70
Uniform Lifetime Table Used
Distribution at beginning of each year
5% growth after taxes and expenses

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending IRA Balance
70	27.4	3.65%	100,000	(3,650)	96,350	4,818	101,168
71	26.5	3.77%	101,168	(3,818)	97,350	4,868	102,218
72	25.6	3.91%	102,218	(3,993)	98,225	4,911	103,136
73	24.7	4.05%	103,316	(4,176)	98,960	4,948	103,908
74	23.8	4.20%	103,908	(4,366)	99,542	4,977	104,519
75	22.9	4.37%	104,519	(4,564)	99,555	4,998	104,953
76	22.0	4.55%	104,953	(4,771)	100,182	5,009	105,191
77	21.2	4.72%	105,191	(4,962)	100,229	5,011	105,240
78	20.3	4.93%	105,240	(5,184)	100,056	5,003	105,059
79	19.5	5.13%	105,059	(5,388)	99,671	4,984	104,655
80	18.7	5.35%	104,655	(5,597)	99,058	4,953	104,011
81	17.9	5.59%	104,011	(5,811)	98,200	4,910	103,110
82	17.1	5.85%	103,110	(6,030)	97,080	4,854	101,934
83	16.3	6.13%	101,934	(6,254)	95,680	4,784	100,464
84	15.5	6.45%	100,464	(6,482)	93,982	4,699	98,681
85	14.8	6.76%	98,681	(6,668)	92,013	4,601	96,614
86	14.1	7.09%	96,614	(6,852)	89,762	4,488	94,250
87	13.4	7.46%	94,250	(7,034)	87,216	4,361	91,577
88	12.7	7.87%	91,577	(7,211)	84,366	4,218	88,584
89	12.0	8.33%	88,584	(7,382)	81,202	4,060	85,262
90	11.4	8.77%	85,262	(7,479)	77,783	3,889	81,872
91	10.8	9.26%	81,672	(7,562)	74,110	3,706	77,816
92	10.2	9.80%	77,816	(7,629)	70,187	3,509	73,696
93	9.6	10.42%	73,696	(7,677)	66,019	3,301	69,230
94	9.1	10.99%	69,320	(7,618)	61,702	3,085	64,787
95	8.6	11.63%	64,787	(7,533)	57,254	2,863	60,117
96	8.1	12.35%	60,117	(7,422)	52,695	2,635	55,330
97	7.6	13.16%	55,330	(7,280)	48,050	2,403	50,453
98	7.1	14.08%	50,453	(7,106)	43,347	2,167	45,514
99	6.7	14.93%	45,514	(6,793)	38,721	1,936	40,657
100	6.3	15.87%	40,657	(6,453)	34,204	1,710	35,914
101	5.9	16.95%	35,914	(6,087)	29,827	1,491	31,318
102	5.5	18.18%	31,318	(5,694)	25,624	1,281	26,905
103	5.2	19.23%	26,905	(5,174)	21,731	1,087	22,818
104	4.9	20.41%	22,818	(4,657)	18,161	908	19,069
105	4.5	22.22%	19,069	(4,238)	14,831	742	15,573
106	4.2	23.81%	15,573	(3,708)	11,865	593	12,458
107	3.9	25.64%	12,458	(3,194)	9,264	463	9,727
108	3.7	27.03%	9,727	(2,629)	7,098	355	7,453
109	3.4	29.41%	7,453	(2,192)	5,261	263	5,524
110	3.1	32.64%	5,524	(1,782)	3,742	187	3,929
111	2.9	34.48%	3,929	(1,355)	2,574	129	2,703
112	2.6	38.46%	2,703	(1,040)	1,663	83	1,746
113	2.4	41.67%	1,746	(728)	1,018	51	1,069
114	2.1	47.62%	1,069	(509)	560	28	588
115	1.9	52.63%	588	(309)	279	14	293

ACT II

Tammy Faye — Inheriting a Retirement Account

Time: Next Sunday evening.

Place: Hank's kitchen.

Hank is reading *Statistical Abstracts of the United States* when Josh knocks at the back door.

"Hank, can I come in? I brought Tammy Faye."

"Sure, Tammy Fay, sorry to hear about your father's death. What's on your mind?"

"Well, I have some questions," says Tammy Faye.

Q1: You know my daddy's nickname was Speedy. That's because he was born first. His twin brother, who came second, was called "Slow Hand." They did everything alike. They each had two identical IRAs of $100,000 (4 total). Each put my name down on the beneficiary designation forms for one of the IRAs. They each put Granny, their mom, down as beneficiary for the other IRAs. I'm confused about the distributions Granny and I must take. Can you help me?

A1: Sure, tell me more.

Q2: Speedy and Slow Hand were born on January 1, 1938. They were 70 on January 1, 2008. They both retired 5 years ago and started taking the same payments out of their IRAs to live on. They both took their RMDs for their first DCY 2008 in February of this year, 2009. They were both in the same car wreck. Speedy died on March 30, this year [2009], but Slow Hand lived until April 2. So how does it work?

