Special Session IV-A

The Magic Age is 70½

Elder Law Series
Financial Assets Series

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The Magic Age is 70½

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Part A of this outline contains the author's required minimum distribution handbook for nonprofessionals (the original "70½"). The remaining Parts B–D are excerpts from the author's other seminar outlines and from the author's book *Life and Death Planning for Retirement*.

Warning! Tax Law Changes Coming?

Two business days before the due date of this Outline, a proposed new tax law was introduced in Congress. See Appendix C for discussion of this proposed law and its effect (if enacted) on matters discussed in this Outline. Throughout this Outline, any statement or section whose content would be directly impacted by the proposed legislation (other than by just general changes to income tax rates and brackets) contains the warning "See Appendix C."

Abbreviations and Defined Terms

In this Outline:

§ Section symbols refer to sections of the Code.

¶ A "¶" symbol refers to a section of the author's book *Life and Death Planning for Retirement Benefits*. The referenced section may not be reproduced in this Outline. *Life and Death Planning for Retirement Benefits*, published by Ataxplan Publications, is a reference work of over 500 pages on estate and distribution planning for retirement benefits. The book may be purchased for $89.95 plus shipping at www.ataxplan.com or by calling 800-247-6553, or in an electronic online edition by subscription at www.retirementbenefitsplanning.com.

Code	Internal Revenue Code of 1986, as amended through October 31, 2017.
IRA	Individual retirement account. § 408.
IRS	Internal Revenue Service.
RMD	Required minimum distribution. § 401(a)(9). See Part B.
Participant	The individual whose retirement benefits we are talking about; for example, the owner of an IRA. For convenience, the male pronoun is usually used for the participant and the feminine pronoun for the participant's spouse.
PLR	Private letter ruling issued by the Internal Revenue Service.
RBD	Required beginning date. See PART B, ¶ 1.2.01, #2.
Roth IRA	Roth individual retirement account. § 408A.

Traditional plan or IRA. A retirement plan or IRA that is not a "Roth" plan or IRA.

Uniform Lifetime Table. The table used by most participants to calculate RMDs during the participant's lifetime. See PART B and Appendix A.

PART A: 70½: THE NONPROFESSIONAL'S GUIDE TO RMDS

Introduction

Calculating required minimum distributions (RMDs) from your IRA is usually not a complicated process. It's actually one of the simpler operations in the Tax Code. With a little knowledge, a calculator, and an hour or two of time each year you can normally take care of your RMDs with no problem. In fact you don't even need to calculate them yourself since the plan or IRA will do it for you. So why is a manual needed?

Because every day I get calls, emails, and letters from unhappy retirees or panicky practitioners, or I read cases and rulings, with stories like these:

- John accidentally took his RMD from his wife's IRA instead of his own. No one noticed the mistake until the following year.
- Allen thought he didn't have to take an RMD from his SEP-IRA (even though he is over 70½) because he is still working.
- Susan has a self-employed 401(k) plan for her small business and an IRA. She took the RMD for both plans from the IRA.
- Mike took his RMD from his IRA and transferred it to a Roth IRA, figuring he might as well do a Roth "conversion" of that distribution since he had to pay tax on the money anyway.
- Augusta computed her IRA RMDs using the original cost basis of her IRA investments as the account's "fair market value."

All these people made mistakes in carrying out the "simple" process of taking required minimum distributions. I don't want you to join this parade of misery. I want you to have confidence that you've done it right. The step-by-step road maps in this outline will provide that assurance.

I want you to have a way to check that your professional advisors know what they are doing in this field. They should affirm and approve of the information you get from this outline. If they don't seem to "get it," you may need a new advisor.

Finally, I want to let you know about the legitimate, safe ways to potentially reduce the tax impact of your RMDs. You don't have to use these ideas, but by reading this outline you will know that at least you considered all your options.

First Section: Taking Your Required Minimum Distributions: The Seven Steps

Once you reach age 70½, whether you're ready or not, the Tax Code dictates that you must start taking annual distributions from your individual retirement account (IRA). This First Section explains why that is so, how to compute these "RMDs," when you must (or may) take them, and *how* to take them. See Second Section for ways to reduce RMDs.

Taking RMDs each year involves a seven-step process, explained in the seven Chapters of this First Section. Here is the process you will use each year, beginning with the year you turn age 70½, to compute and pay required minimum distributions from your traditional IRA. Each year:

Step 1: Determine your "applicable distribution period" (ADP or "divisor") for that year. See Chapter 1.

Step 2: List all your retirement plans and accounts. See Chapter 2.

Step 3: Pull out of the list those that do not have any distribution required this year. See Chapter 3.

Step 4: For each remaining plan or account, compute the RMD. See Chapter 4.

Step 5: Decide *when* to take your RMD. See Chapter 5.

Step 6: If you have a choice, decide *which account* to take your RMD from. See Chapter 6.

Step 7: Decide which *mode of distribution* to use for the RMD. See Chapter 7.

The following Chapters go through the seven steps in detail.

CHAPTER 1
Determine Your "Applicable Distribution Period" (ADP or "Divisor")

The annual RMD will be determined by dividing your account balance by the "applicable distribution period," also called the "ADP" or "divisor. So the first step is to determine your ADP for the year. This step must be done each year because the ADP is different each year.

To get the ADP, you need to know your age and find the right table.

Your age: How old will you be on your birthday this year?

The age you use is your age at the end of the applicable year. For example, if your birth date was January 1, 1945, or December 31, 1945, or any date whatsoever in the year 1945, your age in 2018 for RMD purposes is 73.

Obviously your age changes each year, so that's why you go through the process again each year.

The first Distribution Year is the year in which you attain age 70½. That is also the most confusing year because of the "½": Your age on your birthday in the year you reach age 70½ could be either 70 or 71. It will be 70 if your birthday falls in January through June. It will be 71 if your birthday falls in the second half of the year.

Stan and Anne Example: Stan and Anne both reach age 70½ in 2018. Stan was born December 25, 1947, and Anne was born April 1, 1948. Even though they both turn 70½ in 2018, and therefore 2018 is the first Distribution Year for both of them, their "divisors" will be different. Stan will turn age 71 on his 2018 birthday so his 2018 divisor is 26.5. Anne's age on her 2018 birthday is only 70, so her 2018 divisor is 27.4.

Look up the "Distribution Period" for your age in IRS Table III

Once you have determined your age you can find the ADP or divisor for that age in an IRS Table.

For *almost* everybody, the table to use is the IRS's "Table III: Uniform Table." This table can be found in IRS Publication 590-B. In the 2016 edition of IRS Publication 590-B, this table appears at the END of "Appendix B," on p. 58.

When you look in IRS Publication 590-B, don't get confused and use the wrong table. Do NOT use the "single life table" (Table I)—that is only for beneficiaries.

A few people will not use Table III. They will use Table II instead. Here are the people who use Table II:

Unusual: Use Table II if your spouse is much younger and...

The number for your age in Table III (see preceding subsection) is your divisor or "distribution period" for the year, *unless* you qualify for this special exception:

If the sole beneficiary of your IRA is your spouse, AND your spouse was born in a year more than 10 years after the year of your birth, then you use a different table to find your divisor. You will use Table II (Joint and Last Survivor Life Expectancy) on pages 44-57 of IRS Publication 590-B (2016 ed.) based on the respective ages of yourself and your spouse as of your birthdays in the Distribution Year.

In order for this exception to apply, you must have been married to this more-than-10-years-younger spouse on January 1 of the Distribution Year AND he/she must have been sole beneficiary of your IRA on that date AND you must not have changed the account-beneficiary after January 1 of the year. Bear in mind that:

✓ A divorce or the death of either spouse after January 1 does not count as a change of beneficiary for this purpose. However, such a divorce or death during the year would mean that you will no longer qualify this special exception starting in the *following* year.

✓ If you do an IRA-to-IRA transfer during the year, the special exception should still apply if the younger spouse was sole beneficiary for both accounts throughout the entire year or for the period of such account's existence if less than the full year.

This special rule can apply to you (for years after the year of the marriage) even if you married the much-younger spouse after you turned age 70½:

Laura Example: Laura turned age 75 in 2017. On January 1, 2017, she was unmarried. The designated beneficiary of her IRA was her boyfriend Rob who reached age 63 on his 2017 birthday. In 2017, Laura marries Rob, and confirms him as sole beneficiary of her IRA. For the 2017 Distribution Year, Laura's divisor was 22.9, the factor for age 75 determined using the usual IRS Table III, "Uniform Table." In 2018, however, she will use the Joint and Survivor Life Table to determine her RMD, assuming she does not remove Rob as her IRA beneficiary during that year, so her 2018 divisor will be 23.4 (factor for ages 76 and 64).

Note the slight tax advantage Laura gets by marrying Rob and having him as sole beneficiary of her IRA. Her "divisor" increases from 22.0 (Table III factor for age 76) to 23.4. A larger divisor means a smaller required minimum distribution.

CHAPTER 2
List Your Retirement Plans and Accounts

Create a table or spreadsheet that lists all your retirement accounts. The purpose of this step is to have a record, all in one place, of all your plans and accounts, with (as shown in the following steps) a memorandum for each one regarding why either no distribution was required from that account, or if a distribution is required, how much it is and how the requirement was satisfied.

This step is not a legally required part of the process of determining your RMDs. Creating the list is simply recommended to give you an at-a-glance record each year regarding the process you went through to determine your RMDs. It may be helpful to jog your memory, or help bring an advisor up to speed, or satisfy an auditing IRS agent, when a later question is raised about what RMDs you took and why or why not. The chart helps you in the current year to keep track of your progress in taking care of RMDs from multiple plans and accounts.

If you have only one retirement plan or account, you probably don't need to bother with this step, but for the many retirees who have multiple plans and accounts this is a recommended way to sort out and keep track of the process.

Here are some tips for figuring out how many plans and accounts you have.

First, each IRA (whether Roth or "traditional") that you own should have a separate account statement that you receive from the IRA provider at least annually. It should have its own account number, and the titling of the account should have your name and an indication that it is an individual retirement account. As the final "proof" of how many IRAs you have, each IRA provider is required to file tax Form 5498 annually with the IRS (with a copy sent to the account holder) for every IRA they hold. If you receive five Forms 5498 for the year, that means you have five IRAs.

If your account is an "individual retirement annuity," issued by an insurance company, that counts as a separate IRA and you should receive Form 5498 annually for that one too. Each "individual retirement annuity" account goes onto your list or table.

If you participate in one or more workplace retirement plans, you will receive IRS Form 5498 if the workplace plan is a SEP-IRA or SIMPLE IRA plan.

The other type of workplace retirement plan is a "Qualified Plan." 401(k) plans are an example of Qualified Plans. Qualified Plans do not send Form 5498, but are required to send you a periodic benefits statement. Most Qualified Plans would give the employee this statement at least once a year—more often if the employee directs his/her own investments in the plan, or (at least theoretically) less often in the case of certain pension plans.

CHAPTER 3
Separate the Plans/accounts That Do Not Have Any RMD

The next step in setting up your chart is to move, to a separate section, any plans or accounts for which you do not need to compute RMDs, either because no distribution is required this year or because (as will be explained) the account has been "annuitized."

Once you reach age 70½, generally every retirement plan you participate in will have to pay you an RMD, but there are some big exceptions. Here are the types of retirement plans or accounts that you could have from which you are NOT required to take RMDs, even though you have reached age 70½. If you have a plan or account that qualifies for one of these exemptions from the normal RMD rules this year, place it in a separate section of your chart, with an annotation regarding WHY it is not subject to RMDs this year and what to watch out for.

Roth IRAs

The owner of a Roth IRA is not required to take any distributions from the Roth IRA during his or her lifetime. This exemption from the lifetime-RMD requirement is one of the great attractions of the Roth IRA.

IMPORTANT REMINDERS:

- This RMD exemption for Roth IRAs does not apply to "inherited" Roth IRAs. Only the original Roth IRA owner is exempt from taking RMDs. The RMD exemption lasts only until his/her death, after which the beneficiary must start taking RMDs (unless the beneficiary is the surviving spouse and he/she rolls the inherited Roth IRA over into his or her own Roth IRA—in which case he/she becomes entitled to the "owner's" exemption from lifetime RMDs).

- Also, the exemption from RMDs that applies to Roth IRAs does NOT apply to "Roth 401(k)" accounts. Those must pay RMDs to the account holder to exactly the same extent as "traditional" 401(k) accounts.

Qualified plans: Still working (not retired) and not a 5% owner

Unlike IRAs, employer "qualified" retirement plans are not required to pay RMDs until the year the employee reaches age 70½ or *if later* the year the employee retires. However, this special break does NOT apply to an employee who owns more than 5% of the employer that sponsors the plan. Such "5% owners" have to start taking RMDs at age 70½ regardless of whether they are still working.

But if you do not own the company where you work (or you own a little bit of it—5% or less), *and* you keep working after age 70½, you can postpone RMDs from that company's qualified plan(s) until the year you actually retire. Your "Required Beginning Date" for that company's qualified plans will be the *later of* April 1 of the year after the year you reach age 70½ or April 1 of the year after you retire.

Here's some more good news for you if you qualify for this deal: You may be able to "roll" money from your IRA into the company plan, to stop the RMDs from your IRA for a while. See Chapter 11.

Now for the not so good news. There are several tricky issues regarding the special delayed beginning date for non-5%-owners who are not retired:

- You need to know what type of workplace retirement plan you have. Not every retirement plan you might have at your workplace is a "qualified" plan, entitled to the delayed start of RMDs. For example, this special deal is NOT available for "SEP-IRAs." A SEP-IRA (for RMD purposes) is an IRA, not a qualified plan. You must start distributions from any SEP-IRA at the usual age 70½, even if you are still working and do not own more than 5% of the company that funds your SEP-IRA. Once you are satisfied that your employer's plan is a "Qualified Plan," consider the following additional points:

- What if you personally own less than 5% of the company but your spouse, or relatives, or entities affiliated with you or them, also own part of the company? The 5% ownership test has an "ownership attribution" rule under which stock owned by people or entities related to you may count as ownership by you. In other words, you may be a "5% owner" even if you personally own less than 5% of the company, based on the ownership of your relatives and related entities that is "attributed" to you. If this might apply to you, you need to consult an expert to analyze how the 5% test applies to you. If your employer is a charity you don't have to worry about this issue—charities have no owners at all so no one can be a 5% owner of a charity.

- What if you once did own more than 5% but you divested yourself of some ownership? The 5% ownership test also has a "lookback" rule. You need to consult an expert to analyze how the 5% test applies to you.

- If you're not sure how to apply the 5% ownership test, consult an expert. It applies differently to corporations versus partnerships versus LLCs etc., so it matters exactly what form of business your employer operates under.

- What does "retirement" mean? No one knows for sure because the IRS has never defined the term. It might mean total cessation of all employment....or it might be something less than that. The Plan Administrator of your employer's retirement plan needs to decide this one.

- What if you retire but then go back to work? Can you suspend withdrawals from the plan until you retire *again*? Sorry: The rules don't mention that situation so the answer is probably no.

- If you retire at the end of a particular year, as of December 31, that year is (probably—this is my opinion) your first Distribution Year. However, the IRS has not officially spoken on this question. Some people think retirement as of the end of business on December 31 should be considered retirement in the *following* year.

- Even if you are still working and own less than 5% of the company, the employer is not *required by law* to delay your distributions until actual retirement. Some companies force out distributions starting at age 70½ *regardless* of continued employment. In that case you may be able to roll over the distribution to an IRA; consult an expert.

- You can be "retired" while you are still working! The delayed RMD option is available only for funds that are held in the qualified plan(s) of the employer *you are working for now*:

Rodney Example: Rodney is a college professor. He has worked for three different universities over his career. At each job, he paid money into a retirement fund designed for teachers and run by a nonprofit company specializing in helping teachers with retirement investing. Now age 70½, he is still working for University #3. In Rodney's view, he has only one retirement plan that he has been funding all his life, and he is still working so he should be able to postpone taking any distributions until he retires. But that's not what the IRS says. The IRS says he can postpone RMDs only from the actual University #3 retirement plan. He can't postpone distributions from the plans and accounts that were established with his prior employers, Universities #1 and #2, because he's not still working for those employers. He is considered "retired" as to the retirement plans funded and administered by those prior employers. Thus he must start distributions from those plans at 70½ even though he is still working at University #3.

IRAs that hold annuity contracts

Here is one of the most confusing aspects of IRA investments in general and RMDs in particular: The difference between an "annuitized" IRA and an IRA that merely holds an annuity contract as an investment. I wish I didn't have to try to explain this. If you're lucky this doesn't apply to you and you can skip this section.

All "annuity contracts" are issued by insurance companies, and under state law and IRS income tax rules they are all taxable as "annuities." But for minimum distribution purposes IRA-owned annuity contracts fall into two completely different categories—the contract that has been "annuitized" and the contract that has not been (and actually might never be) "annuitized."

The terminology used in this section is just to help us understand the *minimum distribution* implications of IRA-owned annuity contracts—it may not be the technically correct terminology an annuity expert would use.

<u>Deferred variable annuities purchased as an investment</u>

Let's start with the typical "deferred annuity contract" that is purchased as an investment with IRA funds. The contract comes from an insurance company. It looks like a mutual fund or a collection of mutual funds that are held inside an "annuity contract" wrapper. The concept is usually that you are investing in various market-type mutual funds (which give you upside investment potential) but you also get downside protection in the form of a minimum guaranteed growth rate or at least a no-loss guarantee from the insurance company.

The contract typically has several different "values" numbers in the periodic statements issued to the IRA owner. One value is what you would get if you cashed out the contract right now; typically that's a relatively low value unless you've held the contract for a long time—you get penalized for cashing out early. A second value is the market value of the underlying investments—how the "basket of mutual funds" inside the contract are doing right now. The final value is the "minimum guaranteed value" that you will have (regardless of how the mutual funds perform) when you either die or convert the contract to a retirement annuity at a particular age (or after you've held the contract for a certain minimum number of years).

Until the day comes that you actually do convert this "deferred variable annuity" into an *true* annuity (which you might never do), the deferred annuity contract is considered for minimum distribution purposes to be merely one more investment inside your IRA. It is valued annually for RMD purposes, just as all other IRA investments are valued. However, the IRS does have special rules on valuation of deferred annuity contracts; accordingly, the insurance company or agent should provide to you (each year) the correct IRS-approved valuation of the contract for RMD purposes.

Some day you will either cash out your deferred annuity contract (in which case the cash replaces the annuity contract in the valuation of your IRA) or you will "convert" it into a "true annuity," in which case something different happens—see the following:

"<u>True</u>" <u>annuities</u>

Then there is the other kind of annuity contract—what I'm calling a "true annuity." With a true annuity, you give the insurance company a lump sum of money and they give you in return a promise to pay you $x per month (or per quarter, or per year) for the rest of your life (or for a certain number of years, or for your and your beneficiary's lives).

You could give them that lump sum by transferring cash from your other IRA investments over to the insurance company, and they give you in exchange the contract that says they will pay you the $X per month; or you could give them that lump sum by converting your deferred variable annuity contract into a true annuity contract. Either way you are "annuitizing" your IRA (or annuitizing your deferred annuity contract).

Once IRA assets have been "annuitized," there is a big shift for minimum distribution purposes: The annuity contract itself no longer counts as part of the IRA balance for purposes of computing the RMD from that IRA. It is no longer considered just one more investment inside your IRA; it "disappears" from the annual valuation process. Instead, the payments you receive under the annuity contract will, themselves, be considered the "RMDs" for that annuity contract.

Payments from an IRA-owned true annuity are RMDs only for that contract; they can not be used to offset or reduce the RMDs from the rest of the IRA or any other IRA.

Daphne Example: Daphne has a $1 million IRA. At the end of 2017, the IRA held two assets: shares of Acme Mutual Fund worth $600,000 and a deferred variable annuity contract worth (under the IRA rules for valuing deferred annuity contracts) $400,000. Her 2018 RMD will be computed based on a 12/31/17 account value of $1 million. In 2018 Daphne converts her $400,000 deferred annuity contract into a "true" annuity that will pay her $2,000 a month for the rest of her life. For 2018, her RMD will be computed the usual way—12/31/17 value of $1 million divided by Daphne's 2018 divisor—and the distributions she receives from the new annuity will count towards fulfilling the 2018 RMD so computed. But going forward, starting in 2019, her RMDs will be [the RMD computed in the regular way based on her age and the year-end value of the Acme Mutual Fund] + [the $24,000 she receives from the annuity contract].

So, starting in 2019, when Daphne computes her RMDs, she does not count the value of her $2,000-a-month annuity as part of the prior year-end value of the account. The value of the true annuity contract becomes totally irrelevant; only her RMD for the nonannuitized portion of the account will still be computed in the usual way. That's the "good news." The "other news," however, is that the $2,000 monthly payments Daphne receives from the annuitized portion of her IRA cannot be used to reduce her RMDs from the non-annuitized portion of her IRA. Also, since all the payments she receives from the true annuity contract are "RMDs" (they are the RMDs with respect to the annuitized portion of her IRA), she cannot roll them over into an IRA or other retirement plan. RMDs are not eligible for rollover.

This special treatment of "annuitized" IRAs has unique RMD implications in the case of Qualified Longevity Annuity Contracts (QLACs); see Chapter 9.

CHAPTER 4
Computing the Distribution

Once you've separated out the plans and accounts for which do not need to compute an RMD this year, you must next perform the following three steps for <u>each</u> remaining retirement plan or account:

A. Determine the prior year-end balance

The prior year-end balance is normally the account value as shown on the year-end account statement you receive or should have received from the IRA provider.

What's a bit strange about this is, there is little IRS guidance, and apparently no universal agreement, on how to determine the prior year-end balance of the account. All we know is that:

✓ The value to be used is the "fair market value" of the account.

✓ There is a special valuation rule for deferred annuities held in an account. See "*IRAs that hold annuity contracts*" (Chapter 3) to see if this applies to you.