A2: H'm. They both started taking retirement payments in 2004 when they were about 66. They were both 70½ in 2008. They had the same required beginning date (RBD) of April 1, 2009. But Speedy died before the RBD and Slow Hand died after his RBD! Interesting!

Q3: What's so interesting about that?

A3: Tammy Faye, it doesn't make any difference that they started taking distributions from the IRAs well before they had to. It doesn't make any difference how much they were taking. Because Speedy died before his RBD, one set of rules will apply to the distributions from his IRAs. Because Slow Hand died after his RBD, a different set of rules will apply. For you, the result will be about the same for both the IRAs. But for Granny there will be a difference.

Q4: Oh, Dear! So how do we handle the IRA Speedy left to me?

A4: Well, you're what we call the designated beneficiary. I think you're 39 (*Tammy nods in agreement*). Of course, you could take out all or part of Speedy's IRA right away, but you would have to pay income taxes. If you want to stretch out the payments, you can do it two ways. First, you could buy an immediate annuity for the rest of your life. Or you could take distributions over your life expectancy. You have until December 31, 2010 to do this. But please start early and do not get too close to the deadline.

Q5: How much would an annuity pay?

A5: At your age, an annuity on $100,000 would be about $500 a month with the 10 year treasury note yielding about 3%. (Caution: just an illustration—do your own research.)

Q6: I don't want that because I may need money for some plastic surgery. How would payments over my life expectancy work?

A6: Well, Tammy Faye, with a life expectancy payout, you can always take out money for an emergency. But there's also a certain amount you must take out each year. To figure this, you use the Single Life Table (SLT). Speedy died in 2009. You have until the end of the next year, or the end of 2010, to take the first distribution. In 2010 you will be (*snicker*) 40, Tammy Faye—that you can't deny. Per the SLT, your life expectancy will be 43.6 years. Divide 100 by 43.6 years. That equals 2.29%. So in 2010, you must take out at least 2.29 % of the value of Speedy's IRA at the end of 2009. Now here's where you can get tripped up. In 2011, you don't go back to the SLT. You don't get to recalculate your life expectancy. In 2011, just take 1 from 43.6 to get 42.6 years. Then you must take out at least 2.35%. If you live past your life expectancy, you will run out of money from that IRA. Let me crunch the numbers for you on this PC I have here — yes, here's how it would look. (See Scenario 2a on page 13.)

Q7: Should I take the payment for each year early or late in the year?

A7: Well, late. Keep the tax shelter working as long as possible.

Q8: Don't I get until April 1 of the next year?

A8: No. But they do give you at least a year after you inherit the IRA to decide what to do.

Q9: So how does it work for Speedy's IRA to Granny? She's 95.

A9: She probably doesn't want an annuity at her age. Let's look at the SLT. She will be 96 in 2010. Her life expectancy will be 3.8 years. So in 2010 she must withdraw 26.32%. In 2011, her divisor will be 3.8-1= 2.8 years, and so on. (The 5 year payout is not available to her because she is a designated beneficiary.) So she will run out of tax shelter pretty quick. Here's how it would look. (See Scenario 2b on page 14.) She can have her tax man run the numbers to see if it is worthwhile going to all this trouble; maybe it would be better just to take the account in one or two years.

Q10: OK. So how does it work for me with Slow Hand's IRA?

A10: Slow Hand died after the RBD. So now we use whichever life expectancy is longer: yours or Slow Hand's. Since your life expectancy is longer, it works about the same way as for the IRA you inherited from Speedy.

Q11: Why do you keep saying “about the same” way?

A11: Sharp question! Speedy died before the RBD. So you don’t have to take a distribution for 2009 for him. You can wait until late in 2010 to take the first distribution for 2009. But Slow Hand died after the RBD. For him there can be no hiatus. You will have to take a distribution in 2009 from Slow Hand’s IRA based on the ULT. I haven’t given you all the details on this; see your CPA *right awa*y to get it exactly right!

Q12: And how does it work for the IRA Granny inherited from Slow Hand?

A12: Well, here Granny gets a break. First, there must be a distribution for 2009 for Slow Hand using the ULT. But after that, Granny doesn’t have to use her short life expectancy. Instead, she can use Slow Hand’s life expectancy factor, taken now from the SLT, of 15.5 based on his age of 72 in 2010. This keeps the tax shelter going a lot longer for her than was the case with Speedy’s IRA. Get with her CPA on this right away.

Q13: I want to go till I’m 115. I want to use the table you gave Josh.

A13: Sorry, Tammy Faye. The only person who can use the ULT is the retired participant. People who inherit an IRA can’t use the ULT. They use the SLT.

Q14: Is that fair?

A14: Well, yes. The ULT is extremely liberal. It is designed to cover the retirements of the participant who earned the IRA and his beneficiary, typically the participant’s wife. To give maximum practical coverage, it lasts until the participant would in fact be 115! When you inherit an IRA, you are the beneficiary, not the participant. So the IRS wants to finally get the income tax paid on the account and makes you take it out over your life expectancy.

Q15: But I thought there’s a “just as fast” rule for one who inherits an IRA after the RBD of the IRA participant.

A15: I can see you’ve been reading about minimum distributions on the Internet. A long time ago, a single person who hit his RBD had to use his actual life expectancy, a much shorter period than allowed by the ULT. When he died with a younger beneficiary, the law was stingy and the beneficiary had to take distributions on the same schedule as the participant. But now the ULT is very liberal. The life expectancy of the beneficiaries tend to be shorter than the ULT — so the “at least as fast” rule is automatically satisfied. In other words, to simplify the regulations, it was necessary to partially gut the statute.

Q16: I think I’ll just collect the money and roll it over to my own IRA.

A16: Sorry. There’s no rollover like that for children and other beneficiaries not married to the participant.

Q17: But my girlfriend, Frida Fea, just inherited a 401(k) from her father, and she rolled it over to her own IRA! Maybe I know something you don't know.

A17: I'm sure that's true, Tammy Faye, but not about minimum distributions. Congress recently passed a new law that was called by some a "non-spousal rollover." But that was confusing on two counts. First, the new law applies only to direct transfers from plan to plan that never come into possession of the beneficiary as many rollovers do. Second, it doesn't give the beneficiary his own account as a rollover from a deceased spouse does. The new law creates what is best called a "special inherited IRA."

Here's how it works. Let's say Frida's father died at age 60 while he was working for Piggy Bank & Trust. He had a 401(k) account set up by Piggy Bank for its employees. When her father died, Frida was his designated beneficiary and was allowed by the law to take distributions over her life expectancy as we just discussed. But Piggy Bank didn't want to play ball. They had a rule in their 401(k) plan that made the non-spouse beneficiary take a lump sum from the 401(k) right away. The benefit of a stretch-out just wasn't available, because Piggy Bank didn't want to mess with the children, nieces, friends, and life partners of their non-married employees. (Let's don't pick on Piggy Bank—many if not most of the employers in America had this same rule.)

But under the new law, beginning 2010, qualified retirement plans must help out beneficiaries like Frida. They must at least arrange to turn over the account, with a direct transfer, to the custodian of an IRA that Frida sets up with a friendly financial house. This special inherited IRA will still be in the name of Frida's father, but for the benefit of Frida Fea. The custodian of the special inherited IRA can treat Frida nicely and give her the advantage of the stretch-out.

Now I hear that Piggy Bank has set up a new business unit that is marketing special inherited IRA accounts to beneficiaries like Frida who have been disappointed by the unfriendly terms of qualified plans from which they have inherited accounts. Maybe Piggy Bank would even transfer the 401(k) account inherited by Frida to themselves as custodian of a special inherited IRA for her! Why would they do that? Well this way they turn Frida from an old irksome expense into a new fee-paying customer!

Q18: So the true rollover of an inherited retirement account is still just for spouses?

A18: Yes. And after the dust settles, the account is treated the same as if the surviving spouse had originally earned the account. That's as good as it gets.

"Well, how nice! Some girls in my Poker Club just lost their husbands," says Tammy Faye.

Hank: (*Aside*) "I fear I have another visit coming."

Scenario 2a:
IRA Beneficiary is age 40
Life Expectancy is not recalculated
Distribution at beginning of each year
0% growth after taxes and expenses