For each IRA you hold, the IRA provider is legally required to file Form 5498 with the IRS annually. This is supposed to state the prior year-end value of the account, and it seems reasonable to assume you can rely on the IRA provider's determination.

However, there is apparently not universal agreement among IRA providers about how to determine FMV. For example, a bond held in your account would have accrued interest "attached" to it that you would receive if you sold the bond. Or your account may hold a stock on which a dividend was declared prior to the year end but is not payable until after year-end. Are such accrued bond interest and declared but unpaid dividends includible in FMV? It is believed that different IRA providers follow different practices on this question. The IRS has not spoken.

Also, if the account has "hard-to-value assets" it will presumably be more difficult and perilous to determine the FMV. The IRS requires your IRA provider to report to the IRS each year (on good old Form 5498) whether your IRA contains assets that do not have a readily ascertainable market value. Directly-held real estate, many hedge funds, and closely held businesses would fall into this category. If your IRA holds assets of that type you may need to hire an appraisal firm to determine the fair market value.

B. Rare: Adjust prior year-end balance, if applicable

This one is rare: If you are transferring funds between one retirement account and another, it is possible that the money might not be in either account as of the last day of the year. There is a specific rule for that situation: Such a transfer that is in "midair" as of December 31 must be added into the prior year-end balance of the account that receives the transfer, for purposes of computing the RMD:

Dirk Example: Dirk closed out his 401(k) plan on December 15, Year 1. He intended to, and did, roll over the 401(k) money to a new IRA he established on January 15, Year 2. So the prior year-end balance of both accounts was zero, because the money was in transit between the two plans as of the last day of the year. Dirk will have to make an adjustment. Even though his new IRA did not exist until January 15, Year 2, it will be deemed to have a prior year-end balance, because the money it received in January, Year 2, is added back to the prior year-end balance of zero. Without this rule, it would be easy to eliminate RMDs by transferring money between accounts at the end of each year.

C. The actual computation

Now, divide the prior year-end account balance by your divisor for the year (as obtained in Step 1). The result is your RMD for this account....unless "D" applies!

$$\frac{\text{Prior year-end account balance (adjusted, if applicable)}}{\text{Divisor for your age}} = \text{RMD for the year}$$

Unless D applies, this is the amount you must withdraw from your IRA by the applicable deadline—normally December 31, but a bit later for the first Distribution Year.

D. Rare: RMD can't exceed account balance

Here is a special break I hope does not apply to you: What if, by the time you get around to taking the RMD, the entire account is worth less than the amount you computed in "C?"

This can happen if (for example) you have a really bad investment result, or if a big chunk of your IRA was awarded to your now-ex-spouse in a divorce proceeding after the prior year-end and before you took your RMD. The "good" news is that your RMD for the year from this account will be the RMD computed according to the formula *or, if less, the entire value of the account as of the date of distribution*.

Susan Example: Susan, age 73, who is in the process of getting divorced, computed her RMD for 2018 to be $42,675 based on the 12/31/2017 year-end balance divided by the Table III factor for her age on her 2018 birthday. On June 1, 2018, however, before Susan had yet gotten around to taking any distributions for 2018, the divorce court awarded her entire IRA to her now ex-husband Walter. All the money in her IRA was promptly transferred to a new IRA in Walter's name, leaving Susan's account balance at zero. Her RMD for 2018 is reduced to zero, which is the lesser of the formula-amount RMD ($42,675) and the account balance on date of distribution (zero).

CHAPTER 5
Decide When to Take Your RMD

Generally, once you have computed your RMD for a particular calendar year, you must take that RMD sometime during that particular calendar year—i.e., no later than December 31 of that year. By the way, distributions you took *before the calendar year began* don't count. So there is not a lot of leeway—you must take the distribution some time between January 1 and December 31.

But even in that short period of time you have a choice about whether the take the distribution at the beginning of the year, the end of the year, the middle of the year, or in pieces at different times during the year.

And in ONE year, the first "Distribution Year," i.e., the year you turn age 70½ (or the year you retire in some cases—see Chapter 3) you have an even greater choice range: You can take the distribution during the first Distribution Year or at any time up until April 1 of the following year.

The decision in most years

Your IRA RMD for the year in which you reach age 71½ and every subsequent year must be taken some time between January 1 and December 31 of that year. (The age 70½ year is different–see the next subsection.) Since (after the first year) each year's RMD must be taken some time during that taxable year, there really isn't much choice to be made here. The options are:

✓ *Take the distribution early in the year*. You can take the RMD for the year as early as you can figure out how much it is. That's normally in January, when you receive the prior year-end statements giving you the needed valuations. The advantage of taking the RMD early in the year is, it gets the thing over with so you don't have it hanging over your head all year. This approach also makes sense if you need a lump sum for some purpose (such as funding your small business retirement plan; see Chapter 10). Finally, this approach can make life easier for your beneficiaries if you die during the year, because if you die before you have taken your RMD for the year your beneficiary has to do it. The drawbacks of withdrawing early are, you have to pay income taxes sooner on the distribution (via estimated taxes). Also, by taking out the money sooner, you are reducing your future tax-deferred growth inside the plan.

✓ *Take the distribution in monthly instalments with direct deposit*. This is popular with retirees who are living on their RMDs. They receive the RMD in equal monthly instalments, like a pension. Normally this is worked out with the IRA provider so that the IRA provider takes responsibility for computing the RMD and making sure the distributions occur, thus making life a little easier for the IRA owner. The monthly-payout approach has no particular tax advantage or disadvantage. It raises some slight complications if the participant dies during the year and his/her RMDs keep getting automatically paid into a bank account until someone notifies the IRA provider of the death. And of course there is always the slight risk that the IRA provider will screw up and send the wrong amount, or no amount, in some month(s), so you do have to keep an eye on it to make sure the payments come in. But the convenience, reliability, and peace of mind (especially if income taxes are withheld from the monthly payments) offered by this approach make it a favorite.

✓ *Take the distribution late in the year*. This is recommended if you want to maximize tax-deferred growth inside your IRA (by leaving money in the IRA as long as possible) and defer estimated tax obligations (see Chapter 7). It also might make sense for an individual who doesn't need the money to live on and is leaving the entire IRA to charity on his/her death—if he/she dies during the year, the RMD goes to the charity tax-free instead of generating an income taxable distribution to the participant. The drawback of this approach is the worry (if you are a worrier) about whether the distribution will actually occur on time.

The "when" decision in the first Distribution Year

Generally, your RMD for any particular year must be distributed to you no later than December 31 of that year. But there is a one-time blue-light special for the first Distribution Year: You can take the distribution either *during* that first distribution year *or* any time up until April 1 of the following year. That April 1 deadline is called your "Required Beginning Date" or "RBD."

For an IRA, the first Distribution Year is the year you reach age 70½. For certain workplace plans it is the year you "retire" if later than age 70½ (see Chapter 5). The following discussion deals with IRAs and so uses the age 70½ year as the first Distribution Year. If you are dealing with a workplace plan with a later RBD, keep in mind that the first Distribution Year is the year you "retire" if later than the year you reach age 70½.

So should you take the RMD for the first Distribution Year *during* that first year? Or should you take advantage of the "deferral" possibility and postpone taking that first year's RMD until the following year (no later than April 1)? Which is better?

The answer is....in some cases it is better to take the distribution in the first Distribution Year, while for other situations it is better to postpone until January, February, or March of the following year! In other words there is no one right answer for everybody on this one. Each individual should look at his or her own situation and see which approach is likely to be better for him or her.

Here are some factors to consider when deciding in which year to take that first RMD:

✓ Are you probably going to be in a lower tax bracket in one of the years? If so consider taking the distribution in that year. For example if you are working full time in the year you reach age 70½ but will be retired in the following year, you might pay lower income taxes by postponing your first year's RMD until the second year.

✓ If you want to maximize your "qualified charitable distributions" (see Chapter 8) you should take up to $100,000 of your first year's IRA RMD in the year you turn 70½, in the form of one or more QCDs. The QCD in the year you turn age 70½ would count toward your RMD for that year, without increasing your income for income tax purposes.

✓ If you have an immediate good use for the money (such as to fund a retirement plan—see Chapter 10—or to make family gifts to reduce future estate taxes) take the money in the first year.

✓ Taking the distribution in the first year slightly reduces the amount of the required distribution in the second year, because the first year's distribution is removed from the account balance. If the first year's distribution is postponed, that undistributed money will be part of the "prior year-end balance" in the second year, making the second year's RMD a bit larger.

✓ Beyond that, carefully scope out the income tax effect of taking the distribution in one year or the other. Remember that postponing the first year's distribution means there will be a double RMD in the second year (because you cannot postpone the age-71½-year RMD), and that fact alone might push you into a higher bracket in the second year. Also calculate the effect on your Medicare premiums: Remember that the amount of your adjusted gross income in any particular year determines your and your spouse's Medicare premiums two years later (see Chapter 8).

CHAPTER 6
Decide Which Account to Take Your RMD from
(If You Have a Choice)

Now you've computed your RMD for each plan or account you own that generates an RMD this year. So which plan or account do you actually take the distribution from?

Most of the time: You have no choice

Most of the time you have no choice: You generally must take the RMD for each plan or account from that particular plan or account.

Teresa Example: Teresa is retired and over age 70½. She has a traditional IRA with a mutual fund company and also has money in her former employer's 401(k) plan. This year's RMD from the IRA is computed to be $6,528. This year's RMD from the 401(k) plan is $9,043. The combined total RMDs she must take is $15,571. She must take $6,528 from her IRA and $9,042 from her 401(k) account no later than December 31.

A common mistake in Teresa's situation is to take the combined RMD for both types of plans from just one of them. For example, if Teresa takes the combined total RMD of $15,571 entirely from the 401(k) plan she has a taxable distribution of $15,571, but she has not satisfied the RMD requirement for the IRA at all. She still needs to take $6,528 from her IRA. If she fails to do so (because of her erroneous belief that an IRA RMD can be satisfied by taking a distribution from the 401(k) plan), she has a failure to take her RMD. The penalty for that mistake is 50% of the shortfall ($3,264).

When you have a choice: Multiple IRAs or multiple 403(b)s

There are two special exceptions to the general rule, one for IRAs and one for "403(b) arrangements."

If you own multiple IRAs, you can take the RMD for any IRA from any one or more of your IRAs. For example if you have three IRAs in your name, you compute the three RMDs, then add them up, and you can take the combined total from any one of the three accounts, or any combination of them.

But as with every rule there are exceptions—and there is an exception to this rule, for inherited IRAs: Inherited IRAs cannot be lumped in with your own IRAs for this purpose.

Example: Winnie has three IRAs of her own, plus one IRA she inherited from her mother. For this year, she has determined that the RMDs from her respective IRAs are:

Winnie's own IRA A: $2,456
Winnie's own IRA B: $10,311
Winnie's own IRA C: $5,781
Winnie's Inherited IRA: $4,096

For the inherited IRA, she must take that RMD ($4,096) from the inherited IRA itself. Any distributions she takes from the inherited IRA can NOT be counted towards her required distribution from any of her own IRAs. Any distribution she takes from her own IRAs will not count towards the RMD for this inherited IRA.

The other three IRAs are all “her own” IRAs, so she can take the combined total of the RMDs for those three accounts ($18,548) from whichever one of them (or whichever combination of them) she wants to take it from.

Which IRA should you tap first?

How do you decide which IRA to take the RMDs from if you have a choice? Most of the time for most people it makes just about no difference which account you take it from, so either flip a coin or choose based on one of these factors:

✓ Take it from the smallest account, as a step towards closing that account out and simplifying your life by having fewer IRAs.

✓ If there are other reasons you are considering dropping one particular IRA (such as poor customer service or investment results), deplete that account first.

✓ If one account has cash to cover the distribution, and the others don’t, take it from the account that has cash, for convenience (see Chapter 7).

✓ If there is a particular asset you would like to get out of the IRAs, distribute that asset (see Chapter 7) and have the distribution count towards your RMD for all your IRAs.

✓ If you have kept separate your “rollover IRA(s)” (IRAs that contain NO money other than rollovers from qualified employer plans and the earnings thereon) and your “contributory IRA(s)” (IRAs to which you have made one or more “regular” contributions), deplete the contributory IRA(s) first if you fear you may someday go bankrupt. Rollover IRAs may offer you better bankruptcy protection.

✓ If you have different beneficiaries for the different IRAs, take into account the effect on their respective inheritances if you take disproportionately from the accounts.

CHAPTER 7
Choose Your Mode of Distribution

Surprisingly, you have several choices about exactly HOW to take your RMD. You can take it in cash, “in kind,” by means of a “qualified charitable distribution,” and/or through withheld income taxes. Here are the pros and cons of the four modes of taking distributions from an IRA.

Take your distribution in cash?

Taking the RMD in cash is the most popular and most convenient mode. If your plan account has enough cash to pay the RMD this is probably the “mode” you’ll use. Just request a cash distribution from your account.

If you have multiple IRAs and one of them has enough cash to cover the RMD for all of them, you’ll probably take the RMD for all your IRAs from the one that has cash in it, just because it’s easier.

If you don’t have enough cash to cover the RMD, you have a choice: Either sell assets inside the account to generate cash to pay the RMD....or take assets instead of cash:

Take your distribution in property?

There is no requirement that RMDs be paid in cash. A distribution of stock, or bonds, or any other property, is perfectly legal. The fair market value of the distributed asset (as of the date of distribution)—

✓ Will count towards your RMD for that year.

✓ Will be your tax basis for that asset going forward, for purposes of determining gain or loss when you eventually sell the asset, just as if you had purchased the asset for that amount.

✓ Will be includible in your income (except to the extent, if any, that any of it is considered to be a return of after-tax contributions made to your IRAs).

The date of distribution is the beginning of your holding period for the asset, for purposes of determining whether a subsequent sale generates long- or short-term gain or loss.

Example: Corey needs to take an RMD of $15,000 from his IRA in 2018. His IRA is fully invested and he has no desire to sell any of the investments at this time. He does not use the RMDs for living expenses; he pays those from his other income. His IRA holds about $15,000 worth of Acme Co. common stock (a publically-traded stock), for which the IRA originally paid $3,875. He directs the IRA provider to distribute the stock out of the IRA and transfer it to Corey's personal (taxable) investment account. The IRA provider does so. On the date of distribution, the Acme stock is worth $15,369. The IRA provider reports a distribution of $15,369 to Corey for 2018. Six months after the distribution, Corey sells the Acme stock for $16,201. He will have short-term capital gain of $832 from this sale ($16,201 sale proceeds minus $15,369 tax basis).

Though it's perfectly legal to take distributions in kind, it is a bit of a pain. Cash is a LOT easier. With an in-kind distribution, check to see if the IRA provider charges a fee for this type of transaction. Also, mutual funds may not be able to be transferred this way—it may be that the fund shares can only be transferred back to the fund issuer (i.e. sold). Finally, a brokerage firm's book-keeping systems may have difficulty tracking the basis and holding period for securities that were distributed to you from an IRA rather than purchased in the market. For example, in the "Corey Example" above, it would not be unheard of for the financial firm that holds Corey's accounts to mistakenly continue to show the original cost of the stock ($3,875) as Corey's "cost basis" in the stock, even though the taxable distribution in 2018 gave him a new cost basis of $15,369 (the value on the date of distribution).

So if it's such a pain, why would anyone take distributions in kind rather than in cash? Here are a few reasons people take in-kind IRA distributions:

- ♦ Your IRA account is fully invested and you don't want or need to sell any of the investments, but you do need to take an RMD. See the Corey Example above.

- ♦ You want to remove a particular asset from the account for the purpose of gifting it to family members or some other donee.

- ♦ This is an investment you want to keep, but the asset in question does not have a readily ascertainable market value. There are special IRS reporting requirements applicable to hard-to-value assets held in an IRA. You decide you would prefer to hold this asset outside your IRA rather than get involved with those reporting requirements.

- ♦ Your future plans for this particular asset (or the future plans of other people or entities related to you) might raise "prohibited transaction" issues if the asset continues to be held inside an IRA. A prohibited transaction would disqualify the entire IRA. (Because of the concern about potential prohibited transactions, it is recommended that you not invest your IRA in any private businesses or other assets where you or related parties may be involved in transactions affecting such assets without the professional advice of an expert in IRA prohibited transaction matters.)

Withholding mode: Use your RMD to pay estimated taxes

Most IRA providers permit voluntary withholding of income taxes from IRA distributions. See IRS Publication 575 and IRS Form W-4P. Income taxes withheld from retirement plan distributions (just like income taxes withheld from wages) are treated (for purposes of computing whether a taxpayer owes the penalty for underpayment of estimated taxes) as if paid equally on the four due dates of estimated tax payments. Thus, an IRA distribution in December that is sent to the IRS by the IRA provider as withheld income taxes will be treated (for estimated tax purposes) as if paid in four equal installments on the preceding April 15, June 15, and September 15, and the following January 15.

An individual who normally is required to pay estimated taxes quarterly, and who does not need his RMDs to pay living expenses, can kill two birds with one stone by using the required distribution to pay his estimated taxes. Here's how: Late in the year, the IRA owner requests his required distribution from the IRA, but (by filing Form W-4P) instructs the IRA provider to send all or part of the distribution to the IRS as withheld income taxes. By paying estimated taxes late in the year through withholding, the IRA owner gets a few more months' interest on the money he would otherwise have had to pay to the IRS in April, June, and September.

This mode carries some risk: If the IRA owner dies before the withheld-taxes distribution occurs, he now (being dead) won't be able to take the distribution, and his estate will owe the penalty for underpayment of estimated taxes.

Qualified charitable distributions

A “qualified charitable distribution” (QCD) is a tax-favored way for certain individuals to transfer funds directly from their IRAs to charity. The IRA owner must be over age 70½, only certain types of gifts and certain types of charities qualify, and there is an annual limit of $100,000. If the various requirements are complied with, the QCD provides a safe tax-favored way for an over-age-70½ individual to use his IRA to benefit charity and fulfill the minimum distribution requirement at the same time.

QCDs have been permitted since 2006. However, until the end of 2015 they were allowed only as temporary additions to the tax code. This made planning difficult for IRA owners because you didn’t know until late in the tax year—sometimes very late in the tax year—whether you could make a QCD that year. At the end of 2015, QCDs finally became a “permanent” part of the Code, making planning much easier.

QCDs are such an important part of the post-70½ planning landscape they get their own chapter. See Chapter 8.

Second Section: Five Ways to Reduce Your RMDs

Your RMDs are a punishment for your success. The more money you saved out of your compensation, and the more successfully you invested that money, the bigger your income tax hit will be when RMDs begin. Whether due to good luck, good heredity, or careful health habits, you have lived long enough for this success to be a problem in the form of RMDs.

So remember that one way to reduce RMDs is to die young and leave your IRA to charity. Another way is to lose money on all your investments so that your IRA is not worth very much. If those approaches don’t appeal to you, maybe you should just stop complaining and pay the taxes.

If you want to have your cake and eat it too, i.e. you want to be old and rich but not pay sky high taxes, here are some techniques that may help reduce the tax bite.

CHAPTER 8
Qualified Charitable Distributions from Your IRA

How a QCD works; how it can benefit you

An over-age-70½ IRA owner can, in any calendar year, instruct the administrator of the IRA to transfer up to $100,000 directly from the IRA to one or more eligible charities. The amount so transferred is not includible in the gross income of the IRA owner-donor, even though it is a distribution from his or her IRA, and even though it counts towards the required minimum distribution.

Here is why this is a more tax-effective way to give to charity than simply taking a distribution from the IRA, then donating the distributed amount to charity. A normal IRA distribution is includible in the IRA owner’s gross income for federal income tax purposes, thus increasing his or her “adjusted gross income” (AGI). A normal charitable contribution generates an “itemized deduction” for the contribution amount—but an itemized deduction *does not reduce AGI*.

The QCD bypasses the IRA owner’s tax return altogether. Accordingly, a QCD does *not* increase AGI. It is a way to fulfill your RMD requirement without increasing your AGI.

Having a higher AGI can increase your income taxes and Medicare premiums. Having a lower AGI can lower those costs. Here’s a list of specific taxes and costs you may reduce or avoid by having a lower AGI as a result of satisfying your RMD with a QCD rather than by means of an income-includible distribution from your IRA (based on 2017 rates), with citation to the applicable section of the Internal Revenue Code:

✓ An individual becomes subject to the 3.8% additional income tax on “net investment income” if his AGI is above certain levels. § 1411.

✓ Medical expenses are deductible only to the extent they exceed 10% of AGI. § 213(a). [See Appendix C]

✓ Miscellaneous itemized deductions (such as investment expenses and tax preparations costs) are deductible only to the extent they exceed 2% of AGI. § 67(a).

✓ Itemized deductions are reduced (i.e. become partially not deductible) if the individual’s AGI exceeds a certain level. § 68(a). [See Appendix C]

✓ Social Security benefits may be wholly or mostly excludible from an individual’s gross income, or mostly includible in gross income, depending on the level of the individual’s AGI. § 86.

✓ The QCD does not count for purposes of the percentage-of-income limits on charitable deductions in § 170(b).

✓ A QCD is in effect "deductible" even for someone who does not itemize deductions: The IRA owner can satisfy his charitable gifts with a QCD, exclude the distribution from his income, and still take the standard deduction on his income tax return.

✓ Finally, Medicare premiums are higher for higher-income individuals. The determination of "income" for this purpose is based on the individual's AGI for the year two years prior to the premium year in question. 42 U.S. Code §1395r(I)). Thus, by keeping the RMD out of AGI through a QCD (sorry about all these abbreviations), the IRA owner may keep Medicare premiums lower (two years later) for both the IRA owner and his or her spouse.

Darla Example: Darla is age 73. In 2016 her RMD was $140,000. She took $120,000 of this in cash and made a $20,000 qualified charitable distribution (QCD) to fulfill the rest of her RMD. She files a joint income tax return with her husband Godfrey. Their AGI for 2016 was $290,000. If Darla had taken her entire 2016 RMD in cash, their AGI would have been $310,000 instead of $290,000. This would have put Darla and Godfrey into another, higher, bracket level for purposes of determining their Medicare premiums in 2018, increasing their combined Medicare premiums by about $1,900.