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending Balance
40	43.6	2.29%	100,000	(2,294)	97,706	0	97,706
41	42.6	2.35%	97,706	(2,294)	95,412	0	95,412
42	41.6	2.40%	95,412	(2,294)	93,118	0	93,118
43	40.6	2.46%	93,118	(2,294)	90,824	0	90,824
44	39.6	2.53%	90,824	(2,294)	88,530	0	88,530
45	38.6	2.59%	88,530	(2,294)	86,236	0	86,236
46	37.6	2.66%	86,236	(2,294)	83,942	0	83,942
47	36.6	2.73%	83,942	(2,293)	81,649	0	81,649
48	35.6	2.81%	81,649	(2,294)	79,355	0	79,355
49	34.6	2.89%	79,355	(2,293)	77,062	0	77,062
50	33.6	2.98%	77,062	(2,294)	74,768	0	74,768
51	32.6	3.07%	74,768	(2,293)	72,475	0	72,475
52	31.6	3.16%	72,475	(2,294)	70,181	0	70,181
53	30.6	3.27%	70,181	(2,293)	67,888	0	67,888
54	29.6	3.38%	67,888	(2,294)	65,594	0	65,594
55	28.6	3.50%	65,594	(2,293)	63,301	0	63,301
56	27.6	3.62%	63,301	(2,294)	61,007	0	61,007
57	26.6	3.76%	61,007	(2,293)	58,714	0	58,714
58	25.6	3.91%	58,714	(2,294)	56,420	0	58,714
59	24.6	4.07%	56,420	(2,293)	54,127	0	54,127
60	23.6	4.24%	54,127	(2,294)	51,833	0	51,833
61	22.6	4.42%	51,833	(2,293)	49,540	0	49,540
62	21.6	4.63%	49,540	(2,294)	47,246	0	47,246
63	20.6	4.85%	47,246	(2,293)	44,953	0	44,953
64	19.6	5.10%	44,953	(2,294)	42,659	0	42,659
65	18.6	5.38%	42,659	(2,293)	40,366	0	40,366
66	17.6	5.68%	40,366	(2,294)	38,072	0	38,072
67	16.6	6.02%	38,072	(2,293)	35,779	0	35,779
68	15.6	6.41%	35,779	(2,294)	33,485	0	33,485
69	14.6	6.85%	33,485	(2,293)	31,192	0	31,192
70	13.6	7.35%	31,192	(2,294)	28,898	0	28,898
71	12.6	7.94%	28,898	(2,293)	26,605	0	26,605
72	11.6	8.62%	26,605	(2,294)	24,311	0	24,311
73	10.6	9.43%	24,311	(2,293)	22,018	0	22,018
74	9.6	10.42%	22,018	(2,294)	19,724	0	19,724
75	8.6	11.63%	19,724	(2,293)	17,431	0	17,431
76	7.6	13.16%	17,431	(2,294)	15,137	0	15,137
77	6.6	15.15%	15,137	(2,293)	12,844	0	12,844
78	5.6	17.86%	12,844	(2,294)	10,550	0	10,550
79	4.6	21.74%	10,550	(2,293)	8,257	0	8,257
80	3.6	27.78%	8,257	(2,294)	5,963	0	5,963
81	2.6	38.46%	5,963	(2,293)	3,670	0	3,670
82	1.6	62.50%	3,670	(2,294)	1,376	0	1,376
83	0.6	100.00%	1,376	(1,376))	0	0	0

Scenario 2b:
IRA Beneficiary is age 96
Life Expectancy is not recalculated
Distribution at beginning of each year
0% growth after taxes and expenses

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending Balance
96	3.8	26.32%	100,000	(26,316)	73,684	0	73,684
97	2.8	35.71%	73,684	(26,316)	47,368	0	47,368
98	1.8	55.56%	47,368	(26,316)	21,052	0	21,052
99	.8	100.00%	21,052	(21,052)	0	0	0

ACT III

The Poker Club — The Surviving Spouse Inherits

Time: Next Sunday evening.

Place: Hank's gazebo.

Hank has turned off the lights in his house and is hiding. Suddenly, Tammy Faye and members of the Poker Club appear, spot Hank, and the questions start flying.

Q1: I'm Amelia. My husband died at 45 and I'm 38. I've got 3 kids and I went back to work. All the insurance money is gone, but my husband did have an IRA and I'm the sole beneficiary. The stockbroker wants me to roll it over. Is that OK?

A1: Not so fast, Amelia. If you rollover the IRA, you make it your own. It will be treated just like you earned the IRA. If you need to take money out for an emergency, you'll get hit with a 10% extra income tax because you are not 59½. I think you should just sit tight and continue being a beneficiary. If you like your stockbroker, you could try to move your husband's account to him with a trustee-to-trustee transfer. The account would still be titled in your husband's name.

Q2: But the stockbroker says if I rollover, I can keep the tax shelter longer. When would I have to start taking money out if I remain a beneficiary?

A2: Not for a long time. You get to wait until Bill would have been required to take money out. That's at least 25 years.

Q3: Oh! I don't think the money will last that long.

A3: Just be a beneficiary.

Q4: I'm Betty Boo. But now I'm Betty Boo-Hoo. My husband died a while back at age 65 and I was the sole beneficiary of his IRA. I remained the beneficiary just like you suggested to Amelia. But then April 1 of the year after my husband would have been 70½ came and went and I haven't taken my distributions. (*Wailing*). Are they are going to take 50% of my money? I'm 57 and too old to go back to work. What can I do?

A4: Relax. By failing to take the RMD you changed your husband's IRA into your own — just like magic. You have until you are 70½ before you need to take something. If you take money out before 59½, you would pay 10% extra income tax — but that's not a problem for you since you obviously don't need the money right now. This is called "assuming" the IRA. It's just for spouses and it was put in the law precisely to get you out of the jam you're in. If you like, you could re-title the IRA in your own name.

Q5: Hi, Hanky Boy. I'm Cruella. I've collected from several husbands already. Now #4 died too and he was only 69! What should I do?

A5: You are the one to rollover, Cruella.

Q6: Hanky-let's stick to finances.

A6: I am, Cruella. Transfer your late husband's IRA to an IRA established in your own name. That's a rollover. After that, the account will be treated like you earned it. This gives you a fresh start. The fresh start will have three advantages. First, you can wait until you're 70½ to start RMDs. Second, once you start RMDs, you can use the ULT with its long stretch-out of distributions. Third, your designated beneficiary can take advantage of his lifetime expectancy payments when he inherits from you.