Confusion about QCD vs. the RMD

A QCD does "count" towards the individual's required minimum distribution for the year. Except for that fact, however, there is no relation between the QCD amount and the RMD amount.

For example if someone has already taken his RMD for the year in cash, he can still make a QCD up to the maximum annual limit of $100,000. And, if your RMD for the year is $250,000, your maximum QCD is still only $100,000.

The seven rules of QCDs

Here are the seven rules that apply to this important device:

1. **The age requirement.** Only individuals who are age 70½ or older can make QCDs. This is the only tax code provision to make the age 70½ "birthday" itself a significant event.

Example: Jonathan's 70^{th} birthday was April 1, 2016. 2016 is his first "distribution year." Any distribution he takes from his IRA in 2016 will count towards his 2016 RMD. He turns 70½ on October 1, 2016. He can make QCDs from his IRA any time on or after October 1, 2016. If he wants to use a QCD to fulfill his minimum distribution requirement for 2016 he will have to wait until then to do it.

2. **The type-of-plan requirement.** QCDs may be made *only* from IRAs, not from any other type of plan (such as a Keogh, 401(k) or 403(b) plan).

Unfortunately if you need to take an RMD, but your money is not in an IRA, you can't just transfer it to an IRA in order to fulfill the RMD with a QCD:

Connie's dilemma: Connie is over 70½ and retired. Her retirement money is still in a 401(k) plan with her former employer. She likes to keep the money there because of the plan's excellent investment management. However, now she needs to take her $30,000 RMD for 2017. She would like to fulfill that RMD with a QCD. She can't make a QCD from a 401(k) plan—QCDs can come from IRAs only. So why can't she just transfer $30,000 from the 401(k) plan to an IRA, then make the QCD out of the IRA? Because of the twin rules: Rule #1: You cannot roll over an RMD. Rule #2: The first distribution in any year is the RMD—the RMD comes out first. So she can't instruct the 401(k) plan to send $30,000 to her IRA, because the plan administrator will tell her "Sorry Connie before we can do any transfers to your IRA we FIRST have to pay to you, outright, your RMD for the year. Once we've paid you the $30,000 you've satisfied the RMD for the year, then you can roll as much OTHER money as you want into the IRA."

Should Connie, after taking her $30,000 RMD from the 401(k) plan for 2017, direct the plan to transfer some additional money into the IRA so that she can make a QCD to cover NEXT year's RMD? That doesn't work either—a distribution from the IRA (whether it's a QCD or otherwise) does not "work" to satisfy the RMD for the 401(k) plan. If Connie really really seriously wants to satisfy all her future RMDs with QCDs, she will have to transfer ALL of her retirement money from the 401(k) plan to the IRA—after taking the RMD for the transfer year first, of course.

3. **The annual dollar limit.** The maximum amount a person can give in the form of QCDs is $100,000 in any one calendar year. The limit is $100,000 per individual IRA owner.

So, a husband and wife who are both over age 70½ and who both have IRAs can each transfer up to $100,000 to charity from their respective IRAs in the same year. But if (for example) wife has an IRA and husband does not, wife cannot "borrow" husband's limit and give $200,000 from her IRA.

The donor does not have to give $100,000. $100,000 per IRA owner per year is the maximum and there is no minimum (other than what the IRA provider may impose administratively).

4. **The eligible-charities limit.** Generally any charity that you can make a tax-deductible donation to is also eligible to receive a QCD from your IRA, with a couple of important exceptions. So, the museum, the nonprofit hospital, the educational institution, the church, the aid organization—all the usual charities you donate to can receive your donations in the form of QCDs from your IRA. Except the following:

Exception #1: A "donor-advised fund" may NOT receive QCDs. Even though they are part of the umbrella of a tax-exempt 501(c)(3) charitable organization, the tax law specifically rules them OUT of receiving QCDs.

Exception #2: A "supporting organization" is another common type of charity that is simply not authorized to receive QCDs. Supporting organizations are separate charities that are formed solely to support another charity (such as typically a particular university). They're perfectly legal and 100% charitable but for some reason Congress barred them from receiving QCDs.

Exception #3: A private foundation is a charity that is funded primarily by one individual or family. Some private foundations are eligible QCD recipients and some are not. If the charity you wish to donate to is a private foundation, you will need to consult a tax lawyer to determine if it is eligible to receive QCDs.

5. **The 100%-to-charity rule.** A QCD must not be the type of charitable gift where the donor or other individuals "get something back" from the gift: 100 percent of the gift must go straight into the charity's endowment or operating budget.

Rose Example: Rose wants to fund a charitable gift annuity. She intends to give $100,000 to the art museum and in exchange the museum will pay her $6,700 a year for the rest of her life. If she makes this gift from her taxable account, the gift will qualify for a partial charitable deduction. But this type of gift can not qualify as a QCD, so it can not be made from an IRA, because Rose is getting something back. The money is not going 100% immediately straight into the charity's bank account.

Very often charitable donors "get something back" in the form of "membership benefits" such as free admission, invitations to special donors-only events, dinner with the organization's president, gift shop discounts, coffee mugs, calendars, etc. The IRS actually has elaborate rules for charities and their donors to follow, whereby the value of the get-back is separated from the "true" donation—or ignored altogether because it is so insubstantial in value—for purposes of computing how much of the "donation" is tax-deductible. When those rules are applied to normal (non-QCD charitable donations) the donor is just trying to figure out whether his donation is fully deductible or whether he has to reduce the donation amount by $X because that's the value of the free dinner he received. Unfortunately with QCDs if there is any "get-back" *at all* the gift can not be made via a QCD—unless (under IRS rules) it's the type of get-back that can be ignored for purposes of computing the donor's tax deduction. That's because only gifts that would be 100% tax-deductible contributions under IRS rules can be made via a QCD.

Charities devote their resources primarily to their charitable mission, secondarily to fund raising, and only a distant third to plodding through the IRS rules about the value of what donors get back in exchange for their "donations." Thus, if you plan to make a QCD to a charity where you get any benefits back (membership benefits, other recognition or gifts) it is strongly suggested that you do the following: Either,

✓ Separate your QCD gift from the gifts for which you get anything back. For example, if tickets to your favorite charity's annual fund-raising dinner dance cost $500 each, buy one using your taxable account and make an additional donation if you wish from your IRA via a QCD. The additional donation may get you listed in the program as a sponsor or patron, but you don't get any extra food at the dinner, so there are no issues raised about whether you got back a countable benefit of some kind. Or:

✓ Work with your tax lawyer and/or the charity's representative to figure out how you can make a QCD that will not run afoul of the rule that the transfer must be one that would be 100% deductible if made from your taxable account.

6. **The substantiation requirement etc.** The gift must meet all other requirements applicable to the income tax charitable deduction, such as the requirement that you must obtain a statement (for gifts of $250 or more) from the charity specifying certain information.

For details on the required statement, see IRS Publication 526 ("Charitable Contributions") or the instructions for Schedule A (IRS Form 1040) at https://www.irs.gov/pub/irs-pdf/i1040sca.pdf (at p. 9 of the 2016 edition).

7. **Money must go direct to charity from IRA.** QCDs are allowed only for direct transfers from the IRA to one of the permitted types of charitable recipients. If the money is first distributed to the individual, then donated to charity, it is not a QCD. The distribution will be includible in the IRA owner's income and the gift will be at best an itemized deduction for a charitable gift.

QCDs tax-reporting glitch

There is a sort of glitch in the tax reporting rules for QCDs. The IRA provider is supposed to report the QCD on Form 1099-R, just as if it had paid the distribution to the individual donor rather than to a charity. There is no special code or other indication on Form 1099-R signaling that the distribution is a QCD. Thus, nothing in the 1099-R will reveal that the distribution is nontaxable! As the IRS puts it in the instructions for Form 1099-R, "There's no special reporting" that IRA providers have to do for qualified charitable distributions.

Instead, it's up to the IRA owner-donor to report the nontaxable status, in the following manner: First, he enters the total distribution (as shown on Form 1099-R) on Line 15a of his personal income tax return, Form 1040. Then he enters the taxable portion of the distribution (zero, if the QCD was the only distribution for the year) on Line 15b. See instructions for IRS Form 1040, 2016, p. 25, Lines 15a and 15b, Exception 3. Then the donor is supposed to "Enter 'QCD' next to line 15b."

This method of reporting QCDs probably means that some QCD-donors will not get the benefit of the income tax exclusion. This will happen if the IRA owner-donor simply turns over all his 1099-Rs to his tax preparer without alerting the preparer to the fact that there was a QCD. If the preparer doesn't think to grill the client on this subject, the preparer will presumably report the entire distribution as taxable...and if the client doesn't notice that discrepancy but simply signs and files the return, the U.S. Treasury will collect a bit more money than it's entitled to.

QCD may not be the best way to make your donation

As with any other proposed action, the QCD should be compared with alternative ways of achieving the objective. Of course the QCD is only of interest to an individual who wants to give to charity.

The first question to ask is whether this is the best way to fulfill the RMD requirement for the year. Compare the QCD with other ways of taking the RMD.

Though for most charitably inclined people the QCD is a very tax-favored way to fulfill the RMD, it may not be the most tax-favored way to give amounts beyond the RMD. If the IRA owner wants to give to charity, and the RMD requirement has already been satisfied (either with a QCD or some other way), compare the QCD with other options for making a charitable gift.

Tenley Example: Tenley's $27,000 RMD for the current year has been satisfied (either through a QCD or in some other way). She wants to donate another $50,000 to charity this year above and beyond what she has already given. She could carry out that intent by means of a QCD from her IRA (since she has not hit the $100,000 limit for the year) but she has other options too. She owns $50,000 worth of a publically-traded stock in which her tax basis is only $5,000. Her tax advisor should run calculations for her to determine which will save her more taxes—donating the appreciated stock to charity or a QCD?

CHAPTER 9
Buy a Qualified Longevity Annuity Contract

A longevity annuity is an annuity contract with a delayed starting date. The contract eventually pays you a life income, but the income does not start until you reach a certain age, typically age 85. You buy the contract from an insurance company now, when you are many years younger than the starting age.

Why would someone buy a contract like this? To insure against "living too long"–outliving your income.

Many people might conclude that they have enough money to live in their accustomed lifestyle if they live to their "average life expectancy" or a little longer...but that they will run out of money if they live into their 90s or beyond. One response to that risk is to cut back on spending in your younger retirement years to assure that no matter how long you live you will never run out of income. The problem with that solution is that, if everybody does that, 100 percent of retirees will be cutting back their lifestyle but only half of them will actually live beyond average life expectancy. The other half will be regretting on their deathbeds that they didn't spend it all and have more fun.

Another solution is to buy a longevity annuity. If everybody gives a little money now to the insurance company (the theory is), the insurance company will pool and invest the money, then, many years from now, pay out a good annuity to those pool investors who actually have the need—the half that live beyond average life expectancy.

What happens to the investments of the other half? By definition if you don't live to age 85, you get nothing back from your investment in the longevity annuity. That's because you bought *insurance* and the risk you were insuring against didn't occur. That's how the insurance company can get enough money, by collecting small premiums from everybody, to pay relatively substantial amounts to the people who actually live "too long."

That's the theory of longevity insurance. Despite this theory of how longevity annuities work, however, many such contracts actually do provide some death benefit—so that on your death, your heirs will get back at least what you originally paid for the contract, minus any distributions paid to you during your life. In my personal opinion, that type of death benefit makes no sense. It's like buying a fire insurance policy for your house and the policy says if the house burns down the insurance company will pay to rebuild it, but if your house doesn't burn down they will refund your premium.

The effect of any such "return of premium" guarantee, whether in a fire insurance policy or a longevity annuity contract, is simply to dilute what is supposed to be the true benefit of the contract—either the premium must be increased or the policy benefit must be reduced to "pay for" the "return of premium" guarantee. In my opinion, the best longevity annuity to buy is one that provides no death benefits at all—only the live-too-long annuity payout you are buying the policy for.

What does a longevity annuity have to do with your IRA and its RMDs? Here's the answer:

Normally a delayed annuity that does not begin payouts until age 85 would not be a "legal" investment for a traditional IRA, because the minimum distribution rules require IRA-owned "true annuities" (see Chapter 3) to start paying out no later than age 70½. [Note: A "deferred variable annuity" contract owned by an IRA does not have to start payouts until the later of age 70½ or the date it is "annuitized," i.e., converted to a stream of fixed annuity payments.]

But the IRS has made an exception to permit IRAs to purchase "qualified" longevity annuities (QLACs) with up to $125,000 (increase to $130,000 for 2018 as a result of inflation adjustment) of the IRA balance, or 25% of the IRA owner's total IRA balance if less. **When the QLAC is purchased, the purchase price and value of the QLAC cease to be counted as part of the IRA balance for purposes of computing the IRA's annual RMD, beginning the year after the year of the purchase; see Chapter 3.**

Suki Example: Suki is turning age 70½ and age 71 in 2018. She plans to keep working (and therefore expects to continue to be in a high tax bracket) for several more years. Her projections show she will have a comfortable income even after retirement, though if she lives to a very old age she may have a problem maintaining her lifestyle. She finds a QLAC that will pay her a good income starting when she reaches age 85 in about 15 years. She buys it inside her IRA for $130,000. By removing $130,000 from her account value "base" in 2018, this move will reduce her next year's IRA RMD (i.e. 2019) by $5,078 ($130,000 divided by 25.6, the divisor for age 72), potentially saving her about $2,000 of income taxes that year. Since the $130,000 and its future growth are permanently removed from her RMD "account balance," the income tax savings will continue to accrue each year thereafter until the QLAC starts paying out. Of course her income (and taxes) will go up when she reaches age 85 and starts collecting on the QLAC, but she won't be working then (she figures) so she won't mind the taxable income as much.

You can buy a QLAC in your IRA at any time, including earlier or later than the year you reach age 70½. The earlier you buy it, the longer your $130,000 investment has to accumulate and thus reduce your pre-age-85 RMDs by an even larger amount. However, buying a QLAC as a "tax shelter" is not a good idea if the QLAC itself is not a good investment. Work with a financial advisor to determine whether available QLACs offer a sufficient return on investment (aside from RMD benefits) before going ahead with this idea.

CHAPTER 10
Still working? Keep contributing!

If you are still working after age 70½, so that you still have compensation income, you may be able to reduce the income tax impact or your RMDs by making tax-deductible contributions to some type of retirement plan. This is easy to do if you are self-employed with no other people working for you. It's more complicated (or financially impossible) if you have other people working for you (because you would have to contribute for your employees as well as yourself). It's also easy if you work for a company that allows you to make salary-reduction contributions into a 401(k) or 403(b) plan, but impossible if you work for a company that doesn't have a retirement plan.

Such ongoing retirement plan contributions do not reduce your RMDs; in fact they will increase your *future* RMDs by increasing the balance in your retirement plans. The impact of increased RMDs will be quickly felt since you are already over

70½. However, by providing a (potentially substantial) current tax deduction, a retirement plan contribution can reduce the income tax impact of your *current* RMDs.

The assumption is that, once you eventually stop working, your income will go down because your compensation income ceases, and the increased RMDs caused by your retirement plan contributions will therefore be taxed at a lower tax rate than RMDs you are forced to take *now* are taxed on top of your income from work. You will have to decide for yourself how realistic that assumption is in your case.

Eric Example: In 2017, Eric (who is single) is working as a self-employed lawyer who turned age 71 in 2017. He has no employees. His 2017 net income from the law practice will be about $400,000. On top of that he has to take an RMD of $72,000 from his IRA. With adjusted gross income in the range of $472,000, the IRA distribution will be exposed to federal income tax at the top bracket of 39.6%. Eric contributes $54,000 from his Schedule C earnings to a SEP-IRA for 2017. The contribution reduces his taxable income enough to take him out of the top income tax bracket. Of course it also increases his IRA balance and his future RMDs starting immediately; the addition of $54,000 to the SEP-IRA will increase the RMD by over $2,000 starting the year after the year it is contributed (see the).

Is it wise to defer these taxes or should Eric bite the bullet and pay the taxes? It will be very hard for Eric to pass up an immediate income tax savings of over $21,000 to focus on that longer-term planning question. If Eric decides to make the contribution, I would advise him to follow the "Tax Tip" at the end of this Chapter. If he decides he does *not* want to make a tax-deductible contribution this year that he would otherwise have been eligible to make (perhaps because his tax bracket is acceptably "low" this year), I would advise him to investigate whether there is a way he can at least make a Roth contribution this year (see discussion of Roth contribution avenues in later parts of this Chapter).

Here is a discussion of what kinds of retirement plans you can—and cannot—contribute to.

Traditional IRA contributions

You cannot make a "regular" contribution to a traditional IRA for the year you reach age 70½ or any later year. Traditional IRAs are the only type of retirement plan that have an age limit on contributions. You can still make *rollover* contributions to these accounts; and if you are still working you can generally have contributions made to a "SEP-IRA" (see below). But you cannot make the annual-type contribution of $5,500 or $6,500 to a traditional IRA that younger people are allowed to make from their compensation income.

Regardless of your age, you can make contributions to a Roth IRA if your income is less than the applicable limit for Roth IRA contributions. But since Roth IRA contributions are not tax deductible this will not reduce the tax impact of your current RMDs.

Workplace retirement plans

For an individual who is over age 70½ and still working and earning compensation, the best bet for reducing the current tax impact of RMDs is often to make ongoing contributions to a workplace retirement plan. If the employer offers a 401(k) plan, SEP-IRA, or other retirement plan, these offer a valid way to "shelter" current income after 70½ just as they did before 70½. A SEP-IRA is treated as an IRA for purposes of the minimum distribution rules (so you *do* have to take annual distributions starting at age 70½, even if still working). However employer contributions to a SEP-IRA are *not* subject to the post-age-70½ contributions ban normally applicable to traditional IRAs.

How much can you contribute to a workplace retirement plan? That is not an easy question to answer. There are dollar and percentage limits imposed by the Tax Code—but there are exceptions in the Code that can allow even higher contribution levels in some cases—and then there are other limits in the Code that can shrink your maximum contribution to a particular company's plan. The *general* rule is that the maximum percentage that may be contributed in any year for a particular employee is 25% of his or her taxable compensation for that year from the company that sponsors the plan or (if less) $54,000 (for 2017). The dollar limit is increased to $55,000 for 2018. Let's see what options are available for particular individuals based on their work situations.

You work for a big company...

A "big company" for this purpose means any company (or nonprofit) that you don't personally control. A company where you don't get to decide what kind of retirement plan will be offered to employees such as yourself. If that is your situation, you are stuck with whatever plan options and contribution limits your employer has set up.

If the company offers a "cash or deferred arrangement" (CODA) such as a 401(k) plan or (for nonprofits) a 403(b) plan or (for governmental agencies) a 457(b) plan, you can arrange to have part of your compensation paid into the plan (tax-deferred) instead of being paid to you in your paycheck (currently taxable). The maximum CODA contribution for 2018 is $18,500 ($24,500 if you will be 50 or older by the end of the year)—or your entire salary if less. CODA contributions are exempt from the percentage ("25% of taxable compensation") limit, so you can contribute the dollar maximum regardless even if that comes to more than 25% of your compensation.

But: You cannot contribute MORE than your total compensation. Also, the CODA limit generally applies to each individual, not each plan. So the maximum CODA dollar amount for you for 2018 is $18,500/$24,500 even if you participate in multiple 401(k) plans.

And another caveat: Your company may have lower limits. Also, if the company is making contributions on your behalf in addition to your CODA contributions, additional limits may kick in.

If your company offers a "designated Roth account" option, you can make your CODA contribution to that instead of to your "regular" or "traditional" (tax-deferred) CODA account. Of course a Roth contribution will not reduce your income taxes in the contribution year.

Once you've lined up the maximum CODA contribution you can make, find out whether your company's plan allows additional after-tax (nondeductible) employee contributions. If it does, and if your company's plan has designated Roth accounts, you can make additional contributions to the "voluntary employee contribution account" and then convert that account to a Roth account in the plan ("in-plan conversion") to earn tax-free future returns on those contributions.

If you control the company and have other employees....

Since you control the employer, you can adopt any kind of retirement plan you want. The catch is, with other employees, you will need to make contributions on their behalf. If this is your situation, consult with a knowledgeable accountant, employee benefits firm, or other tax expert to determine whether there is a retirement plan that would be worthwhile for you to adopt for your business—a plan that would provide meaningful tax deferred benefits for you and for your employees at a cost that is within your budget.

If you are self-employed with no other employees...

This is the sweet spot.

You can adopt any kind of retirement plan you want. You will have to formally adopt the retirement plan—and you will be the "plan administrator" of that plan, with certain responsibilities. Popular plans for people in this situation are the SEP-IRA and the solo 401(k). The SEP-IRA has fewer paperwork and IRS reporting obligations. The solo 401(k) offers more choices in plan design and potentially larger contributions.

A **SEP-IRA** allows you to contribute 20% of your net income from self-employment, but not more than $54,000 (2017) or $55,000 (2018). Net income from self-employment is your net profit from the business (Line 30 of Schedule C to IRS Form 1040) minus the deduction for self-employment tax (see Form 1040 Line 27, and Schedule SE to Form 1040). There is no "catchup" contribution that increases the SEP-IRA contribution limit, nor is there any minimum permitted contribution that would allow you to bypass the percentage limit. So a 70-year old self-employed individual with net income from self-employment of $80,000 could contribute $16,000 to a SEP-IRA (20% X $80,000). Note that though SEP-IRAs ARE considered IRAs for purposes of the minimum distribution rules, they are NOT considered IRAs for purposes of the rule that IRA contributions are not permitted after age 70½.

A **solo 401(k)** allows you to contribute on a "cash or deferred" (CODA) basis up to $18,500 (2018 limit), or $24,500 if 50 or older, but not more than 100% of your net earnings from self-employment. So a 70-year old self-employed individual with net income from self-employment of $80,000 could contribute $24,500 to a solo 401(k) plan—$8,500 more than the SEP-IRA would allow. The increased contribution arises from the over-50 catch-up contribution (allowed for CODA plans, not allowed for a SEP-IRA) and from the "100% of compensation" limit for CODA contributions (vs. 20% of net income from self-employment for SEP-IRAs).

The solo 401(k) plan can also permit you to make additional deductible "employer" contributions beyond the CODA, subject to the overriding percentage limit of 20% of net income from self-employment and the overriding dollar limit of $55,000 (2018).

And your solo 401(k) plan could also allow designated Roth accounts, voluntary nondeductible employee contributions, and in-plan conversions; though these options do not help reduce your current income tax they may allow for future tax-free investment accumulations.

To figure out whether any of these plans may benefit you, start by investigating small business retirement plans via the IRS website (see IRS Publication 560) and via the websites of major mass market IRA/retirement plan providers. For example, Fidelity Investments' small business retirement plan website area offers free calculators showing your maximum contribution under various types of plans. Vanguard's website offers solo 401(k) plans that include the designated Roth account option. After learning what you can through such websites, consult a knowledgeable accountant, employee benefits firm, or other tax expert for assistance with the final choice, plan adoption, calculations, and ongoing compliance.

Tax Tip: Make Your Contribution after the End of the Year: As a self-employed person with a SEP-IRA, you can fund your contribution at any time during the year or until the due date of your tax return for such year (including any extension, if and only if you obtain an extension of time to file your tax return). So "Eric" (see example at the beginning of this Chapter) can contribute his contribution for the year 2017 during calendar 2017 or after the end of 2017—until April 15, 2018 (or October 15, 2018, if he obtains a six-months extension of time to file his 2017 return). If he contributes $54,000 in 2017, his RMD for 2018 will be about $2,100 higher than if he waits until early 2018 to contribute. That's because the contribution will become part of his RMD base in the year it's contributed. His divisor or factor or ADP for 2018 (the year he will turn 72) will be 25.6. $54,000 divided by 25.6 = $2,109.38.

CHAPTER 11
Roll IRA Money into Qualified Retirement Plan

While self-employed individuals have the edge when it comes to the ease of establishing a retirement plan to receive current contributions (see Chapter 10), people who work for big companies have the advantage when it comes to this technique: Rolling your IRA into a qualified plan to stop the flow of RMDs.

When you are 70½ or older, as we know, you must start taking RMDs from your IRA. But if you are still working (not retired), and you are less than a 5% owner of the company you work for, you do not have to take RMDs from that company's plans until *the later of* age 70½ or actual retirement see Chapter 3. If the preceding sentence describes you, you can defer RMDs from your IRA by rolling the IRA into the retirement plan of the company you work for.

Why does this technique work? Because the RMD rules are based on the plan the money is actually in, not the plan it used to be in. Once the funds are in that company retirement plan, you do not have to take RMDs from that plan until you actually retire from the service of that employer.

For this to work, the following pieces have to be in place:

✓ You are not a "5% owner" of the company you work for.

✓ The company you work for has a retirement plan that accepts rollovers from IRAs.

How do you know if you are a "5% owner?" If the company is a nonprofit (such as a university), by definition you are not a 5% owner because a charity has no "owners." If you work for a for-profit company, and neither you nor any member of your family nor any entity owned by you or your family owns any interest in the company, and neither you nor they owned any such interest at any time since you reached approximately age 70, you are not a 5% owner. If you own a little bit but you know it's less than 5% (e.g. you work for Ford Motor Company and you own 100 shares) you are not a 5% owner.

If there is any question about whether you are a 5% owner...for example if it is a small company and it's possible that you and/or related parties owned more than 5% at sometime since you reached 70, consult an accountant or tax lawyer to determine whether you are a 5% owner.

Rolling your IRA into the employer's retirement plan will stop further RMDs from your IRA. Of course this strategy will eventually increase your RMDs once you do actually retire and have to start taking RMDs. The expectation is you will be in a lower income tax bracket then because you will no longer have income from work.

CHAPTER 12
Roth IRA Conversions

There are no RMDs required from your Roth IRA during your lifetime. Whether you are 70½, 80½, or 120½, working or retired, you do not have to take RMDs from your ROTH IRA.

Caution! This exemption from RMDs does NOT apply to "Roth 401(k)" plans nor does it apply to beneficiaries holding inherited Roth IRAs! It applies only to the original Roth IRA owner.

Therefore it would appear that one way to reduce your RMDs is to convert all your traditional retirement plans to Roth IRAs. Well it's true—that DOES work, but the problem is that transferring funds from your traditional IRA or other traditional retirement plan to a Roth IRA (called a "Roth conversion") is treated for income tax purposes as a *distribution of the transferred amount to you*. Thus, normally, the cost of converting (say) your $1 million IRA to a Roth IRA is, you have to pay income tax as if you had received a $1 million IRA distribution.

Is it worth it to pay that price? That's a complicated question, but first we're going to look at a much easier question. This is the ultimate no brainer good idea in the Tax Code: A TAX-FREE Roth conversion. It's great to own a Roth IRA and if the price tag is zero you should get one. Certain people can reduce their future RMDs by doing such tax-free Roth conversions.

Tax-free Roth conversion from qualified plan

If you are a participant in your employer's qualified retirement plan (QRP), AND you have "after-tax money" in that plan, there is a move you should definitely make when the time comes to take your money out of that company plan—for example, when you are changing jobs or retiring:

First, open a Roth IRA and a traditional IRA (if you don't already have them). Then, when retiring, or taking a distribution of your plan benefits for any reason, request the plan administrator of the employer's qualified retirement plan to send a direct rollover of all pretax money in your account to the traditional IRA and a direct rollover the after-tax money to the Roth IRA.

Though the merits of paying taxes now to create a forever-tax-free Roth IRA can be endlessly debated, *tax-free* Roth IRA conversions are *always* good. Since 2008 anyone who is a participant in a QRP has been permitted to roll an eligible rollover distribution directly from the QRP to a Roth IRA. The IRS allows an individual who has after-tax money in his QRP to use this direct-rollover provision to "cherry pick" and convert *only* the after-tax money, if he wants to do a tax-free Roth IRA conversion. Here are the very important limitations on this great move:

✓ To start with you have to have after-tax money in your employer's qualified retirement plan. Most people do not have after-tax money in any QRP and so they cannot use this idea...period.

✓ You can only do this when you are entitled to, and want to, request a distribution from the plan. Although everybody can get their money out of a QRP when they reach "normal retirement" (typically defined as separation from service at age 65 or later), plans vary in whether they allow employees to take "in-service distributions" (distributions while still working) or to take distributions prior to a certain age. You cannot use this tax-free Roth conversion move unless and until you are allowed to take a distribution from the plan.

✓ The money moves from the QRP to the Roth and traditional IRAs by means of a plan-to-plan transfer—called a "direct rollover" in this case. Whether and how to accomplish this by means of a 60-day rollover is not discussed in this outline.

✓ Finally, you cannot simply request a distribution of the after-tax money in your plan account. The Tax Code says that every plan distribution carries out proportionate amounts of the pre- and after-tax money in the account the distribution comes from. So you can't request a distribution of "just the after-tax money please" or "just the pretax money please." Rather, this technique is used, when you get a distribution that contains both pre- and after-tax money, to send the pre- and after-tax money to different "destinations." The pretax money is sent to a traditional IRA; the after-tax money is sent to a Roth IRA.

Elmer Example: Elmer, age 71, is retiring from Acme Widget. He is a participant in the Acme Widget Profit-Sharing Plan. Many years ago, this plan allowed employees to make after-tax contributions to the plan, and Elmer contributed $15,000 of after-tax money per year for three years. As a result, Elmer has two "accounts" in the Acme Widget plan. He has the "employer contribution account," which contains $450,000 of employer contributions and $570,000 of "earnings" (the income and growth that accrued in the employer contribution account over the years), all of which is "pretax money" (money that Elmer has never paid tax on). His "employee contribution account" in the plan holds $45,000 of "employee contributions" (after-tax money) and $93,000 of "earnings" (the income and growth that accrued in the employee contribution account over the years). The "earnings" portion of the employee contribution account is pretax money.

Elmer opens a Roth IRA and a traditional IRA at Trustmee Bank. Even though he is over 70½ (so he's not eligible to make a regular contribution to a traditional IRA) and even though he has a high income (so he's not eligible to make a regular contribution to a Roth IRA), he can open such accounts for the purpose of receiving rollover contributions.

Then Elmer takes his RMD for the year. Although the RMD is based on the combined balances of all his accounts in the plan, he can actually take the RMD from whichever plan account he chooses. He takes the entire RMD from the employer contribution account. Then, working with the IRA provider's forms and personnel, and the plan administrator of the Acme Widget plan, Elmer arranges for the after-tax money in his employee contribution account ($45,000) to be transferred via "direct rollover" into the Roth IRA. He arranges for all the rest of his Acme Widget plan money (i.e., the pretax money...$450,000 + $570,000 + $93,000 = $1,113,000, minus RMD already distributed) to be transferred via direct rollover into the traditional IRA. He has accomplished the "tax-free Roth conversion" of the after-tax money he held in the Acme Widget plan.

Tax-free Roth conversion from your IRA

What if you have after-tax money in an IRA rather than in a qualified retirement plan (QRP)? You still may be able to do a tax-free Roth conversion of just the after-tax money but it's more complicated. This idea can be used by anyone who:

✓ Has after-tax money in his or her IRA; and

✓ Is a member of a QRP at work (such as a 401(k) plan) that accepts rollovers from IRAs.

If you are not a participant in any QRP (for example, because you are totally retired and no longer have money in your former employer's QRP), or if you are a member of a QRP but that plan does not accept rollovers from IRAs—you can't do this, sorry!

The strategy: "Roll" (transfer), into the QRP, all of the pretax money from all of your IRAs. That leaves your IRA(s) holding nothing but the after-tax money. Then convert the remaining IRA (which is all or almost all after-tax money) to a Roth IRA. Here's the step by step:

1. Make sure your qualified plan accepts rollovers from IRAs. Find out from the plan administrator exactly how the check should be made payable in order for the rollover to be placed in your plan account.

2. Request a check from the IRA provider, payable to the qualified plan, in an amount that does not exceed the pretax money in the IRA.

3. Deliver the check to the qualified plan, along with your certification to the plan (the plan administrator should provide the form to use) certifying that the check consists entirely of "pretax money" from your IRA. (The plan is not legally allowed to accept a rollover of "after-tax money" from an IRA....that is why you must be extremely careful to roll over only pretax money and to deliver this certification to the plan.)

4. Once the rollover amount has been removed from the IRA and successfully transferred into your qualified plan account, open a Roth IRA and (using a direct transfer) transfer the remaining balance of your traditional IRA into the Roth IRA.

Stu Example: Stu is a participant in the Famis Employee Retirement Plan. He also has a $400,000 IRA of which $30,000 is after-tax money (consisting of the cumulative nondeductible contributions he made to the IRA over the years). The plan administrator of the FERP confirms that the plan accepts rollovers from IRAs and gives Stu the certification form to complete. Stu requests the IRA administrator to transfer $369,000 from the IRA to the qualified plan. The IRA provider gives Stu a check for $369,000 payable to the FERP. Stu delivers that check and the certification to the FERP plan administrator, who deposits it in the employee rollover account for Stu, noting that it is all pretax money. Stu now has a $31,000 IRA, of which $30,000 is after-tax money. He converts this account to a Roth IRA, paying income tax on the $1,000 of pretax money he had left in the account.

Other Roth conversions

This is a more problematic strategy. If all your retirement money is in a Roth IRA you will not be troubled, for the rest of your life, by required minimum distributions. That's because Roth IRAs do not generate RMDs during the owner's life. (Of course the rules could change—there are periodic proposals in Washington to make Roth IRAs subject to the RMD rules just like regular IRAs.)

Therefore one sure fire way to eliminate RMDs is to convert all of your retirement plans to Roth IRA. The only problem with that strategy is that the "conversion" of traditional plans or IRAs to a Roth IRA is taxed to you exactly the same as a "distribution" of the same amount from such plan or IRA would be taxed. For most people most of the time, the cost of a Roth conversion will hardly seem worth it.

Accountants and financial planners can generate projections regarding the potential financial benefits (or lack thereof) of a Roth conversion. For now, it's just worth mentioning that you should consider a Roth conversion whenever it can be done at a tax rate that you consider a "bargain." For example, if your income is temporarily low in a particular year due to unemployment or business losses. Or if you are convinced that income tax rates must go up in the future so that today's tax rates are the lowest you'll ever see.

[This is the end of the nonprofessional's guide to RMDs]

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PART B: THE LIFETIME MINIMUM DISTRIBUTION RULES

This Part B is excerpted from Chapter 1 of the forthcoming 12th (2018) edition of the author's book *Life and Death Planning for Retirement Benefits*.

The minimum distribution rules dictate when benefits must be distributed from a retirement plan.

Congress wants tax-favored retirement plans to be retirement plans, not estate-building wealth-transfer vehicles. To that end, Congress enacted § 401(a)(9), which compels certain annual "required minimum distributions" (RMDs) from plans beginning generally at age 70½ or, if earlier, death. § 401(a)(9) and its related regulations are called the "minimum distribution rules" or the "RMD rules." The **"required minimum distribution**" or **RMD** is the amount that must be distributed under these rules in a particular year.

This Chapter explains the minimum distribution rules applicable for 2003 and later years under the IRS's final minimum distribution regulations for defined contribution plans. See ¶ 1.1.01 for other years and other types of plans. Make sure you understand the "minimum distribution fundamentals" (¶ 1.2) before tackling other parts of this Chapter.

The minimum distribution rules were "suspended" for defined contribution plans for the calendar year 2009. See ¶ 1.1.04.

1.1 Introduction to the RMD Rules

The major attraction of the types of retirement plans discussed in this book (¶ 1.1.02) is the ability to accumulate funds inside the plan on a tax-deferred basis (or tax-free, in the case of a "Roth" plan). The minimum distribution rules dictate when this tax-sheltered accumulation must end. § 401(a)(9) tells us when benefits must start coming out of a retirement plan, and, once forced distributions start, how much must be distributed each year. Advisors need to know the RMD rules because these rules set the outer limits on plan accumulations, and because failure to comply with the rules involves substantial penalties (¶ 1.9.02).

The RMD rules come in two flavors: "life" (distributions required during the participant's life; see ¶ 1.3–¶ 1.4); and "death" (distributions required after the participant's death; see ¶ 1.5–¶ 1.8).

*1.1.01 **Where to find the law***

Congress established the required minimum distribution (RMD) system in substantially its present form in the Tax Reform Act of 1986 (P.L. 99-514). The RMD rules are found in (the very brief) § 401(a)(9) of the Code and in the Treasury's (very lengthy) final RMD regulations: Reg. § 1.401(a)(9)-0 through § 1.401(a)(9)-9; § 1.403(b)-6(e); § 1.408-8; § 1.408A-6, A-14, A-15; § 54.4974-1 and § 54.4974-2. Reg. § 1.402(c)-2, answers A-3(b)(2), A-7, and A-8, also bear on RMDs.

The final regulations described in this Chapter apply to all defined contribution (DC) plan participants and beneficiaries for calendar years beginning after 2002. Reg. § 1.401(a)(9)-1, A-2(a); § 1.403(b)-6(e)(2); § 1.408-8, A-1(a). For the two versions of proposed minimum distribution regulations promulgated in earlier years, see the author's *Special Report: Ancient History* (www.ataxplan.com).

*1.1.02 **Which plans are subject to the RMD rules***

For definitions of plans referred to in this section, see ¶ 8.3.

The minimum distribution rules are contained in § 401(a)(9), which applies to **Qualified Retirement Plans (QRPs)** (employer-sponsored retirement plans that are "qualified" under § 401, i.e., meet the 30+ requirements of § 401(a)). The Code specifies that rules "similar to" the rules of § 401(a)(9) shall also apply to **IRAs** (§ 408(a)(6)) and **403(b) plans** (§ 403(b)(10)).

Because the minimum distribution *regulations* were first written for QRPs, they refer to the **participant** (the individual who earned the benefits; see Appendix D) as the "employee." The Treasury has made the same regulations applicable (with certain variations) to IRAs. Reg. § 1.408-8, A-1(a). When applying the QRP regulations to an IRA, "the employee" is to be read as "the IRA owner." Reg. § 1.408-8, A-1(b). "Simplified employee pensions" (**SEP** or **SEP-IRA**; § 408(k)) and **SIMPLE** IRAs (§ 408(p)) are treated the same as other IRAs for purposes of § 401(a)(9), and accordingly are subject to the same RMD rules and regulations as "regular" traditional IRAs. Reg. § 1.408-8, A-2.

Roth IRAs are subject to the IRA minimum distribution rules *only* after the participant's death; the lifetime RMD rules do not apply to Roth IRAs. ¶ 5.2.02(A).

Reg. § 1.403(b)-6(e)(2) provides that the IRA minimum distribution regulations are also used to determine RMDs under **403(b) plans**, except as otherwise provided in Reg. § 1.403(b)-6(e).

1.1.03 ***RMD economics: The value of deferral***

The most valuable feature of traditional tax-favored retirement plans is the ability to invest without current taxation of the investment profits. In most cases, investing through a retirement plan defers income tax not only on the investment profits but also on the participant's compensation income that was originally contributed to the plan. The longer this deferral continues, the better, because, generally, the deferral of income tax increases the ultimate value of the benefits.

As long as assets stay in the plan, the participant or beneficiary is investing not just "his own" money but also "Uncle Sam's share" of the participant's compensation and the plan's investment profits, i.e., the money that otherwise would have been paid to the IRS (and will eventually be paid to the IRS) in income taxes. Keeping the money in the retirement plan enables the participant or beneficiary to reap a profit from investing "the IRS's money" along with his own. Once funds are distributed from the plan, they are included in the gross income of the participant or beneficiary, who then pays the IRS its share (see Chapter 2). Thereafter the participant or beneficiary will no longer enjoy any investment profits from the government's share of the plan. Long-term deferral of distributions also tends to produce financial gain with a Roth retirement plan, even though income tax is not being deferred; see ¶ 5.1.01.

Despite the apparent goal of the RMD rules (assuring that tax-favored retirement plans are used primarily to provide retirement income), § 401(a)(9) permits the retirement account to stay in existence long past the death of the participant whose work created the benefit—*if* the participant leaves his retirement benefits to the right kind of beneficiary. If various requirements are met, the law allows the retirement benefits to be paid out gradually, after the worker's death, over the life expectancy of the worker's beneficiary. ¶ 1.5.05. The financial benefit of the long-term deferral of distributions permitted by the minimum distribution rules puts a premium on naming a beneficiary who will qualify for the life expectancy payout method. Depending on investment returns, if the beneficiary is young, and takes no more than the RMD each year, the value of the inherited plan can soar, under the life expectancy payout method, by the time the beneficiary reaches retirement age.

Of course, deferring income taxes is not necessarily beneficial. The individual's (or beneficiary's) tax rate could be higher when taxable distributions are withdrawn than the rates that applied when tax-deductible contributions were made to the plan or the plan earned tax-deferred investment profits. Though there are non-tax advantages to these plans (participants are normally less likely spend the money in their retirement plans, thus boosting retirement wealth; there is some creditor protection), financial planning work projecting income and tax rates can pay off when determining how much to contribute to or withdraw from plans.

1.2 RMD Fundamentals

This ¶ 1.2 explains the nuts and bolts of the minimum distribution system. You must understand these concepts before you can work with RMDs or understand the rest of this Chapter.

1.2.01 ***The 12 Fundamental Laws of RMDs***

Here are the basic principles underlying the required minimum distribution (RMD) scheme for defined contribution (DC; ¶ 8.3.05) plans. Note that many rules have at least one exception!

1. **RMDs start at a particular time.** The starting point for lifetime required distributions is approximately age 70½ (or upon later retirement in some cases); see ¶ 1.4 for explanation of the "first Distribution Year" and the "Required Beginning Date." The final Distribution Year for "lifetime" distributions is the year of the participant's death. ¶ 1.5.04(A). The starting point for post-death RMDs is measured from the participant's death. ¶ 1.5.05(B), ¶ 1.5.06, ¶ 1.5.08, ¶ 1.6.04.

2. **The RMD must be taken by December 31 each year.** Once RMDs begin, the participant or beneficiary must take a distribution each and every calendar year, no later than December 31, as long as he lives (or until the plan runs out of money). Reg. § 1.401(a)(9)-5, A-1. There are several exceptions to this rule. First, the "5-year rule" does not require annual distributions; see ¶ 1.5.06. Second, in the case of lifetime RMDs, the distribution for the first Distribution Year can be postponed until the Required Beginning Date (RBD) (which occurs in the following year); see ¶ 1.4.01. Third, there were no RMDs for the year 2009; see ¶ 1.1.04. Fourth, see ¶ 1.2.06(D) for how to use rollovers to *stop* RMDs. Finally, RMDs can be delayed beyond the normal deadline in two situations: a review period for QDROs and (in the case of insured plans) delay caused by receivership of the insurance company; see Reg. § 1.401(a)(9)-8, A-7, A-8, regarding these exceptions.

3. **Each year's RMD is determined by dividing the prior year-end account balance by a factor from an IRS table.** RMDs are computed by dividing an annually-revalued account balance by an annually-declining life expectancy factor. Reg. § 1.401(a)(9)-5, A-1(a). (Exception: This principle does not apply to post-death distributions under the 5-year rule. ¶ 1.5.06.) This life expectancy factor is obtained from an IRS table and is called the **Applicable Distribution Period** (**ADP**) or **divisor**; see ¶ 1.2.03 for more on the definition of these terms and where to find the IRS tables. The ADP is a divisor, not a percentage; see Kenny Example, ¶ 1.3.01. For how to determine the account balance, see ¶ 1.2.05.

4. **There is no maximum distribution.** The formula tells you the required *minimum* distribution. The rules impose no *maximum* distribution; the participant or beneficiary is always free, as far as the IRS is concerned, to take more than the minimum (but see #6). See Reg. § 1.401(a)(9)-5, A-1(a), A-2.