Q7: I'm Dorothy. My husband was already past his RBD when he died recently. I'm the sole beneficiary of his IRA. I'm 65. What should I do?

A7: Well you have the same basic choices we discussed already: (1) remain a beneficiary, (2) assume your husband's IRA, or (3) rollover to your own IRA. The difference is the Treasury is already getting some taxes on your husband's distributions. So of course there must be some extra rules to make things more complicated.

Q8: What's the simplest choice?

A8: Well, if you assume or rollover, there's only one extra rule. For this year, there must have been a distribution to your husband before he died or there must be one to you as a beneficiary. Then you're off with your own IRA.

Q9: And what if I want to be a beneficiary?

A9: Beginning in 2010 [next year], you will start taking distributions over your life expectancy. You start off with your age at your birthday in 2010 using the single life table. After that, you get to recalculate your life expectancy each year. Here's what that would look like. (Scenario 3a on page 17.)

Q10: What happens to the money left over when I die?

A10: Now this gets a bit tricky! You can leave your own beneficiary designation form for that. But your beneficiary can't recalculate. Your beneficiary will then get payments based on your life expectancy at the year of your death. Lets suppose you started taking payments in 2010 when you are 66. Then you died 10 years later, at age 76, and left your niece as your designated beneficiary. Here's what it would look like. (Scenario 3b on page 18.)

Scenario 3a:

IRA Spouse Beneficiary is age 66
Life Expectancy is recalculated annually
Distribution at beginning of each year
0% growth after taxes and expenses

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending Balance
66	20.2	4.95%	100,000	(4,950)	95,050	0	95,050
67	19.4	5.15%	95,050	(4,899)	90,151	0	90,151
68	18.6	5.38%	90,151	(4,847)	85,304	0	85,304
69	17.8	5.62%	85,304	(4,792)	80,512	0	80,512
70	17.0	5.88%	80,512	(4,736)	75,776	0	75,776
71	16.3	6.13%	75,776	(4,649)	71,127	0	71,127
72	15.5	6.45%	71,127	(4,589)	66,538	0	66,538
73	14.8	6.76%	66,538	(4,498)	62,042	0	62,042
74	14.1	7.09%	62,042	(4,400)	57,642	0	57,642
75	13.4	7.46%	57,642	(4,302)	53,340	0	53,340
76	12.7	7.87%	53,340	(4,200)	49,140	0	49,140
77	12.1	8.26%	49,140	(4,061)	45,079	0	45,079
78	11.4	8.77%	45,079	(3,954)	41,125	0	41,125
79	10.8	9.26%	41,125	(3,808)	37,317	0	37,317
80	10.2	9.80%	37,317	(3,659)	33,658	0	33,658
81	9.7	10.31%	33,658	(3,470)	30,188	0	30,188
82	9.1	10.99%	30,188	(3,317)	26,871	0	26,871
83	8.6	3.76%	26,871	(3,125)	23,746	0	23,746
84	8.1	12.35%	23,746	(2,932)	20,814	0	20,814
85	7.6	13.16%	20,814	(2,739)	18,075	0	18,075
86	7.1	14.08%	18,075	(2,546)	15,529	0	15,529
87	6.7	14.93%	15,529	(2,318)	13,211	0	13,211
88	6.3	15.87%	13,211	(2,097)	11,114	0	11,114
89	5.9	16.95%	11,114	(1,884)	9,230	0	9,230
90	5.5	18.18%	9,230	(1,678)	7,552	0	7,552
91	5.2	19.23%	7,552	(1,452)	6,100	0	6,100
92	4.9	20.41%	6,100	(1,245)	4,855	0	4,855
93	4.6	21.74%	4,855	(1,055)	3,800	0	3,800
94	4.3	23.26%	3,800	(844)	2,916	0	2,916
95	4.1	24.39%	2,916	(711)	2,205	0	2,205
96	3.8	26.32%	2,205	(580)	1,625	0	1,625
97	3.6	27.78%	1,625	(451)	1,174	0	1,174
98	3.4	29.41%	1,174	(345)	829	0	829
99	3.1	32.26%	829	(267)	562	0	562
100	2.9	34.48%	562	(194)	368	0	368
101	2.7	37.04%	368	(136)	232	0	368
102	2.5	40.00%	232	(93)	139	0	139
103	2.3	43.48%	139	(60)	79	0	79
104	2.1	47.62%	79	(38)	41	0	41
105	1.9	52.63%	41	(22)	19	0	19
106	1.7	58.82%	19	(11)	8	0	8
107	1.5	66.67%	8	(5)	3	0	3
108	1.4	71.43%	3	(2)	1	0	1
109	1.2	83.33%	1	(1)	0	0	0

Scenario 3b:
IRA Spouse Beneficiary is age 66
Life Expectancy is recalculated annually
Distribution at beginning of each year
0% growth after taxes and expenses
IRA Spouse Beneficiary dies at age 76,
and Designates Niece as Successor Beneficiary