5. **Taking more than the required amount in one year does not give you a "credit" you can use to reduce distributions in a later year.** Each year stands on it own. Reg. § 1.401(a)(9)-5, A-2. Taking larger distributions in one year *indirectly* reduces later RMDs by reducing the account balance.

6. **The plan is not required to offer every option the law permits.** Generally participants and beneficiaries must accept whatever distribution options the plan happens to offer, provided the plan does not call for *slower* distributions than the minimum distribution rules would require. See ¶ 1.5.10. See ¶ 3.2.01, ¶ 4.2.02(B), and ¶ 4.2.04 for use of post-death rollovers or transfers to solve this problem (in some cases).

7. **The RMD cannot exceed 100 percent of the account balance.** "...[T]he required minimum distribution amount will never exceed the entire account balance on the date of the distribution." Reg. § 1.401(a)(9)-5, A-1(a). This rule can help if the account is "wiped out" before the RMD is taken; see ¶ 1.2.05.

8. **Distributions before the first Distribution Year don't count.** The first year for which an RMD is required is called the "first Distribution Year." See ¶ 1.4.01. Distributions in years prior to that year have no effect on the computation of the RMD for the first (or any other) Distribution Year (other than indirectly, by reducing the account balance). Reg. § 1.401(a)(9)-2, A-6(a).

9. **Distribution period generally does not involve an election.** Generally, determination of the ADP for benefits, either during the participant's life or after his death, does not involve an "election" on the part of the participant or beneficiary. The ADP is prescribed by law based on the identity of the participant and beneficiary. (This is in contrast to the now-obsolete 1987 proposed regulations (¶ 1.1.01), under which the participant had to make various irrevocable elections at his RBD.) For the exceptions to this rule, see ¶ 1.5.07 (if the participant dies before his RBD, leaving his benefits to a Designated Beneficiary, the beneficiary may have to elect between the life expectancy payout method and the 5-year rule) and ¶ 3.2.03 (surviving spouse may elect or be deemed to have elected to treat an inherited IRA as the spouse's own IRA).

10. **The regulations "overrule" the Code.** You cannot compute RMDs simply by following the Internal Revenue Code. The IRS regulations have fundamentally altered the Code's approach in several ways. For example, the Code dictates that lifetime distributions must be made over the life expectancy of the participant or the joint life expectancy of the participant and his beneficiary. § 401(a)(9)(A)(ii). The regulations make the identity and life expectancy of the beneficiary almost irrelevant; see ¶ 1.3.02. For other examples, see ¶ 1.5.04 ("General Comments") and ¶ 1.5.07.

11. **RMDs are determined under the rules applicable to the plan that holds the benefits**, not the rules applicable to some prior plan where the benefits "used to live" prior to a rollover. Reg. § 1.401(a)(9)-7, A-2. See ¶ 1.2.06(D).

12. **Missing an RMD has consequences.** A participant or beneficiary who misses an RMD becomes liable for a 50 percent "excise tax" on the missed distribution (though waiver can be obtained in some cases); see ¶ 1.9.02.

*1.2.02 **Which distributions do or do not count towards the RMD***

Regs. § 1.401(a)(9)-5, A-9(a), and § 1.408-8, A-11(a), state that, except as otherwise provided in A-9(b) or A-11(b) of such regulations, or as may later be otherwise provided by other IRS pronouncements, "all amounts distributed" from a plan or IRA during the applicable Distribution Year (or grace period; ¶ 1.4.01) "are taken into account in determining whether section 401(a)(9) is satisfied…." Distributions before the Distribution Year don't count; see ¶ 1.2.01, #8. Here is the RMD status of various other distributions:

A. Distribution of an annuity contract does NOT count. When all or part of a participant's or beneficiary's plan account or IRA balance is used to purchase an immediate annuity, distributions under the contract must comply with RMD rules. Reg. § 1.401(a)(9)-5, A-1(e), § 1.401(a)(9)-8, A-2(a)(3); see ¶ 1.1.05. Distribution of a nonassignable immediate annuity contract that complies with the RMD rules is a nontaxable event (¶ 2.1.06(G)) and does not count as a distribution for RMD purposes. Reg. § 1.401(a)(9)-8, A-10.

B. Corrective and deemed distributions do NOT count. QRP contributions that are returned to the participant because they exceeded various contribution limits do not count towards the RMD requirement. Reg. § 1.401(a)(9)-5, A-9(b)(1)–(3). IRA contributions returned (together with the "earnings thereon") by the extended due date of the participant's tax return ("corrective distributions"; see ¶ 2.1.08) do not count. Reg. § 1.408-8, A-11(b)(1)–(3). Neither do plan loans that are treated as distributions due to failure to comply with the plan loan rules (¶ 2.1.07(A)), or the imputed income arising from life insurance held by a plan. Reg. § 1.401(a)(9)-5, A-9(b)(4), (6).

C. ESOP dividends do NOT count. Dividends on employer stock in an ESOP can be paid by the issuer directly to the participant or beneficiary. § 404(k). Such dividend payments do not count towards the RMD requirement. Reg. § 1.401(a)(9)-5, A-9(b)(5).

D. Nontaxable distributions DO count. When a participant or beneficiary takes a distribution from a retirement plan, and that plan contained after-tax money, the *entire distribution* generally counts towards the RMD, even if part or all of it is a nontaxable distribution of after-tax money. Reg. § 1.401(a)(9)-5, A-9(a), § 1.408-8, A-11(a). See PLR 9840041 (discussed at ¶ 2.5.07). For the two exceptions to this rule see "A" and "B" above.

To determine what portion of any particular distribution is after-tax money, see ¶ 2.2. If a QRP distribution is greater than the RMD, and the distribution contains after-tax (nontaxable) money, the nontaxable portion is applied first to the RMD. Reg. § 1.402(c)-2, A-8. If the RMD amount exceeds the nontaxable portion of the distribution, then the rest of the RMD is "filled up" from the taxable portion. Any balance of the distribution remaining after the RMD is satisfied is eligible for rollover (¶ 2.6.03). See ¶ 1.3.05 if the employee has multiple accounts in a QRP.

E. Distributions in kind DO count. (For an exception to this rule see "A.") A participant or beneficiary can take RMDs in kind as well as in cash. Plans are permitted to distribute property as well as cash. See Reg. § 1.401(a)(9)-5, A-9(a) (third sentence); § 1.402(a)-1(a)(1)(iii); Notice 89-25, 1989-1 C.B. 662, A-10; and Instructions for IRS Form 1099-R (2016), pp. 9-10 (instructions for Box 1), p. 17 (instructions for "Code K").

F. Trustee-to-trustee transfers generally do NOT count. A direct transfer from one IRA to another IRA *of the same type* (traditional or Roth) is not treated as a distribution for purposes of fulfilling the RMD requirement. Reg. § 1.408-8, A-8(a). Thus, the RMD with respect to the transferring IRA for the year must still be satisfied. However, since that RMD can be satisfied by a distribution from another IRA (including the transferee IRA) (see ¶ 1.3.04), the IRA-to-IRA transfer can be done without distributing or holding back the RMD; see ¶ 2.6.08. For a transfer that is treated *as a rollover*, i.e., a direct rollover from a QRP or 403(b) plan to an IRA or Roth IRA (see ¶ 2.6.01(C), ¶ 4.2.04(D)), or a transfer (conversion) from a traditional IRA to a Roth IRA (¶ 5.4.07), the RMD must be distributed to the participant or beneficiary *before* the transfer or conversion occurs. See ¶ 2.6.03, ¶ 5.2.02(E).

G. Payment of account expenses does not count. ¶ 8.1.04(A).

H. Qualified HSA funding distribution. A qualified HSA funding distribution (¶ 2.1.06(K)) made by the beneficiary of an inherited IRA or inherited Roth IRA does count towards the RMD of such beneficiary. Notice 2008-51, 2008-1 CB 1163.

*1.2.03 **Tables to determine Applicable Distribution Period (ADP)***

Annual RMDs are determined by dividing the prior year-end account balance by a life expectancy factor (from an IRS table) called the **Applicable Distribution Period (ADP)** or divisor. The term "ADP" is used to mean both, particularly, the numerical factor used as a divisor in computing the RMD for a particular year (¶ 1.2.01, #3) (as in "look up the ADP for age 78 in the Uniform Lifetime Table") and, more generally, the payout period that will apply to a particular participant or beneficiary (as in "the ADP is the oldest beneficiary's life expectancy"; ¶ 1.7.05(B)).

There are currently three tables in use for purposes of computing RMDs. All three tables are reproduced in full in IRS Publication 590-B (2015), "Distributions from Individual Retirement Arrangements." All three tables are "unisex" (life expectancy for men and women is the same).

Lifetime RMDs (¶ 1.3) are calculated using either the **Uniform Lifetime Table** (¶ 1.3.02) or (if the participant's sole beneficiary is his more-than-10-years-younger spouse) the **Joint and Last Survivor Table**. ¶ 1.3.03. The Uniform Lifetime Table is found at Reg. § 1.401(a)(9)-9, A-2, and in Appendix A of this book. The Joint and Last Survivor Table is found at Reg. § 1.401(a)(9)-9, A-3 (not reproduced in this book).

Post-death RMDs based on the life expectancy of the surviving spouse (¶ 1.6.03(C), (D)); of a nonspouse Designated Beneficiary (¶ 1.5.05); or of the deceased participant (¶ 1.5.08); are calculated using the **Single Life Table**. The only post-death RMDs *not* governed by the Single Life Table are the RMD for the year of the participant's death (¶ 1.5.04(A)) and distributions under the 5-year rule (¶ 1.5.06). The Single Life Table is found at Reg. § 1.401(a)(9)-9, A-1, and in Appendix A of this book.

The IRS uses a different set of actuarial tables for estate and gift tax valuations; see § 7520. The *estate and gift tax* actuarial tables must be updated at least every 10 years. § 7520(c)(2). The 2009 updates to the transfer tax actuarial tables have *no effect* on the calculation of RMDs. The tables used to calculate RMDs were last updated in 2002. T.D. 8987, 67 FR 18987. They may be updated from time to time by the IRS. Reg. § 1.401(a)(9)-9, A-4.

*1.2.04 **Meaning of "age," methods of computing "life expectancy"***

To obtain the ADP or divisor (¶ 1.2.03) from the IRS tables, you need to know the participant's or beneficiary's *age* and how to use the life-expectancy tables.

Age for RMD purposes means the age the person will attain on his birthday in the applicable Distribution Year; it is the age he will be at the end of the Distribution Year. Reg. § 1.401(a)(9)-5, A-4(a), (b); A-5(c).

The tricky part is that for some RMDs the age is determined only once, at the beginning of the payout period; this is popularly known as the "fixed-term" or "reduce-by-one" method. For other RMDs, the age is redetermined annually ("recalculation method"). The participant or beneficiary has no choice in this matter—the regulations dictate which method applies in which situation.

A. **Recalculation method.** The recalculation method applies for purposes of computing all lifetime RMDs (¶ 1.3.02), including the RMD for the year of the participant's death if any (¶ 1.5.04(A)), and post-death RMDs when the surviving spouse is the sole beneficiary (¶ 1.6.03(D)). Under the recalculation method, the individual's age is redetermined each year, and the ADP used is the divisor applicable to the new age, instead of just deducting one from last year's divisor. Under the recalculation method, life expectancy never runs out as long as the distributee is alive: See "Kenny Example" (¶ 1.3.01); ¶ 1.3.02; and "Josephine Example" (¶ 1.6.03(D)).

B. **Fixed-term method.** Under the "fixed-term method," you determine the beneficiary's age and the corresponding ADP in the year after the year of the participant's death. Then in subsequent Distribution Years the divisor is simply the prior year's divisor reduced by one. Reg. § 1.401(a)(9)-5, A-5(c)(1). Some call this the "**reduce-by-one method**." Unlike with the recalculation method, you do not revise the ADP annually based on the beneficiary's new age. See Diane Example at ¶ 1.5.05(A). The fixed-term method is used to determine RMDs after the participant's death when RMDs are based on the beneficiary's life expectancy, unless the surviving spouse is the sole designated beneficiary (¶ 1.6.03(D)). For when post-death RMDs are not based on the beneficiary's life expectancy see ¶ 1.5.04(A) and ¶ 1.5.06–¶ 1.5.08. The fixed-term method is *never* used to calculate RMDs during the participant's lifetime.

*1.2.05 **How to determine "account balance" for RMD purposes***

Each year, the RMD is determined by dividing the *prior year-end account balance* by the ADP. This section explains which account balance you use and what adjustments are required. See ¶ 1.2.08 for how to value the account balance.

In the case of a qualified retirement plan (QRP), the account balance to use is "the account balance as of the last valuation date in the calendar year immediately preceding" the Distribution Year. Reg. § 1.401(a)(9)-5, A-3(a). The regulation provides certain adjustments for contributions and distributions. The account balance excludes the value of any Qualified Longevity Annuity Contract (QLAC) (¶ 1.1.05). Generally, any immediate annuity within the plan account is treated as a separate retirement plan for minimum distribution purposes and *not* included in the account balance; see ¶ 1.1.05.

Reg. § 1.408-8, A-6, provides that the account balance for an IRA is to be determined in the same manner as provided for qualified plans except as follows:

✓ Instead of "the last valuation date," the relevant date is "as of December 31 of the calendar year immediately preceding the calendar year for which distributions are required to be made." excluding the value of any QLAC, subject to the following adjustments. Reg. § 1.408-8, A-6.

✓ Unlike with qualified plans, no adjustments are made for contributions and distributions except as follows.

✓ The prior year-end balance must be increased by the amount of any "outstanding rollover" (rollover in transit into the account as of the last day of the prior year). See ¶ 1.2.06(A). Except for this adjustment for certain rollovers, the year-end account balance is *not* increased by contributions to the account made after the end of the year—even if the contribution is attributable to the prior year (*e.g.*, a 2016 IRA contribution that is made in early 2017 as permitted by § 219(f)(3)). Reg. § 1.408-8, A-6, second sentence.

✓ The prior year-end balance must be increased by the amount of any recharacterization, in the Distribution Year, of a Roth conversion that occurred in the prior year. See ¶ 1.2.07.

Note that if the participant chooses to postpone the RMD for the first Distribution Year into the second Distribution Year (see ¶ 1.4.01), the prior year-end account balance is NOT reduced by the amount of the postponed RMD when computing the RMD for the second Distribution Year. T.D. 8987, 2002-1 C.B. 852, 858, "Calculation Simplification." Regarding the possibility of a reduction of the prior year-end account balance by the amount of any other RMDs that were missed (not distributed) in prior years, see ¶ 1.9.02.

Note also that, with one exception, there is no adjustment allowed for post-year-end decreases in the value of the account, such as could occur through investment losses, a divorce in which part of the account is transferred to the participant's ex-spouse, or a creditor's seizing the account. The exception: The RMD is reduced as necessary so that it does not exceed the entire account balance on the date of the distribution. See ¶ 1.2.01, #7.

Biff Example: Biff's IRA is worth $1 million as of 12/31/15. He turns 74 in 2016, so his 2016 RMD is $42,017. In 2016, he gets divorced, and the divorce court awards Mrs. Biff half of Biff's IRA in a tax-free split under § 408(d)(6), so Biff's IRA is reduced to approximately $500,000. Biff still has to take out $42,017 in 2016. If the divorce court had awarded the *entire* account to Mrs. Biff, reducing Biff's account balance to zero before he had taken his 2016 RMD, the 2016 RMD would be reduced to zero (every cloud has a silver lining).

*1.2.06 **How rollovers impact calculation of RMD***

This ¶ 1.2.06 explains how rollovers and plan-to-plan transfers affect application of the minimum distribution rules. See also ¶ 1.2.07 regarding recharacterization of Roth IRA conversions. For how RMDs impact rollovers, see ¶ 2.6.03.

A. Adjustment required for outstanding rollovers. You must increase the prior year-end balance (¶ 1.2.05) by any amount that was added to the account in the Distribution Year ("Year 2") and that represented a rollover from another plan or IRA, if the amount in question was distributed from such other plan or IRA in the *prior* calendar year ("Year 1"). The IRS calls such rollovers that are in transit from one account or plan to another on the last day of the year "**outstanding rollovers**." the addition is valued as of the date of its receipt by the recipient plan, not as of the date of distribution.

For purposes of computing RMDs for the *receiving* plan, the rollover amount is deemed to have been received in the prior calendar year (i.e., Year 1) and not the year it was actually received (Year 2). Reg. § 1.401(a)(9)-7, A-2, last sentence. If this rule did not exist, people could cheat by moving money around from account to account at the end of the year, so as to avoid having the funds count as part of the year-end account balance of *either* plan.

Reg. § 1.408-2(b)(6)(v), which states the opposite (outstanding rollovers added back to the distributing plan) was rendered obsolete by the final RMD regulations and so does not apply for 2003 and later years. See Reg. § 1.408-8, A-1.

B. Other rollover effects on balance. Reg. § 1.401(a)(9)-7 contains other rules regarding the effect of rollovers and plan-to-plan transfers on the calculation of RMDs, but (except as noted in "A") a rollover or transfer *into* a plan or IRA has no effect on RMDs *from* that plan or IRA until the year after the rollover or transfer is received. Reg. § 1.401(a)(9)-7, A-2. The rollover or transfer has the effect of increasing the plan balance of the receiving plan, which increases the RMD for the year *following* the rollover.

C. **Effect of rollover on Required Beginning Date (RBD).** Generally, if a rollover contribution (¶ 2.6.01(B)) or IRA-to-IRA transfer (¶ 2.6.08) is made into a new IRA (an account which contained nothing at the time it received the rollover contribution), there is no distribution required from such new IRA for the year in which the contribution comes into the account, because the prior year-end account balance was zero (for exceptions see "A" and ¶ 1.2.07). The RBD for the new account will be the later of (1) April 1 of the year after the year the participant reaches age 70½ or (2) December 31 of the year after the year of the rollover. Compare ¶ 1.6.03(B) (spousal election to treat inherited IRA as spouse's own IRA).

D. **Rollover can change applicable RMD rules.** RMDs are determined under the rules applicable to *the plan that holds the benefits*. It does not matter that the benefits may have previously been held in some other type of plan prior to a rollover. See Reg. § 1.401(a)(9)-7, A-2. The regulation has no rule or procedure for "looking back" to the plan of origin when determining RMDs with respect to rollover contributions. This means that a rollover can change the RMD rules applicable to the rolled over assets. There are three situations in which an individual can use a rollover to stop (or head off) the flow of required distributions. Of course he must withdraw the RMD for the year of the rollover (if any) *before* doing the rollover; see ¶ 2.6.03.

✓ A participant who is over age 70½, and therefore is forced to take RMDs from his traditional IRAs (and from any QRPs maintained by any employer as to which the participant is a 5-percent owner), can staunch the flow of RMDs *if* he is still working for (i.e. not "retired" with respect to) an employer as to which he is *not* a 5-percent owner and which maintains a QRP that accepts rollovers, by rolling over the benefits to this employer's QRP. See ¶ 1.4.04 and PLR 2004-53015.

✓ A participant can stop or prevent RMDs from traditional plans and IRAs, and DRACs, by rolling them to a Roth IRA. See ¶ 5.2.02(A), ¶ 5.7.08(B).

✓ A surviving spouse beneficiary can use a rollover or Roth conversion to prevent, delay, or stop RMDs from a plan inherited from the deceased participant. See ¶ 3.2.01(A), (C), ¶ 3.2.04.

1.2.07 ***Adjustment for post-year-end recharacterizations***

A "Roth conversion" (see ¶ 5.4) can be "recharacterized" (reversed or undone) by transferring the "conversion contribution" (and its earnings) from the Roth IRA to a traditional IRA by a certain deadline. See Appendix C]

If there is a Roth conversion in a particular year ("Year 1"), and that conversion is recharacterized in the following year ("Year 2"; see ¶ 5.6.06 for the deadline), the recharacterized conversion contribution, and the net income—or loss—allocable to it (which must be transferred to the traditional IRA along with the contribution itself in order to have a valid recharacterization; see ¶ 5.6.02) are added to the prior year-end account balance of the traditional IRA that received the recharacterized amount, for purposes of computing the RMD for *the year of the recharacterization* ("Year 2"). This rule applies to recharacterizations of both "failed" (¶ 5.4.06) and valid Roth conversions. Reg. § 1.408-8, A-8(b). Note that the amount added to the prior year-end balance is the amount that is actually transferred into the traditional IRA, NOT the prior year-end balance of the Roth IRA itself.

Although "regular" (annual-type) contributions to a Roth IRA or traditional IRA can also generally be "recharacterized" as a contribution to the other type of IRA (¶ 5.6), the special rule of Reg. § 1.408-8, A-8(b), does not apply to recharacterizations of regular contributions. It applies only to recharacterized *conversion* contributions, for a good reason. An individual cannot make a contribution to a traditional IRA in the year he attains age 70½ or any later year. § 219(d)(1). Thus, an individual who is subject to the lifetime RMD rules (which apply to a traditional IRA beginning in the age-70½ year; ¶ 1.4.02) cannot make a "regular" contribution to a traditional IRA. He can (if he has compensation income, and his adjusted gross income is below certain levels) make a regular contribution to a *Roth IRA*, but he cannot recharacterize that contribution as a contribution to a traditional IRA because he is forbidden to make a regular contribution to a traditional IRA; such a purported recharacterization would be an excess IRA contribution (¶ 2.1.08).

1.2.08 ***Valuation rules for determining account balance***

¶ 1.2.05–¶ 1.2.07 explain which account balance is used and what adjustments to the balance are required. But the most important thing about that account balance is its value. The value of the account balance is what the ADP is divided into to determine the RMD.

IRA providers are required to provide the year-end fair market value (FMV) of the IRA to the IRS annually on Form 5498. Reg. § 1.408-8, A-10. Except for one special valuation rule for variable annuities (see "C"), there is no guidance on how to determine FMV for RMD purposes. IRS Notices 2002-27, 2002-1 CB 814, and 2003-3, 2003-1 CB 257, both providing guidance to IRA providers regarding their reporting requirements under Reg. § 1.408-8, A-10, contain no valuation rules.

A. **Assets without readily available FMV.** Despite the lack of rules, indications are that the IRS is starting to place greater scrutiny on IRA valuations, at least with respect to non-publicly-traded investments. The IRS has added boxes and codes to Forms 5498 and 1099-R, for required reporting of whether the IRA holds (or has distributed) assets that do not have a "readily available" fair market value, including what type of assets those are and their values. See IRS Forms 5498 and 1099-R and their instructions (for 2014 and later years). Form 5498 is filed every year for every IRA; Form 1099-R is filed only for years in which there is a distribution from the IRA. The information in these boxes will presumably help the IRS select IRAs for audit in connection with RMD compliance.

B. **Income accrued but not received.** As of any valuation date a portfolio of securities will have accrued income that has not yet been received, such as interest accrued on bonds or dividends that are declared but not yet paid. It would appear that such accrued income should be included in the "FMV" of the account (as is true in the estate tax valuation arena). However, there is no IRS statement on this point. Anecdotal evidence suggests that some IRA provider do and some do not include accrued income in the year-end FMV.

C. **Special rule for nonannuitized annuity contracts.** Here is the special rule governing how to value (for RMD purposes) an annuity contract that is held inside a defined contribution (DC) plan but that has not yet been "annuitized." Generally, the value of the annuity contract for RMD purposes is (1) its cash value ("the dollar amount credited to the employee or beneficiary under the contract") plus (2) "the actuarial present value of any additional benefits (such as survivor benefits in excess of the…[cash value]) that will be provided under the contract." The "actuarial present value" must be "determined using reasonable actuarial assumptions," but without regard to any individual's actual health. Reg. § 1.401(a)(9)-6, A-12(b).

There are two exceptions to this special valuation rule. First, if the *only* additional benefit provided by the contract is a death benefit equal to the total premiums paid (minus prior distributions), such additional benefit may be disregarded in valuing the contract for RMD purposes. Reg. § 1.401(a)(9)-6, A-12(c)(2).

Second, if the contract provides additional death and/or life benefit guarantees beyond the mere return of premiums, it may *still* be possible to disregard the contract's additional benefits for RMD purposes—but only if the additional benefits meet the somewhat-complicated tests contained in Reg. § 1.401(a)(9)-6, A-12(c). For example, as an initial matter, you may be able to "disregard" the value of these additional contract features if the total value of the contract including the extra features is no more than 120% of the cash value of the contract. In order for an annuity-holder to take advantage of this "disregard" provision, it would appear that the insurance company that issued the annuity would have to value every contract held by an individual over age 70 every year. Either that or the participant has to hire his own actuary.

The special RMD valuation rule for annuities may NOT be used to value a contract for purposes of a Roth IRA conversion; Reg. § 1.408A-4, A-14 ; and it applies only to annuity contracts that have not been "annuitized" (see ¶ 1.1.05).

1.3 RMDs During Participant's Life

This ¶ 1.3 and ¶ 1.4 explain the minimum distribution rules that apply during the participant's life. For the rules that apply after the participant's death see ¶ 1.5–¶ 1.8.

An individual (the **participant**) who owns a retirement plan account generally must start taking annual "required minimum distributions" (RMDs) from that account at a certain point in his life. The exception: Roth IRAs are not subject to the lifetime distribution requirement; see ¶ 5.2.02(A).

For when lifetime RMDs must start, see ¶ 1.4. Once commenced, annual RMDs continue for the rest of the participant's life; for this rule and its exceptions, see ¶ 1.2.01, #2. Although the computation of *post-death* RMDs can be radically different depending who is the beneficiary of the plan (see ¶ 1.5), *lifetime* RMDs are computed the same way for most people. See ¶ 1.3.01 for the method most people use (and the list of people who do *not* use it).

1.3.01 ***Road Map: How to compute lifetime RMDs***

Follow Steps 1–7 below to compute a participant's "lifetime" RMD for a particular year (the "Distribution Year") from a qualified retirement plan (QRP), 403(b) plan account, or traditional IRA. Reg. § 1.401(a)(9)-5, A-4. This calculation must be done separately for each IRA or plan the participant owns; see ¶ 1.3.04.

As a reminder, this method does not apply to defined benefit plans or to the "annuitized" portion of any defined contribution plan; see ¶ 1.1.05.

Step 1: **Determine whether a distribution is required** for this year. If the participant has not yet reached his "first Distribution Year" (¶ 1.4.01), you're done—no RMD is required. For the first Distribution Year itself, see ¶ 1.4.07. If the participant has passed his RBD, a distribution is required. If a distribution is required for the year, proceed to Steps 2–7.

Step 2: **Determine the prior year-end account balance** for this plan or IRA. See ¶ 1.2.05–¶ 1.2.08.

Step 3: **Determine the participant's age.** See ¶ 1.2.04.

Step 4: **Obtain the Applicable Distribution Period (ADP or divisor)** from the Uniform Lifetime Table (¶ 1.2.03) for the participant's age (Step 3)—unless the sole beneficiary of the account is the participant's more-than-10-years-younger spouse (in which case see ¶ 1.3.03 for where to find the divisor).

Step 5: **Compute the current Distribution Year's RMD** by dividing the prior year-end account balance (Step 2) by the ADP (Step 4).

Step 6: **Add any missed RMDs from prior years** to the amount obtained in Steps 1–5. See ¶ 1.9.02.

Step 7: **And the answer is…** The RMD for the Distribution Year is the amount determined under Step 6, or, if less, the total value of the account on the distribution date (¶ 1.2.01, #7), *unless* the participant qualifies for one of two rarely-encountered "grandfather rule" exceptions: For a QRP participant who has a pre-1984 "TEFRA 242(b) election" see ¶ 1.4.08. For a 403(b) participant who has a pre-1987 account balance see ¶ 1.4.05.

Here is an example of how to compute a lifetime RMD for a participant who does not qualify for any grandfather rule exceptions, has not failed to take the RMD in any prior year, and does not have a more-than-10-years-younger spouse as his sole beneficiary:

Kenny Example: Kenny turns 73 on his 2016 birthday. Under the Uniform Lifetime Table, the ADP (divisor) for age 73 is 24.7. On 12/31/15, the value of his IRA was $750,000; assume no adjustments (¶ 1.2.06(A), ¶ 1.2.07) are required. Divide $750,000 by 24.7; the result ($30,364) is Kenny's RMD for 2016. Kenny must withdraw $30,364 from his IRA sometime in 2016 (i.e., after December 31, 2015, and before January 1, 2017). In 2017, Kenny will reach age 74. To compute his 2017 RMD, he will use the age-74 factor from the Uniform Lifetime Table. This will be divided into the 2016 year-end account balance to produce the 2017 RMD. This is the "recalculation method" of determining life expectancy; ¶ 1.2.04(A).

*1.3.02 **The Uniform Lifetime Table: Good news for retirees***

The divisors in the Uniform Lifetime Table represent the joint life expectancy of a participant age 70 (or older) and a hypothetical beneficiary who is 10 years younger than the participant. T.D. 8987, 2002-1 C.B. 852, 854, "Uniform Lifetime Table." Thus, the initial divisor under this table (for a participant age 70) is 27.4 years, which is the joint and survivor life expectancy of one person age 70 and another person age 60.

The participant's divisor is redetermined annually by returning each year to look up the factor his new age in the Uniform Lifetime Table. Reg. § 1.401(a)(9)-5, A-4(a), (b). So the participant does not start with a 27.4-year distribution period and then reduce it by one each year. If the lifetime-distributions calculation used such a "fixed-term method," then all money would have to be distributed out of the plan by the time the participant reached age 97 (70 + 27). Instead, the divisor decreases by less than one full year most years. At age 75, the divisor is 22.9 (not 22.4), at age 89 it is 12.0 (not 8.4). The divisor never goes below 1.9 (see Table 1, Appendix A), so if the participant takes only the RMD the account balance will never go to zero, regardless of how long the participant lives, unless it is wiped out by an external factor such as investment losses.

In fact, depending on the rate of investment return, there may well be more in the account when the participant dies than there was when RMDs began. For example, if the participant takes only the RMD starting at age 70½, and the account has a steady six percent annual investment return, the account will have more dollars in it when he reaches age 89 than it did when he started taking RMDs at 70½.

The Uniform Lifetime Table is the IRS's way of implementing the Tax Code's rule that benefits must be distributed either in full on the RBD, or, "beginning not later than the required beginning date...over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary)." § 401(a)(9)(A)(ii). But instead of using the joint life expectancy of the participant and his "real" beneficiary, the IRS gives every participant a hypothetical 10-years-younger beneficiary and the RMD payout is calculated based on the life expectancy of this hypothetical beneficiary.

*1.3.03 **Lifetime RMDs: Much-younger-spouse method***

As generous as the Uniform Lifetime Table is, the participant enjoys even smaller RMDs if his sole beneficiary is his more-than-10-years-younger spouse.

"[I]f the sole designated beneficiary of an employee is the employee's surviving spouse, for required minimum distributions during the employee's lifetime, the applicable distribution period is the longer of the distribution period determined in accordance with…[the Uniform Lifetime Table] or the joint life expectancy of the employee and spouse using the employee's and spouse's attained ages as of the employee's and the spouse's birthdays in the distribution calendar year." Reg. § 1.401(a)(9)-5, A-4(b)(1). Note that this formulation mandates annual recalculation (¶ 1.2.04(A)) of the participant's and spouse's life expectancies.

The Joint and Last Survivor Table (¶ 1.2.03) will produce larger ADPs (divisors) and smaller RMDs than the Uniform Lifetime Table if the spouse-beneficiary was born in a year more than ten years later than the year of the participant's birth. For example, if the participant was born in 1946, the joint table will provide larger divisors than the Uniform Lifetime Table if the spouse was born in 1957 or later.

See ¶ 1.3.04 and ¶ 1.3.05 regarding the much-younger-spouse calculation when the participant has multiple plans or separate accounts within a single plan; and note the following additional points regarding this method:

A. **No election required.** The participant does not have to elect to use the joint life expectancy of the participant and spouse as his ADP. If the participant's spouse is his sole beneficiary, then the participant's divisor is *automatically* the ADP determined under the Uniform Lifetime Table, or under the Joint and Last Survivor Table, whichever is larger.

Vinny Example: Vinny is 74 and his wife Marie is 63. Marie is sole beneficiary of Vinny's IRA. Vinny uses the Uniform Lifetime Table to compute his RMD for the year, being unaware he was entitled to use the Joint and Last Survivor Table. As a result, he takes a distribution that is larger than his actual required distribution. If he discovers the mistake soon enough he can roll the excess distribution back in to his IRA. See ¶ 2.6 regarding rollovers.

B. **Tests for whether spouse is sole beneficiary.** The spouse is the sole Designated Beneficiary for purposes of determining the participant's RMDs "if the spouse is the sole beneficiary of the employee's entire interest at all times during the distribution calendar year." Reg. § 1.401(a)(9)-5, A-4(b)(1). Marital status is determined on January 1 of each Distribution Year for purposes of computing that year's RMD; therefore the *death* of either spouse, or a *divorce*, during the Distribution Year does not cause the spouse to lose her status as "spouse" until the following calendar year. The spouse is deemed to be the "sole beneficiary" for the entire year if she is the sole beneficiary on January 1 of the year *and* the participant does not change his beneficiary designation prior to the end of the calendar year. Reg. § 1.401(a)(9)-5, A-4(b)(2). "Sole beneficiary" means sole *primary* beneficiary; see ¶ 1.6.02, ¶ 1.7.02.

C. **"Trust for spouse" vs. "spouse individually" as beneficiary.** If the participant names a trust for the benefit of his more-than-10-years-younger spouse as sole beneficiary, rather than naming the spouse herself, does the participant still get to use the more favorable joint-and-survivor life table to compute his RMDs?

¶ 1.6.06 explains when the minimum distribution rules treat a "trust for the spouse" that is named as beneficiary of a retirement plan the same as "the spouse" him/herself individually for purposes of computing post-death RMDs. The same type of trust for the spouse that qualifies for spouse-is-sole-beneficiary treatment for purposes of post-death RMDs also entitles the participant to use the joint-and-survivor life table for computing his lifetime RMDs. So the answer to the question posed in "C" is yes—*if* the trust is a qualifying see-through "conduit" trust for the spouse but *no* if the trust is a typical "QTIP" trust. See ¶ 6.2.03 for the requirements of a see-through trust. See ¶ 6.3.05 for the definition of a "conduit" trust. See ¶ 1.6.06(C) for contrast with the typical "QTIP" trust. See ¶ 6.2.08(B) for the documentation that must be provided to the plan administrator if intending to use the joint-and-survivor life table to compute lifetime RMDs when a conduit trust for the more-than-10-years-younger spouse is the sole beneficiary.

D. **Post-RBD marriage or designation OK.** The determination of whether the much-younger-spouse table applies is made separately for each Distribution Year, based on the marriage and beneficiary-designation status as of January 1 of that year. Thus, it can apply for a particular Distribution Year even if the participant had not been married to that younger spouse (or had not named her as his beneficiary) in some prior year when (for example) he turned 70½ or reached his

RBD. If the participant has named some other beneficiary, he can change the beneficiary to his spouse (or marry after his RBD and name his new spouse as beneficiary) and use the much-younger-spouse table thereafter.

Red and Ginger Example: Red was a widower when he reached his RBD in 2010. In 2014, at age 74, he became friends with Ginger, age 60, and named her as his sole IRA beneficiary. In February 2015 he and Ginger married. Because they were not married on January 1, 2015, Red's RMDs continued to be determined using the Uniform Lifetime Table in 2015. On January 1, 2016, he was still married to Ginger and she was still his sole IRA beneficiary. Red's RMD for 2016 will be determined using the Joint and Survivor Life Table using the ages Red and Ginger will attain on their 2016 birthdays even if one of them dies in 2016 (provided Ginger was still Red's sole beneficiary at the time of such death) and even if they divorce in 2016 (unless Red changes his beneficiary in 2016 to someone other than Ginger before the divorce).

1.3.04 ***Taking distributions from multiple plans***

This section explains the rules for participants who are taking lifetime RMDs from more than one retirement plan. For rules applicable to beneficiaries taking distributions from inherited plans, see ¶ 1.5.09 instead.

A. **Qualified plans.** If the participant has benefits in more than one qualified retirement plan (QRP), the RMD must be calculated separately for each such plan, and each such plan must distribute the RMD calculated for that plan. Reg. § 1.401(a)(9)-8, A-1. Thus if he participates in two pension plans and a 401(k) plan, he will receive three separate RMDs (even if all the plans are provided by the same employer).

B. **IRAs.** A different rule applies for IRAs. The RMD must be calculated separately for each IRA, but (with exceptions noted below) the participant is not required to take each IRA's calculated amount from that IRA. He can total up the RMDs required from *all* of his IRAs and then take the total amount from one of the IRAs or from any combination of them. Reg. § 1.408-8, A-9. For purposes of this rule, all traditional IRAs—whether contributory, rollover, SIMPLE, or SEP—are treated the same; they may all be aggregated with each other. Reg. § 1.408-8, A-2.

Beware Possible Reporting Glitch: Beginning with the year an IRA owner reaches age 70½, the IRA provider (on the IRS Form 5498 it must file annually for each IRA it holds) must check the "distribution required" box on the form (Box 11) every year for the rest of the participant's life. *E.g.*, for the 2016 Form 5498 (which will be filed in the first half of 2017), Box 11 directs "check if RMD for 2017." The IRS might attempt to match these forms with Forms 1099-R filed for 2017 by the same IRA provider, reporting distributions from this account. If the participant did not take any distribution from an IRA that had the "distribution required" box checked, he might get an inquiry from the IRS about why there was no distribution taken from this account—even if the participant took the RMD from some other account as permitted by law.

However, despite the presumed purpose of all this reporting to the IRS, anecdotal evidence suggests that the IRS is not actively chasing people who skipped RMDs. RMD errors seem to be discovered by individuals and their advisors, not the IRS.

C. **403(b) accounts.** This optional aggregation rule also applies (separately) to 403(b) accounts. The RMD must be calculated separately for each 403(b) account, but (with exceptions noted below) the participant is not required to take each 403(b) account's calculated amount from that 403(b) account. He can total up the RMDs required from all of his 403(b) arrangements, and then take the total amount all from one of them or from any combination of them. Reg.§ 1.403(b)-6(e)(7).

Note that IRAs may be aggregated *only* with other IRAs, and 403(b)s may be aggregated *only* with other 403(b)s. Reg. § 1.408-8, A-9, fifth sentence.

D. **Exceptions to IRA/403(b) aggregation rule:**

✓ An individual's IRAs held as *owner* may not be aggregated with IRAs he holds as *beneficiary*; an individual's 403(b) plans held as *employee* may not be aggregated with such individual's 403(b) plans held as *beneficiary.* Regs. § 1.408-8, A-9; § 1.403(b)-6(e)(7). For aggregation rules applicable to inherited IRAs and 403(b) plans, see ¶ 1.5.09.

✓ Distributions from Roth IRAs will not count towards the RMD requirement for a traditional IRA and vice versa. Reg. § 1.408-8, A-9, sixth sentence.

✓ If any part of an IRA or 403(b) account has been "annuitized" (used to purchase an immediate annuity), the annuitized portion becomes subject to the defined benefit plan RMD rules. The non-annuitized portion remains subject to the defined contribution rules and the two portions cannot be aggregated for RMD purposes. Reg. § 1.401(a)(9)-8, A-3. See ¶ 1.1.05.

1.3.05 Separate accounts within a single plan

A QRP may maintain multiple accounts for an employee on the plan books, for example a rollover account, an employer contribution account, an employee after-tax contribution account, and a designated Roth account (DRAC; see ¶ 5.7.01). These multiple accounts within a single QRP are treated as one account for RMD purposes during the employee's life. Reg. § 1.401(a)(9)-8, A-2(a)(1). Thus a distribution from any of these accounts will count towards satisfying the RMD requirement for the employee's total combined interest in the plan.

Though a single retirement plan account or IRA payable to multiple beneficiaries can be divided into "separate accounts" (each payable to a different beneficiary) for RMD purposes after the owner's death (¶ 1.8.01), separate accounts treatment for portions payable to different beneficiaries is apparently *not* available for RMD purposes during the participant's life. Thus, it is not possible to use the much-younger-spouse method to calculate the RMD for the fractional portion of the account of which the spouse is the beneficiary if she is not the sole beneficiary of the participant's entire account in the plan. See Reg. § 1.401(a)(9)-8, A-2(a)(2), first sentence.

1.4 The RBD and First Distribution Year

Computing lifetime RMDs (¶ 1.3) is much easier than figuring out when they start. This ¶ 1.4 explains what the "RBD" and "first Distribution Year" are for various types of retirement plans and looks at the anomalies created by the disconnect between the first Distribution Year and the RBD (¶ 1.4.07).

1.4.01 Required Beginning Date (RBD); Distribution Year

A year for which an RMD is required is called a "distribution calendar year" in the regulations (Reg. § 1.401(a)(9)-5, A-1(b)), a **Distribution Year** in this book. For plans subject to the lifetime RMD rules (¶ 1.1.02), the "first Distribution Year" is the year the participant reaches age 70½ (or, in some cases, retires, if later; see ¶ 1.4.02– ¶ 1.4.05). Reg. § 1.401(a)(9)-5, A-1(b), second and third sentences.

See ¶ 1.2.06(C) for the effect of rollovers and IRA-to-IRA transfers on determination of the first Distribution Year.

Normally, the deadline for taking the RMD for a particular Distribution Year is December 31 of such year (¶ 1.2.01, #2), but, for lifetime distributions only, in the case of the first Distribution Year, the deadline is April 1 of the *following* year. Reg. § 1.401(a)(9)-5, A-1(c). That postponed deadline for the first year's RMD is called the **Required Beginning Date** or **RBD**. § 401(a)(9)(C); § 408(a)(6); Reg. § 1.408-8, A-3. This postponement of the RMD for the first Distribution Year does not apply to death benefits (¶ 1.5).

The RBD matters mainly for *compliance* purposes: The participant must start taking RMDs by that date to avoid penalty (¶ 1.9.02). Also, the calculation of post-death RMDs is different depending on whether death occurred before or after the RBD; see ¶ 1.5.02, Step 3. The RBD has little significance for *planning* purposes.

The starting point for determining the RBD is the attainment of age 70½. The "½" year is determined by months (six calendar months) not days (183.5 days): "An employee attains age 70½ as of the date six calendar months after the 70th anniversary of the employee's birth. For example, if an employee's date of birth was June 30, 1933, the 70th anniversary of such employee's birth is June 30, 2003. Such employee attains age 70½ on December 30, 2003. ...However, if the employee's date of birth was July 1, 1933, the 70th anniversary of such employee's birth would be July 1, 2003. Such employee would then attain age 70½ on January 1, 2004...." Reg. § 1.401(a)(9)-2, A-3.

If the participant's date of birth is December 31, 1947, it is not clear whether he attains age 70½ on June 30, 2018, or July 1, 2018, but it doesn't matter because either way he attains age 70½ in 2018 so his RBD will be April 1, 2019.

1.4.02 RBD for IRAs and Roth IRAs

The RBD for a traditional IRA is April 1 of the calendar year following the year in which the participant reaches age 70½, regardless of whether he is "retired." Reg. § 1.408-8, A-3. Exceptions: For certain rollover contributions, see ¶ 1.2.06(C).

Roth IRAs have no RBD. The participant is *never* compelled to take distributions from his Roth IRA. Minimum distribution requirements do not apply to a Roth IRA until after the participant's death. See ¶ 5.2.02.

1.4.03 ***QRPs: RBD for 5-percent owner***

For a participant who is a "5-percent owner," the RBD for a QRP is the same as the RBD for a traditional IRA (¶ 1.4.02): April 1 of the calendar year following the year in which the participant reaches age 70½, regardless of whether he is "retired." § 401(a)(9)(C)(ii)(I); Reg. § 1.401(a)(9)-2, A-2(b). As the Code puts it, the normal RBD for QRPs (later of retirement or age 70½; see ¶ 1.4.04) is not applicable for "an employee who is a 5-percent owner (as defined in § 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½…."