Age	Years	%	Beginning Balance	Annual Distribution	Subtotal	Annual Growth/(Loss)	Ending Balance
66	20.2	4.95%	100,000	(4,950)	95,050	0	95,050
67	19.4	5.15%	95,050	(4,899)	90,151	0	90,151
68	18.6	5.38%	90,151	(4,847)	85,304	0	85,304
69	17.8	5.62%	85,304	(4,792)	80,512	0	80,512
70	17.0	5.88%	80,512	(4,736)	75,776	0	75,776
71	16.3	6.13%	75,776	(4,649)	71,127	0	71,127
72	15.5	6.45%	71,127	(4,589)	66,538	0	66,538
73	14.8	6.76%	66,538	(4,498)	62,042	0	62,042
74	14.1	7.09%	62,042	(4,400)	57,642	0	57,642
75	13.4	7.46%	57,642	(4,302)	53,340	0	53,340
76	**12.7**	**7.87%**	**53,340**	**(4,200)**	**49,140**	**0**	**49,140**
77	11.7	8.55%	49,140	(4,200)	44,940	0	44,940
78	10.7	9.35%	44,940	(4,200)	40,740	0	40,740
79	9.7	10.31%	40,740	(4,200)	36,540	0	36,540
80	8.7	11.49%	36,540	(4,200)	32,340	0	32,340
81	7.7	12.99%	32,340	(4,200)	28,140	0	28,140
82	6.7	14.93%	28,140	(4,200)	23,940	0	23,940
83	5.7	17.54%	23,940	(4,200)	19,740	0	19,740
84	4.7	21.28%	19,740	(4,200)	15,540	0	15,540
85	3.7	27.03%	15,540	(4,200)	11,340	0	11,340
86	2.7	37.04%	11,340	(4,200)	7,140	0	7,140
87	1.7	58.82%	7,140	(4,200)	2,940	0	2,940
88	0.7	100.00%	2,940	(2,940)	0	0	0

The line in bold is the last year for recalculation by the spouse as beneficiary. Thereafter, the niece is the successor and there is no more recalculation.

ACT IV

M. P. Moneypenny — Designated Beneficiary

Time: Next Sunday

Place: Hank's study.

M.P. Moneypenny is seated stiffly wearing coat and tie. After an awkward silence, Hank says:

"How can I help you, M.P.?"

"Well, Hank, I'm here in my capacity as President of the Neighborhood Association. There's been a lot of traffic at your house lately."

"Don't worry, I'm not practicing law. I'm just giving *free* advice."

"Oh. Free you say! Well. . . in that case. . . you've been telling everybody about getting a "stretch-out" from retirement plans. And to do this, you have to have the right beneficiaries. So, I have a few questions."

Q1: What's a beneficiary?

A1: M.P., the basic idea is for a participant to use the money in his retirement account to support himself when he's old. But many participants need to provide also for others, such as a spouse, child, life partner, or friend. We call these persons the "beneficiaries." Some retirement accounts have built-in rules about which "others" can be included. Other accounts allow the participant to name anyone he wishes as beneficiary.

Q2: Why go to all that trouble? Why not let the benefits go by the participant's last will and testament like any other property?

A2: The sponsors of retirement accounts want clear, simple instructions what to do when the participant dies. The sponsors need to act whether or not the participant has a will. So retirement benefits are set up to "avoid probate." Usually the participant fills out a beneficiary designation form. On the participant's death, the benefits typically go to the person named in the form. If the participant doesn't fill out a beneficiary form, the retirement plan will often say who inherits the money in the account. Or the retirement plan could provide for the participant's account to pass to the participant's estate by default. The account would then pass by the participant's will if he had one; or if he died without a will, to his heirs by intestacy.

Q3: Well, why doesn't everybody just leave their accounts "to my estate"?

A3: As long as money is in the retirement account, any income on the investments is exempt from income tax. The retirement account is an income tax shelter. This tax shelter often can be extended past the death of the participant for many years if the beneficiaries are correctly designated. But the survivors usually lose most or all of this tax shelter if the account is left to the estate. Also, creditors of the participant usually cannot reach assets from retirement accounts left to beneficiaries. If retirement accounts go to the estate, then creditors may be able to reach them.

So here is the important point: if you have signed a will, you still haven't finished your estate plan. You're still on third base. To get home and score a run, you need to go over your beneficiary designation forms to be sure they are properly coordinated to the will and work well for the survivors.

Q4: OK, I'm convinced. What's a *designated* beneficiary?

A4: That's a good question because only a designated beneficiary normally can qualify for the longest stretch-out. The statute says that it's "any individual" designated as a beneficiary. There can be more than one. For example, you can name "my three children, A, B, and C." You can also name a class of individuals who can be determined at the time you die. An example of this would be "my grandchildren living at my death." Usually you can have a primary beneficiary and a secondary beneficiary in the event the primary beneficiary dies before you. Then the beneficiary alive at your death becomes the designated beneficiary.

Q5: So only individuals need apply?

A5: Well, that's what the statute says. And this makes sense, because if you want a stretch-out based on the life of a beneficiary, you have to identify an individual rather than a legal entity (that doesn't have a natural birth and death). However, by popular demand, the Treasury has fudged a bit on this in the regulations.

Q6: So who besides an individual can be a designated beneficiary?

A6: With certain relatively straight-forward trusts, the regulations say that you can "look through" the trust and count as designated beneficiaries the individual or individuals who are beneficiaries of the trust. But an estate cannot be a designated beneficiary. Other types of legal entities such as a charity or a business corporation cannot be a designated beneficiary.

Q7: So this means you can't make your account payable to your estate?

A7: Well, you certainly can. But the estate would be an ordinary beneficiary. It would not get the favorable tax treatment available to a designated beneficiary. For example, if you die before your RBD and have a designated beneficiary, that person can often elect to take the account over his life expectancy. But the estate would only have five years after the year in which you died to take the funds out.

Of course, in many cases the retirement plan is of moderate size and five years of deferral is all the beneficiary needs. But for larger retirement accounts, making the estate the beneficiary will often miss an opportunity to give the survivors a worthwhile tax shelter.

Q8: I have one IRA made out half to my son and half to my church. Is that a problem?

A8: Yes, because your son will not be treated as a designated beneficiary when the charity receives part of the money. If your son wants to be a designated beneficiary, he may be able to fix the problem. September 30th of the year following the year of your death will be the deadline to determine if there is a designated beneficiary. Your son can probably arrange for the charity to receive its distribution before September 30th. Then he would be the only beneficiary and therefore a designated beneficiary. That would allow him to stretch out the distributions over his life expectancy.

Q9: Does every kind of retirement account make deferral available for the designated beneficiary?

A9: No. When a plan includes deferral, the sponsor of the account may have to stay involved with on-going payments to the beneficiary for decades. Many if not most sponsors refuse to get involved in such a long-term responsibility and expense. So they include in the retirement plan a provision that requires beneficiaries to take a lump sum payment promptly. For example, if a pilot at Global Airlines has his child as his designated beneficiary and the pilot dies before his RBD, Global Airlines will try pay the pilot's pension plan in one lump sum to the child. That could likely throw the child into the top income tax bracket that year and the tax shelter would be gone!

Q10: Goodness. How can you avoid that?

A10: There are two ways now to try to deal with this:

- One way is to seek to establish a special inherited IRA. I discussed this in detail with Tammy Faye (See Act II, Q&A 17 at page 12).
- If the pilot retires, Global Airlines probably will be happy to pay him his retirement in a lump sum. Then the pilot can roll it over to his own IRA and name the child as the beneficiary. On the pilot's death, the child will be able to use the child's life expectancy for a stretch-out.

Q11: Well, I guess most non-spouse beneficiaries are adults. But some are minor children, grandchildren, or other relatives. Can a minor be a designated beneficiary?

A11: Yes. But then you run into the problem that nobody can safely pay money to a minor. There has to be some arrangement for the protection of the money once the minor receives a lump sum or a smaller payment under a stretch-out.

Q12: You are giving me a headache! How do you help a kid get a stretch-out of a retirement plan?

A12: This is an area of the law that is unsettled, and there are no good answers. But here are a couple of the many ideas that have been discussed in the area of the law:

- You might use a guardianship under control of the probate court. Legal title to the funds would rest with the child. Possession of the funds would be with the guardian, who is controlled by the court and backed-up by a bond from an insurance company. The guardian would give the sponsor of the retirement plan binding legal instructions for the payments under the stretch-out. The sponsor would be protected because it would be making payments to a ward under court protection. Then the guardian could spend money on the ward if needed or accumulate the funds. The ward would file his own individual income tax returns, assisted, of course, by the guardian. When the child attains age 18 and is recognized as an adult, the guardianship funds would be distributed to him and he would then continue the stretch-out program if he wishes. Now the costs of operating a guardianship can be substantial. This probably would make a guardianship practical only if the retirement fund was pretty substantial in size.
- The traditional way of protecting the inheritance of a minor is a trust for the minor, usually established in the will of the person who died. But here we have a problem because the Treasury Regulations about retirement payouts do not give satisfactory guidance how to qualify a trust for a minor as a designated beneficiary.

- But let me give you an example of how you might use a trust. Suppose you leave your estate in your will to your children in equal shares. But one child had predeceased you leaving a minor grandchild. Let's say you put a trust in your will for that minor grandchild. The terms of the trust are for his benefit only. He will get all the money in the trust outright when he is age 30. If he should die before age 30, the money would pass to his estate. This is a simple form of trust that lawyers call a "vested share trust." Then, let's say you made an account payable to "the trust under my will for grandson A." A trust like this ought to work, but we have no encouragement on this from the Treasury Department.
- Another idea would be to set up a trust that would only own the rights to collect payments while the child was alive. If the child died before the trust terminates, disposition of the retirement account would not be controlled by the trust at all. Then the trust would have only one beneficiary as far at the retirement plan is concerned and that beneficiary, an individual, would be a designated beneficiary. This ought to work, but at the moment there is no authority to support this proposition.