§ 416(i)(1)(B)(i) defines 5-percent owner as someone who owns "*more than* 5 percent of the outstanding stock of the corporation or stock possessing more than 5 percent of the total combined voting power of all stock of the corporation, or…if the employer is not a corporation, any person who owns more than 5 percent of the capital or profits interest in the employer" (emphasis added). Note that someone who owns exactly 5 percent is not a 5-percent owner—you must own more than 5 percent to be a 5-percent owner! See PLR 2005-24032 for an example of an analysis of 5-percent ownership with respect to a partner in a law firm.

In determining ownership percentages under § 416, a modified version of the "constructive ownership" rules of § 318 applies. § 416(i)(1)(B)(iii). Under these complicated rules, a participant could be deemed, for purposes of the 5 percent test, to own stock held by various family members, trusts, estates, partnerships, or corporations; and stock options must be taken into account. Explanation of the constructive ownership rules is beyond the scope of this book.

Reducing the ownership share after the age-70½ year does not change the RBD: "Once an employee is a 5-percent owner…distributions must continue to such employee even if such employee ceases to own more than 5 percent of the employer in a subsequent year." Notice 97-75, 1997-2 C.B. 337, "Background."

1.4.04 ***QRPs, cont.: RBD for non-5-percent owner***

The RBD for a QRP participant who is not a "5-percent owner" is generally "April 1 of the calendar year following the later of (I) the calendar year in which the employee attains age 70½, or (II) the calendar year in which the employee retires." § 401(a)(9)(C). See ¶ 1.4.03 for the definition of "5-percent owner." See ¶ 1.4.06 for the meaning of "retires." Note the following:

✓ A QRP participant who filed a pre-1984 "TEFRA 242(b) election" (rare) may have a later RBD than that specified in § 401(a)(9)(C); see ¶ 1.4.08.

✓ A QRP is not required to recognize the "later of retirement or age 70½" RBD. A QRP may choose to require *all* employees to commence distributions by April 1 of the year following the year in which they reach age 70½, even non-5-percent owners who are not retired. Reg. § 1.401(a)(9)-2, A-2(e).

If the plan forces all employees to commence distributions by April 1 of the calendar year following the year they reach age 70½, things get complicated for the nonretired employee who is not a 5-percent owner: He has one RBD for certain purposes, but some of his "required" distributions from the plan are not considered "required" distributions for other purposes. Specifically, for purposes of *determining RMDs from that plan*, and *determining whether the employee died before or after his RBD for that plan*, the employee's RBD is the RBD set by the plan, *not* the RBD described in the statute. Reg. § 1.401(a)(9)-2, A-6(b).

However, any distributions the employee receives during the period that is after the employee has passed *the plan's* RBD but not his *statutory* RBD are eligible for rollover: Such distributions are not considered "required distributions" for purposes of the definition of eligible rollover distribution (see ¶ 2.6.03) until after the employee's *statutory* RBD. Somehow the distribution *is* an RMD when the check is cut by the plan, but it is *not* an RMD when the check arrives in the employee's mailbox! Notice 97-75, 1997-2 C.B. 337, A-10(c).

1.4.05 ***RBD for 403(b) plans (including "grandfather rule")***

The RBD for 403(b) plans is generally April 1 of the calendar year following the later of the year the participant reaches age 70½ or the year the participant retires. Reg. § 1.403(b)-6(e)(3). That is because 403(b) plans are established by religious, government, or charitable employers, where there is no possibility of a different rule for 5-percent owners (¶ 1.4.03). However if the employer does somehow have a "5-percent owner" the RBD for that individual is the same as for an IRA. Reg. § 1.403(b)-6(e)(3), third sentence. In contrast to the rule for qualified plans, there is no apparent permission for the employer to establish an RBD earlier than that in the statute (compare ¶ 1.4.04).

A "grandfather rule" applies to pre-1987 balances in 403(b) plans if separately identified in the plan's records. See Reg. § 1.403(b)-6(e)(6). The Tax Reform Act of 1986 made the minimum distribution rules applicable, for the first time, to all 403(b) plans, but made this rule prospective only by exempting any pre-1987 403(b) plan balance from the new regime, provided such balance is accounted for separately by the plan. The pre-1987 account balance, while not subject to the full panoply of today's minimum distribution rules, is still subject to the more primitive predecessor of today's rules, the "incidental death benefits" rule.

Here are the three advantages of qualifying for this grandfather rule:

- ✓ The age for starting lifetime required distributions from the pre-1987 balance is actual retirement or, if later, age 75 (not age 70½). See PLR 9345044.

- ✓ Required distributions from the grandfathered balance are computed under the **incidental death benefits rule** rather than in the manner explained at ¶ 1.3. Under this rule, any mode of distribution to the participant qualifies provided that it is projected *either* to distribute all the benefits over the lifetimes of the participant and his spouse-beneficiary *or* to distribute at least 50 percent of the benefits during the participant's life. Reg. § 1.403(b)-6(e)(6)(vi); Rev. Rul. 72-240, 1972-1 C.B. 108; Rev. Rul. 72-241, 1972-1 C.B. 108.

- ✓ There are no requirements for how rapidly benefits must be distributed after the participant's death if the participant dies before commencing distributions.

The pre-1987 grandfather amount is a frozen, fixed-dollar amount; investment earnings and gains do not increase the grandfathered balance. Reg. § 1.403(b)-6(e)(6)(i). With the passage of time, new contributions to the plan and investment growth tend to make the pre-1987 balance an ever-smaller percentage of the overall plan balance, so in most cases it is not a significant planning factor. Also, any distributions taken from the plan that are in excess of the RMDs from the post-1986 balance are deemed to come first out of the pre-1987 balance. Reg. § 1.403(b)-6(e)(6)(iii). For more on the 403(b) grandfather rule, see the *Special Report: Ancient History* (www.ataxplan.com).

1.4.06 ***What "retires" means; rollover in retirement year***

When planning for an employee whose RBD is based on "retirement" rather than on attaining age 70½, remember that her first "Distribution Year" will be the year the retirement occurs—*and that no rollover can be allowed in that year until after the RMD has been distributed*. See ¶ 2.6.03.

The meaning of "the calendar year in which the employee retires" (see ¶ 1.4.04, ¶ 1.4.05) is not always obvious, because the meaning of "retires" has never been articulated by the IRS or any court.

A. **Retirement from employer maintaining the plan.** We do know that "retirement" means retirement "from employment *with the employer maintaining the plan*." Reg. § 1.401(a)(9)-2, A-2(a); Reg. § 1.403(b)-6(e)(3). Emphasis added.

Arch Example: Arch, age 73, works at Acme Co. Arch has never been a 5-percent owner of Acme. He is a participant in the Acme Plan. This plan holds funds contributed to Arch's account by Acme as well as funds rolled over into this plan from the retirement plan of Arch's prior employer, Zenith, and funds rolled over from an IRA. Even though the funds in Arch's accounts in the Acme Plan partly represent funds from an IRA (which, if they were still held in an IRA, would not be eligible for the postponed RBD), and from the plan of a former employer (from whose employment Arch has "retired"), Acme is "the employer maintaining the plan" that now holds these funds, and accordingly Arch is not required to take any distributions from any part of the Acme Plan until April 1 following the year in which he retires from Acme.

The question of what is "retirement" for purposes of a 403(b) plan has been a source of contention among participants, schools, and the IRS. Professor Mark has worked at 10 different universities over his career, with each university contributing to his TIAA-CREF accounts and contracts. As far as Professor Mark is concerned, he is not "retired" and he should not have to start taking RMDs as long as he is still working for SOME university that contributed to his TIAA-CREF nest egg. However, under the IRS definition he is "retired" with respect to a particular 403(b) plan if he has left the payroll of the employer that maintains that particular plan.

B. **Does retirement equal separation from service?** For purposes of determining his RBD under a QRP or 403(b) plan, how many hours must the participant work, in what time frame, in order to be considered not "retired?"

Neither the regulations, nor any IRS Publication, nor IRS Notice 97-75, 1997-2 C.B. 337 (which provides guidance to employers on the tax law changes made by the Small Business Jobs Protection Act of 1996) says anything on this point. Thus it is not clear whether "retirement" means a complete termination of employment, or whether some less drastic reduction of employment might be considered "retirement" for this purpose. Courts have looked to the dictionary definition of "retirement" ("withdrawal from one's position or occupation or from active working life") to decide what a "retirement plan" is. It is possible that the plan's own definition of "retirement" or of who is deemed to be an "employee" might be controlling. A person who is on a leave of absence might still be considered an "employee" and thus not retired, but merely receiving compensation (such as severance pay) presumably does not negate "retirement" in the case of someone whose performance of services for this employer has ended.

C. **Retirement followed by re-employment?** Can a person retire more than once? The statute reads as though there is only one "retirement" per employee. The IRS has issued no guidance on this question; accordingly there is no authority for suspending distributions upon reemployment.

Carmen Example: Carmen retires from the Royal Cigar Co. at age 72 and starts receiving RMDs from the RCC plan. At age 73 she goes back to work for RCC (where she is not and never has been a 5-percent owner). There is no authority for suspending her distributions until she retires *again*.

D. **Retirement on December 31.** If an employee's last day of work is December 31, Year 1, has he retired "in" Year 1? If so, and if he has attained age 70½, his RBD will be April 1, Year 2. Some conclude that his retirement actually occurred in Year 2, since he worked throughout Year 1, and Year 2 is the first year in which he did no work at all, therefore his RBD is not until April 1, Year 3. Strangely, there is no case, ruling, or IRS pronouncement of any type discussing this question.

In my opinion, an employee who goes home for good at the close of business on December 31, Year 1, and does not appear on any payroll in Year 2, has retired "in" Year 1, and his RBD is April 1, Year 2. In my opinion that is probably why the RBD was set a few months later—to give the many people who retire at the end of a calendar year time to take their first RMD without incurring a penalty for lateness. But that's just my opinion so feel free to disagree.

1.4.07 ***RBD versus first Distribution Year: The limbo period***

The disconnect between the first Distribution Year and the RBD (¶ 1.4.01) creates a "limbo period," beginning January 1 of the first Distribution Year and ending on April 1 of the following year (the RBD). Odd effects occur during this limbo period:

A. **If the first year's RMD is postponed**, two RMDs are required in the second year. The two RMDs in the second year will have different deadlines, be based on different account balances, and use different divisors.

Bernie Example: Bernie turns age 70½ in 2017, so 2017 is the first Distribution Year for his IRA. To calculate the 2017 RMD, he uses the 2016 year-end account balance and the Uniform Lifetime Table divisor for the age he attains on his 2017 birthday, which will be 70 if he was born before July 1, or 71 if he was born after June 30. He can take the 2017 RMD at any time from January 1, 2017, through April 1, 2018. There will then be *another* RMD for the year 2018, which must be taken between January 1, 2018, and December 31, 2018. The 2018 RMD will be based on the December 31, 2017 account balance and will use the Uniform Lifetime Table factor applicable for the age he attains on his 2018 birthday.

Bernie decides to postpone the 2017 distribution until March 2018. This postponement will mean his RMDs are "bunched up" in 2018 (because he will receive two years' distributions in that one year). It will also mean that his 2018 RMD will be larger than it would be if he took the 2017 distribution in 2017, because the prior year-end account balance used to compute the 2018 RMD will not be reduced by the amount of the 2017 RMD; see ¶ 1.2.05. Bernie doesn't care about these negative aspects of deferring the first year's RMD, because he expects his other income to be much lower in 2018, so deferring the first year's RMD will still lower his overall income taxes

B. **No rollover or conversion until RMD has been taken.** Even though the participant does not have to take the RMD for his first Distribution Year until April 1 of the second Distribution Year, he cannot, in the first Distribution Year (or any other Distribution Year) roll over (or convert to a Roth IRA) any funds from that plan or IRA to another plan or IRA until *after* he has taken the RMD for that Distribution Year; see ¶ 2.6.03(D) and ¶ 5.2.02(E). This rule does not apply to IRA-to-IRA transfers; see ¶ 1.2.02(F).

C. **Death during the limbo period.** If the participant dies on or after January 1 of the year he turns age 70½ (or retires, whichever is applicable), but before April 1 of the following year, he has died "before" his RBD and therefore the rules of § 401(a)(9)(B)(ii),(iii), and (iv) (life expectancy of beneficiary or 5-year rule; ¶ 1.5.03) apply to distribution of his death benefits, not § 401(a)(9)(B)(i) (the at-least-as-rapidly rule; ¶ 1.5.04). Reg. § 1.401(a)(9)-2, A-6(a); PLR 2009-35045.

What becomes of the RMDs that have "accrued" for the age 70½ and age 71½ (if applicable) year(s) in such a case of death during the "limbo period?" Those RMDs are simply "erased." They need not be taken at all. If "Bernie" (see "A") had died on March 31, 2018, he would have died before his RBD. Because he died before he was required to start taking RMDs, *no one* has an obligation to take Bernie's 2017 and 2018 RMDs; they vanish. Even if he had taken part or all of his 2017 and 2018 RMDs before his death, his death would still be "before" his RBD for purposes of computing post-death RMDs. This conclusion is based on the following authorities:

- § 401(a)(9)(B)(i) provides that the "at-least-as-rapidly rule" applies "if distribution of the employee's interest has begun" in accordance with § 401(a)(9)(A)(ii) (the lifetime minimum distribution rules). Reg. § 1.401(a)(9)-2, A-6(a), provides that "distributions are not treated as having begun to the employee [for that purpose]…until the employee's [RBD]…. Thus, section 401(a)(9)(B)(i) [the at-least-as-rapidly rule] *only* applies if an employee dies *on or after* the employee's" RBD. Emphasis added.

- "*If an employee dies on or after the required beginning date*, the distribution period applicable for calculating the amount that must be distributed during the distribution calendar year that includes the employee's death is determined as if the employee had lived throughout that year." Reg. § 1.401(a)(9)-5, A-4(a). Emphasis added. This is the only regulation that explicitly states a rule for the year of death, which indicates there is no RMD for the year of death if the participant dies before the RBD. A-5 (which covers post-death RMDs in case of deaths both before and after the RBD) begins in each case with the year *after* the year of death.

- If the surviving spouse is the sole beneficiary of a deceased participant's IRA and elects to treat the IRA as her own (¶ 3.2.03), Reg. § 1.408-8, A-5(a) provides that, if the spousal election is made in the year of the participant's death, "the spouse is required to take a required minimum distribution for that year, determined with respect to the deceased IRA owner under the rules of A-4(a) of section 1.401(a)(9)-5, to the extent such a distribution was not made to the IRA owner before death." The referenced regulation is the one that says the balance of the year-of-death RMD must be taken by the beneficiary "if the employee dies on or after" the RBD.

- Finally, Reg. § 1.401(a)(9)-3, A-1, provides that, if the employee dies before his RBD, "distribution of the employee's entire interest must be made in accordance with" the rules of § 401(a)(9)(B)(ii), (iii), and (iv). Those subsections refer only to the 5-year rule and payouts over the life expectancy of the designated beneficiary, with no reference to taking any distribution that the decedent would have been required to take had he not died.

These regulations lead to the conclusion that, since the decedent was not required to take an RMD for the age 70½ (or age 71½) year(s) if he died before his RBD, the beneficiary is not required to take the balance of the RMD for the year of death, because there is no RMD to take the balance of. There is no authority that contradicts this conclusion.

[Note: "TEFRA 242(v) elections" and Post death RMD material omitted]

1.9 Enforcement of the RMD Rules

*1.9.01 **Who enforces the minimum distribution rules***

Compliance with the minimum distribution rules is one of the more than 30 requirements a qualified retirement plan (QRP) must meet to stay "qualified." § 401(a). The plan administrator is the enforcer of the QRP minimum distribution rules. Since disqualification of the plan would be a disaster for all concerned, the plan administrator is extremely concerned to make sure RMDs are distributed—even though the penalty for missing an RMD is imposed on the "payee" rather than on the plan. ¶ 1.9.02.

An IRA does not have to be "qualified" in the same way that QRPs must be qualified; the IRS does not issue individual determination letters for IRAs. Rev. Proc. 87-50, 1987-2 C.B. 647, § 4.03. The penalty tax for failure to take the RMD falls on the payee, not on the IRA provider.

However, IRA providers are required to report to the IRS annually, on Form 5498, for each noninherited IRA they hold, whether an RMD is required from the account for the year in question. Reg. § 1.408-8, A-10. The IRA provider is also required to inform the IRA participant that a distribution is required, and to either calculate or offer to calculate the amount of the RMD for the participant. Notice 2002-27, 2002-1 CB 814. To date the IRS does not impose this obligation on IRA providers with respect to inherited IRAs.

In March 2010, the Treasury prepared an internal "Audit Report." The report concluded that there is "growing noncompliance" with the minimum distribution rules (and also with the rules for IRA contributions). Extrapolating from a statistical sample, the report concluded that there were over 250,000 individuals who failed to take their minimum required distributions during the tax years 2006–2007. http://www.irs.gov/instructions/i1099gi/ar02.html#d0e640. The auditor and the IRS management who reviewed the report agreed that a "Service-wide strategy" is needed to address retirement plan noncompliance.

1.9.02 ***Failure to take an RMD: 50% excise tax, other effects***

The Code imposes an excise tax (popularly referred to as a "penalty," although it is not technically a penalty) for failure to take an RMD. The tax is 50 percent of the amount that was supposed to be, but was not, distributed. § 4974(a). For how to compute the excise tax, see Reg. § 54.4974-1.

Note: Improper rollover or Roth conversion of the RMD: If an individual rolls over his RMD or converts it to a Roth IRA, he has not made a valid rollover or Roth conversion; see ¶ 2.6.03. He has a problem—but exactly what problem does he have? A common error in such situations is to frame the problem as "failure to take the RMD." This characterization of the problem is erroneous. The situation involves two steps: A distribution from the first plan and a contribution to the second plan. There is *no problem* with the first step: As far as the IRS is concerned, the individual *did take* the RMD—so there is no 50% penalty involved. "...[I]f an amount is distributed by one plan and is rolled over to another plan, the amount distributed is *still treated as a distribution by the distributing plan for purposes of section 401(a)(9)*, notwithstanding the rollover." Reg. § 1.401(a)(9)-7, A-2; emphasis added. The mistake that needs to be cleaned up is the second step—the invalid rollover or Roth conversion. The mistake must be dealt with either is an excess IRA contribution.

The excise tax is imposed on the "payee" (nonpayee?). § 4974(a). Presumably, in the case of a single IRA left to multiple beneficiaries, each beneficiary is liable for a excise tax only to the extent he fails to take *his particular share of the distribution*, though there is no authority or guidance on this point.

When it appears that a participant or beneficiary may owe the excise tax for past years, remember that the RMD rules have changed over the years; it may be that based the rules in effect in the applicable year the individual did NOT violate the RMD rules. To determine RMDs for 2009 and for pre-2003 years see the author's *Special Report: Ancient History* (Appendix C).

An *individual participant or beneficiary* who has failed to take an RMD (or failed to take the full amount of the RMD) must file Form 5329 for each year for which an RMD was wholly or partly missed. If he hasn't yet filed his income tax return for the year the distribution was missed, and he is required to file a return for that year, the Form 5329 should be attached to the return (Form 1040; you cannot use Form 1040A or 1040EZ if you must file Form 5329; IRS Publication 590-B (2015), p. 29). However, if he already has filed his tax return for the year the distribution was missed, or if he is not required to file a return for that year, he should file Form 5329 as a stand-alone form. See Reg. § 301.6501(e)-1(c)(4) and instructions for IRS Form 5329.

If the *fiduciary* of a trust or estate fails to take an RMD that should have been paid to the trust or estate (as beneficiary of an inherited IRA), the fiduciary should attach Form 5329 to the estate's or trust's Form 1041; see instructions for Forms 1041 (2015), p. 32 (Schedule G, line 7) and 5329 (2015), p. 8.

When an RMD is not taken in the Distribution Year to which it is attributable, it is added to and considered part of the RMD for the next Distribution Year *for purposes of determining whether distributions in the subsequent year are eligible for rollover*. Reg. § 1.402(c)-2, A-7(a) (last sentence). (RMDs are not "eligible rollover distributions"; see ¶ 2.6.03.) However, it does not appear that the missed RMD is subject to the 50 percent extra tax in more than one year; see IRS Form 5329 (2015) and Instructions (p. 7). Presumably, despite the "carryover" rule, if an RMD was missed in only one year, Form 5329 needs to be filed only for that year, not for all subsequent years until it is taken.

If an RMD has been missed, do you deduct the missed RMD from the "prior year-end account balance" when computing the RMDs for *subsequent* years? Nothing in the regulations authorizes such an adjustment for IRAs; see Reg. § 1.401(a)(9)-5, A-3.

If an individual postpones the RMD for his first Distribution Year beyond the end of the first Distribution Year (¶ 1.4.01), but then fails to take the RMD by the Required Beginning Date, Form 5329 should be filed for the year in which the RBD falls, not the first Distribution Year (to which the distribution was actually attributable). Instructions for IRS Form 5329 (2015), Part IX, third sentence (p. 8).

When the 5-year rule is applicable, there is no required distribution for any year except the last year of the period. In the fifth year, the RMD is 100 percent of the account balance. See ¶ 1.5.06.

1.9.03 ***IRS waiver of the 50 percent excise tax***

There are two paths to a waiver of the 50 percent excise tax imposed by § 4974(a) for failure to take an RMD (¶ 1.9.02). One (rarely used) is the automatic excise tax waiver for certain beneficiaries who comply with the 5-year rule; see ¶ 1.5.11(C).