I guess you can see the upshot of all this. Many or most retirement plan accounts payable to a trust for a minor under today's law will probably be paid in a lump sum (or over 5 years). The tax shelter will be lost and there will be income tax to pay in the higher brackets.

Q12: Assuming that a trust would work, who exactly has the responsibility to decide how much to withdraw each year from the IRA and put into the trust?

A12: Not an easy question to answer for sure. Trustees are responsible for what property has been transferred to them, but not for planning the estate of the beneficiary. The practical answer might be for the natural guardian or guardian of the estate to agree with the trustee on a course of action that would be in the best interest of the child.

"Well, Hank, you are certainly an asset to our Neighborhood Association. I'm going to appoint you Chair of the Minimum Distributions Committee!" says M.P.

Hank: (*Aside*) "I was hoping he would shut down this operation!"

ACT V

Ruth — the Roth IRA

Time: Next Sunday

Place: Hank walking the dog. Ruth approaches. Dog sniffs. Ruth speaks:

Q1: My dad has a Roth IRA. What exactly is a Roth IRA?

A1: It's one of the strangest critters in the Internal Revenue Code. I call it a traditional IRA turned inside out. With a typical traditional IRA, you get a deduction when you make a contribution and everything that comes out is income. With a Roth IRA, you never get a deduction for a contribution; but once the Roth IRA is mature, you never pay income tax on anything that comes out.

Q2: My dad is a widower, and I'm the sole beneficiary of his Roth IRA. Are you saying I'll not have to pay income tax if I inherit the Roth account?

A2: Yes! The beneficiaries of a traditional IRA usually have to pay income tax on the distributions they receive. But the beneficiaries of a Roth IRA never pay income tax if the Roth IRA is mature.

Q3: What's this "mature" you keep talking about?

A3: Oh, the Roth IRA needs to be more than 5 years old to avoid paying income tax on what was earned inside the account.

Q4: That's great, dad started his Roth 7 years ago. What can he do to make it a big as possible?

A4: Invest in the next Microsoft. Capital gains are not taxed in a Roth IRA, so it makes a great vehicle for speculations as well as savings.

Q5: Well, I mean, how can dad put in as much money as possible?

Q5: Sorry. I'm not a Maximum Contributions Lawyer, only a Minimum Distributions One. But here are some basic rules. If your dad wants make a contribution of $X in a year, then he must have compensation income of at least $X that will be included in his gross income for that year. But if he makes too much money in a year, he can't make a Roth contribution for that year. He's a widower, so his Roth contribution for 2009 will be trimmed back or eliminated if his adjusted gross income is $105,000 or more. The max contribution for 2009 is $5,000 plus an additional $1,000 for those 50 or older. And he can continue to make contributions past the time he is 70½. In addition, he may be able to convert part or all of a traditional IRA to a Roth IRA. He needs to see his CPA or stockbroker to discuss the many details about Roth IRA contributions and conversions.

Q6: But doesn’t dad have to start taking money out when he’s 70½?

A6: No! He never has to take anything out! There is no minimum distribution required for the participant. So all other things being equal, he should spend his other money and preserve the Roth for you.

Q7: So how does it work if he dies and I’m named as the beneficiary? I’m 35.

A7: Because your dad never has to take distributions, there is no RBD. When you inherit, the rules are the same as when the participant of a traditional IRA dies before his RBD. You are a designated beneficiary. As designated beneficiary, you can stretch out the distributions over your single life expectancy.

Q8: But if there’s no income tax, why not just take it all now?

A8: You can. It’s your call. Most people can’t pass up a chance to spend money when it comes tax-free. But then they miss out on the tax-shelter that they could have had. Let’s say you dad dies this year and you are named as sole beneficiary. You have until December 31 next year to start taking distributions. You will turn 36 next year. Your life expectancy will be 47.5 years. Divide 100 by 47.5 = 2.105%, and that’s all you have to take out for next year.

The year after that, you will have to take out 2.15% (47.5 - 1 = 46.5. Divide 100 by 46.5 = 2.15%). With any sort of decent investments, the IRA should keep growing for quite a few years, all the while protected from income tax. And this is money you never worked a minute for.

Q9: Sounds fantastic. Why is it called “Roth”?

A9: In honor of William L. Roth, the Senator from Delaware who dreamed it up. He pushed it for years. Finally Congress passed it and turned Bill’s last name into part of the English language (in the United States at least). At the next opportunity, the people of Delaware voted him out of office.

Epilogue

Sorry it’s not funny,
This comedy of money,
And income tax institutions;
For naught so deranged,
And way past strange,
As Minimum Distributions

March 12, 2009