The more often used way to negate the excise tax is to request a waiver from the IRS. The excise tax can be waived by the IRS on a case-by-case basis (§ 4974(d)) "if the payee described in section 4974(a) establishes to the satisfaction of the Commissioner" that "(1) the shortfall...in the amount distributed in any taxable year was due to reasonable error; and (2) reasonable steps are being taken to remedy the shortfall." Reg. § 54.4974-2, A-7(a). The request for a waiver is submitted with Form 5329; see IRS Publication 590-B (2015), p. 27.

Form 5329 can be filed as an attachment to the income tax return, Form 1040 or 1041. Alternatively, it can be filed as a stand-alone return (for example, if the taxpayer has already filed the income tax return for the applicable year). When Form 5329 is filed as a stand-alone return for a particular year form which the taxpayer has already filed an income tax return, there is no need to also file an amended income tax return. Reporting and paying (or requesting a waiver of) the excise tax for a past year does not change the reportable income or the income tax calculation for such past year.

The "payee" does *not* have to pay the excise tax as a condition of requesting the waiver; that condition imposed by the IRS prior to 2005 no longer applies.

Unlike with hardship waivers of the 60-day rollover deadline (¶ 2.7.05), the IRS has not published guidance regarding what constitutes "reasonable error" sufficient to justify failure to take an RMD. In PLRs 2014-37025 and -37034, the distribution of death benefits from an IRA was prevented by court order pending the outcome of bona fide litigation among various parties regarding who was entitled to the account. Once the litigation was settled the winning contestants received a waiver of the excess accumulations tax; the IRS found that the court order preventing access to the IRA was "reasonable cause" for failure to take the RMD.

Presumably the requirement that reasonable steps be taken to remedy the shortfall means that the taxpayer must take the distributions that were missed in prior years before requesting the waiver.

For a detailed roadmap to applying for a waiver of the excess accumulations penalty see the author's *Special Report: IRA Mistakes and How to Fix Them* (Appendix C).

1.9.04 ***Statute of limitations on the 50 percent excise tax***

In general, the IRS must assess taxes within three years after a required return for those taxes was filed—and there is *no* statute of limitations if no return is filed. § 6501(a), (c)(3). The goal of participants and beneficiaries should be to assure themselves the protection of the statute of limitations with respect to assessment of the 50 percent excise tax for missed RMDs under § 4974.

A. **What is the "return" you have to file?** A "return" for this purpose generally means "the return required to be filed by the taxpayer." In the case of the 50 percent excise tax, the "return" required to be filed to report the tax is Form 5329. See Reg. § 301.6501(e)-1(c)(4).

The tax for failure to take a required distribution is imposed by § 4974, which is part of Subtitle D ("Miscellaneous Excise Taxes") of the Code. In the case of an excise tax such as that under § 4974, "the filing of a return" for the applicable period "on which an entry has been made with respect to a tax imposed under a provision of subtitle D (including a return on which an entry has been made showing no liability for such tax for such period) shall constitute the filing of a return of all amounts of such tax which, if properly paid, would be required to be reported on such return for such period." § 6501(b)(4). While this suggests that just filing the annual income tax return, Form 1040, with a "zero" entry on the line for "Additional tax on IRAs, other qualified plans, etc.", could be sufficient to start the statute of limitations running even *without* filing Form 5329, the Tax Court has ruled that Form 5329 is *the* return that must be filed to start the statute running with respect to another IRA-related excise tax under Chapter 43 of the Code, namely, the tax on excess IRA contributions(§ 4973). *Robert K. Paschall et ux.,* 137 TC 8. In light of the *Paschall* case, all participants over age 70½, and all beneficiaries (including trusts or estates named as beneficiaries) holding inherited retirement benefits, should consider filing Form 5329 every year, even when they believe they owe no penalty, just to start the statute of limitations running in case the IRS ever disagrees.

B. **How to avoid the six-year statute.** § 6501(e)(3) provides that a *six-year* statute of limitations applies to Subtitle D taxes (which would include the excess accumulations tax) "if the return omits an amount of such tax properly includible thereon which exceeds 25 percent of the amount of such tax reported thereon." If the taxpayer files a Form 5329 showing zero as the amount of excise tax he owes, and it is later determined that some tax was owed, it is obvious that the amount "omitted" will always be more than 25 percent of the amount shown on the return.

The Code provides a way out of this problem. "In determining the amount of tax omitted on a return, there shall not be taken into account any amount of tax…which is omitted from the return if the transaction giving rise to such tax is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the existence and nature of such item." § 6501(e)(3).

Therefore, to keep the statute of limitations at three years instead of six years, one would need to file (in addition to a return showing "zero" penalty owed) a description of the "item" in the "return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the district director…of the existence and nature of such item." Reg. § 301.6501(e)-1(c)(4). A statement could be attached to the return listing the retirement plans owned by the taxpayer, his age, and other relevant facts, and explaining how the RMD was calculated (or why no RMD was required).

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PART C: QUALIFIED CHARITABLE DISTRIBUTIONS

This Part C is excerpted from the author's seminar outline "Charitable Giving with Retirement Benefits"

Generally, lifetime gifts of retirement benefits are not a tax-favored way to deal with such benefits; see discussion at ¶ 7.7.01. One minor but very popular exception is the "qualified charitable distribution" (QCD)—the ability of *some people* to transfer *a limited amount* of funds directly from *certain types of IRA* to *certain types of charities*. Specifically, an over-age-70½ IRA owner or beneficiary (see ¶ 7.6.02) can instruct the administrator of the IRA (see ¶ 7.6.03) to transfer up to $100,000 in any calendar year (see ¶ 7.6.04) to one or more eligible charities (see ¶ 7.6.05). The amount(s) so transferred is not includible in the gross income of the IRA owner-donor (see ¶ 7.6.07), even though it is a distribution from his or her IRA, and even though it may be used to satisfy the required minimum distribution (see ¶ 7.6.09(A)).

This ¶ 7.6 explains QCDs—the requirements, mechanics, limitations, and benefits.

*7.6.01 **Where to find the law***

The QCD is created by § 408(d)(8), which has in effect been part of the Tax Code since 2006—"in effect" because it was enacted several times on a temporary and often retroactive basis before being made a permanent part of the Code in December 2015.

Originally enacted as a temporary measure (good for IRA distributions in 2006 and 2007 only), § 408(d)(8) was extended in late 2008 for two more taxable years (2008 and 2009). In December 2010, § 408(d)(8) was extended for two more years (2010–2011). The American Taxpayer Relief Act of 2012 (ATRA) extended them *again*, for 2012–2013. (All the rest of ATRA's provisions were permanent). They were again reauthorized by late-in-the-year legislation for 2014, but once again only as a temporary provision: Subsection (F) of § 408(d)(8) stated that the section would not apply to distributions after 2014.

Finally, QCDs were re-authorized *and made permanent* for 2015 and later years by the "Protecting Americans from Tax Hikes (PATH) Act of 2015" enacted December 18, 2015, which struck subsection (F). See PATH, section 112.

The Treasury's only authoritative pronouncement specifically on QCDs to date is **IRS Notice 2007-7 (Part IX), 2007-5 I.R.B. 395, Q & A 34 through 44**, cited throughout the rest of this section.

The QCD is a watered down version of the "charitable IRA rollover" that the philanthropic community has sought to get enacted since at least the late 1990s. Under the "dream" charitable IRA rollover, which does not yet exist and may never exist, unlimited transfers would be allowed from any retirement plan by any participant to any tax-exempt charitable entity including charitable remainder trusts. The QCD is a distant relation to this "dream" charitable rollover.

*7.6.02 **Who can make QCDs: Individuals over age 70½***

Only individuals who are age 70½ or older can make QCDs. § 408(d)(8)(B)(ii).

The QCD donor can be either an IRA participant donating from his own IRA or a beneficiary donating from an inherited IRA. IRS Notice 2007-7, A-37. The only requirement is that the donor (whether owner or beneficiary) must be age 70½ or older.

This is the only tax code provision to make the age 70½ "birthday" itself a significant event. Required minimum distributions are based on the YEAR the participant reaches age 70½, not the DAY he reaches that age. Someone who reaches age 70½ on (say) December 30 could have a tough time getting his IRA provider to make the QCD on the last day of the year. It would have been easier for all concerned to allow QCDs to occur anytime during or after the calendar year the individual reaches age 70½—but that's not what the law says.

Example: In 2016, Jonathan inherited an IRA from his mother. He also has an IRA of his own. Jonathan's 70th birthday was April 1, 2017. He turns 70½ on October 1, 2017. He can make QCDs from either his own IRA or the inherited IRA he holds as beneficiary of his mother (or both) any time on or after October 1, 2017. The combined total of his QCDs from both accounts may not exceed the $100,000 limit (see ¶ 7.6.04).

7.6.03 ***From IRAs only (but not ongoing SEPs or SIMPLEs)***

QCDs may be made *only* from IRAs. § 408(d)(8)B). So, a QCD can not be made from a "qualified retirement plan," i.e., a plan qualified under § 401(a) of the Code, such as a pension, profit-sharing, Keogh, or 401(k) plan); or from a 403(b) plan; or from a 457 plan.

A QCD can be made from *any type of IRA* (including a Roth IRA) subject to the following exceptions/limitations:

✓ A QCD may **not** be made from an "ongoing" SEP-IRA or SIMPLE IRA. § 408(d)(8)(B). SEPs and SIMPLEs are IRAs funded directly by contributions from the individual's employer. See § 408(k) and § 408(p). An "ongoing" SEP or SIMPLE in any particular year is one that receives an employer contribution in such year. IRS Notice 2007-7, A-36.

✓ A QCD can come from a Roth IRA, to the extent the amount distributed would be included in the owner's gross income if distributed to him or her; see ¶ 7.6.07. § 408(d)(8)(B). But generally a person would not make a QCD from a Roth IRA. For one thing, most Roth IRA distributions are income tax-free, and so not eligible to be the subject of a QCD; see ¶ 5.2.03 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011). Even if an over-age 70½ person holds a Roth IRA distributions from which could be partly includible in his/her income (because he/she had not held a Roth IRA for the required 5-year holding period of § 408A(d)(2)(B); see ¶ 5.2.05 of *Life and Death Planning for Retirement Benefits*), the Roth IRA owner can expect that these funds eventually will qualify for income-tax free treatment and it would not be advantageous to throw away that future tax benefit just to make a QCD.

Carl Example: Carl is age 76 and still working at Acme Widget. In 2016, he holds the following retirement accounts: an IRA he inherited from his father, a Roth IRA he had owned for 10 years, a SEP-IRA to which Acme Widget is contributing in 2016, and a 401(k) plan account in the plan of his prior employer, Bacchus Detective Agency. He can make a QCD in 2016 from the inherited IRA. He cannot make a QCD from the Roth IRA because anything distributable to him from that account would be excludible from his income and thus not QCD-eligible. He cannot make a QCD from the SEP-IRA this year because it is "ongoing" (receiving an employer contribution) in 2016. He cannot make a contribution from the 401(k) plan because it is not an IRA.

The fact that QCDs cannot be made from a qualified plan such as a 401(k) plan creates an insurmountable obstacle for retirees who chose to leave their benefits in their former employer's plan but would like to make QCDs:

Lorraine Example: Lorraine is 73. She retired some years ago from Wealthy Funds Inc. She chose to leave her $500,000 Wealthy 401(k) plan balance in the Wealthy 401(k) plan because (as a plan member) she had continued access to the company's excellent investment management services, not generally available to the investing public. Now she would like to take her $20,000 2017 RMD in the form of a QCD...but there is no way she can do so. She can't make a QCD directly from her 401(k) account because QCDs are allowed only for IRA distributions. She can't "roll" the $20,000 out of the 401(k) plan and into an IRA because the first distribution she takes from the 401(k) plan in 2017 will be considered her RMD for that year—and as an RMD it is not eligible to be rolled over. What if she takes $50,000 out of the 401(k), keeps $20,000 in her taxable account (representing her 2017 RMD) and rolls the other $30,000 into the IRA? That's fine...and she can then make a 2017 QCD from the IRA with all or part of the $30,000 she just rolled into the IRA...but that will not be her 2017 RMD because she already took that in (fully taxable) cash. If she leaves the $30,000 in the IRA, that still won't help her avoid tax on her 401(k) plan RMD next year, because next year (in 2018) she will still have to take a (nonrollable) RMD from the 401(k) plan!

The only way Lorraine can use QCDs to reduce her taxable RMDs is to roll ALL of her 401(k) balance into an IRA (after taking the RMD for the rollover year)...but then she will lose out on her inside track to the Wealthy Funds Inc. investment management services!

7.6.04 ***How much? $100,000 per year per IRA owner***

The QCD income exclusion is limited to $100,000 per year. § 408(d)(8)(A). The limit is per IRA owner, not per IRA. "For married individuals filing a joint return, the limit is $100,000 per individual IRA owner." IRS Notice 2007-7, A-34. So, a husband and wife who are both over age 70½ and who both have IRAs can each transfer up to $100,000 to charity from their respective IRAs in the same year. But if (for example) wife has an IRA and husband does not, wife cannot "borrow" husband's limit and give $200,000 from her IRA.

An individual's limit is $100,000, even if he is making gifts from both his own IRA and an inherited IRA. See ¶ 7.6.02.

The donor does not have to give that much. $100,000 per individual donor per year is the maximum and there is no minimum (other than what the IRA provider may impose administratively).

Example: Jody, age 83, gives $1,000 per year to her church and does not make any other charitable gifts. Since 2006 she has made these annual gifts directly from her IRA as QCDs. Her sister Agatha, age 81, gives $200,000 a year to charity. She makes half her annual gift in the form of a QCD and the rest using appreciated stock held in her taxable account.

*7.6.05 **What type of charity qualifies to receive a QCD***

A QCD can be made to "any charity described in § 170(b)(1)(A)" with two exceptions: A QCD can NOT be made to a donor-advised fund (§ 4966(d)(2)) or a supporting organization (§ 509(a)(3)). § 408(d)(8)(B)(i). Donor-advised funds and supporting organizations are fine as beneficiaries of retirement plan *death benefits* (see, *e.g.*, ¶ 7.5.03); but they are not eligible recipients of *lifetime* (QCD) gifts from IRAs.

Charities "described in § 170(b)(1)(A)" would include pretty much all churches, schools, hospitals, and publically supported "501(c)(3)"-type charities.

Some but not all private foundations are eligible recipients of QCDs. If considering a QCD gift to a private foundation, you will need to study the definitions in § 170.

*7.6.06 **Requirements applicable to the gift itself***

Here are the rules applicable to the gift made from the IRA to the charity.

A. **Cash not required.** There is no requirement in the Code that a QCD gift must be paid in cash; "any distribution" that meets the various other requirements described here can be a QCD. § 408(d)(8)(B). Cash is the most common and convenient choice for a QCD but a distribution of property to the charity would also qualify. The IRA provider or charity might have rules limiting noncash gifts; the Code does not.

B. **QCD cannot be used for a split-interest gift.** A major limitation applicable to QCD gifts is that a distribution is a QCD "only if a deduction for the entire distribution would be allowable under § 170" (except that for this purpose the percentage-of-income limits in § 170(b) are disregarded). § 408(d)(8)(C).

This limitation means, first of all, that a "split-interest" gift can NOT qualify as a QCD, because under a split-interest gift part of the gift value goes to an individual instead of 100% going to the charity. Thus, QCDs can NOT be made to a charitable remainder trust (¶ 7.5.04) or pooled income fund (¶ 7.5.10), or in exchange for a charitable gift annuity (¶ 7.5.08). A charitable remainder trust is an excellent choice of beneficiary for retirement plan *death benefits* (see ¶ 7.5.06), but cannot be the recipient of a *lifetime* transfer from the IRA (QCD).

C. **Donor cannot get back anything of substantial value.** More problematic is the effect of the § 408(d)(8)(C) limitation when the donor is to receive goods or services from the charity in exchange for his gift. The IRS has extensive and elaborate rules on this subject—for regular charitable gifts.

If the goods or services do not have substantial value...

If the goods or services that the donor gets back have "insubstantial value" they are disregarded and the donor can deduct 100% of his gift. Reg. § 1.170A-1(h)(3). Therefore a QCD can be made in exchange for such goods or services of insubstantial value, because that type of get-back does not reduce the deductibility of a regular charitable gift.

How do you determine if goods or services are of "insubstantial value?" That's easy (not)! Just read § 1.170A-13(f)(8)(i) and the guidelines provided in Rev. Procs. 90-12, 1990-1 C.B. 471, and 92-49, 1992-1 C.B. 987, and any successor documents, including Rev. Rul. 67-246, 1967-2 CB 104, and Rev. Proc. 2015-53, 2015-44 IRB 615!

In general "membership benefits" such as free museum admission, parking, and gift shop discounts can be disregarded. But general rules are hard to come by here. A coffee mug with the charity's logo on it may be disregardable based on its cost and fair market value and the amount of the donation relative to that cost and fair market value—but if the donor also received a calendar or a "listener's guide" or a dinner along with the mug, the combined value may mean the value she received is not "insubstantial."

It is to be hoped that each charity would have its own tax counsel review these IRS guidelines, and the goods and services the charity is providing, and then provide each donor with written confirmation that the full gift is tax-deductible (i.e., the membership or other benefits or token gifts can be disregarded as of insubstantial value). Unfortunately, charities (especially smaller ones) are often not well versed enough in these rules to know what is "disregardable" and what isn't.

If the goods or services DO have "substantial value"

When a charitable gift is made in exchange for goods or services that DO have "substantial value," the rules for *non-QCD* charitable donations are simple: The donor just deducts only the excess of the gift over the value of the goods and services received. For example, if a charity is having a benefit dinner, and tickets cost $500 each, but the value of the meal received is $50, the donor writes a check for $500 and gets a tax deduction for $450.

Can this type of part-gift part-sale be made by means of, or in conjunction with, a QCD?

If the entire $500 is paid from the IRA, it appears that none of it would be treated as a QCD, so the entire $500 would be taxable as a "regular distribution" from the IRA: A transfer to charity from an IRA will be treated "as a qualified charitable distribution only if a deduction for the *entire distribution* would be allowable under section 170..." § 408(d)(8)(C).

Could the transaction be done as a "bifurcated" donation, under which the charity would accept two checks totaling $500, one for $50 (from the donor's taxable account) to pay for the dinner and one for $450 from the IRA as a charitable donation and QCD. The charity would give two separate receipts; the receipt for the QCD would show no goods or services received in exchange.

In my opinion, this should work, but there is no IRS pronouncement on it.

Professor Christopher Hoyt of the University of Missouri-Kansas City Law School has pointed out that, in the field of private foundations, such "bifurcated donations" (where, in our example, the foundation pays the charitable donation portion of the ticket and the dinner-attendee pays only the dinner-cost portion) are considered self-dealing transactions and therefore forbidden. See PLR 9021066, where the IRS ruled that, since the individual could not have attended the dinner without the foundation's having made a contribution (even though the individual paid personally for the cost of the food), the foundation's donation was conferring a financial benefit on the individual. Some are concerned that what would be forbidden self-dealing in the private foundation context might be a "prohibited transaction" in the IRA context, since the retirement plan prohibited transaction rules grew out of and in some ways copy the private foundation self-dealing rules.

However, the rationale of the private foundation ruling does not extend to the IRA context. A private foundation is absolutely forbidden to confer benefits on the donor-disqualified person. In contrast, an IRA is REQUIRED to confer benefits on the IRA owner. In fact an IRA is forbidden to confer benefits on anyone other than the IRA owner and his or her beneficiaries.

If the transfer to the charity is a QCD, then it cannot be a prohibited transaction. IRS Notice 2007-7, A-44, states that the Department of Labor (in charge of interpreting the PT rules) affirms that the QCD is deemed to be a transfer "to" the individual IRA owner for purposes of § 4975(d). Under § 4975(d), a distribution to the IRA owner can NOT be a prohibited transaction because it is "receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan." § 4975(d)(9).

If the transfer to the charity is *not* a QCD, then "the amount paid is treated as (a) a distribution from the IRA to the IRA owner that is includible in gross income....and (2) a contribution from the IRA owner to the charitable organization..." IRS Notice 2007-7, A-43. And, again, as a distribution to the IRA owner, it cannot be a prohibited transaction.

The bottom line

Because of the sticky muddy rules about "stuff you get back for your gift," you have two choices when seeking to make a QCD to an organization where you are a "member" or otherwise getting something "back" from the organization. Either you sit down with your or the organization's tax lawyer and prepare a written memorandum, with citations, about why the stuff you are getting back is disregardable under applicable IRS regulations (so your QCD qualifies as a "100% deductible gift," despite the get-back stuff), or you find a way to totally sever your IRA-funded donation from your membership or event ticket—perhaps by making a "bifurcated donation" as above described.

Or perhaps you just follow this advice of a prominent New York tax lawyer:

"In the meantime, as long as I'm not sure this works, I wouldn't use a QCD for a charity dinner or for membership in my local public television station or zoo or museum." —Bruce Steiner.

D. **Pledge is no problem.** A QCD can be made in fulfilment of a donor's pledge to the charity. A transfer made to a charity in fulfilment of the donor's pledge is not considered "donated" until the transfer occurs (not when the pledge was made). Reg. § 1.170A-1(a). A transfer from the IRA to a charity at the IRA owner's request is considered a transfer "to" the IRA owner and thus is not a "prohibited transaction" (¶ 8.1.06) even if it is in fulfilment of the donor's pledge. Notice 2007-7, A-44; IRS Information Letter 2010-0204.

E. **Substantiation required.** The rules requiring substantiation of the amount of the charitable gift (and confirming that nothing of substantial value was received in exchange for the gift) are the same for a QCD as for any charitable gift made from the donor's taxable account. IRS Notice 2007-7, A-39. The rules for substantiating a charitable gift of $250 are found in § 170(f)(8), Reg. § 1.170A-13(f), and IRS Publication 1771.

F. **Gift must go direct from IRA to charity.** QCDs are allowed only for direct transfers from the IRA to one of the permitted types of charitable recipients. If the money is first distributed to the individual, then donated to charity, it is not a QCD, and all the usual limits and drawbacks described at ¶ 7.7.01 will apply (there was an exception to this for certain charitable transfers in January 2013).

7.6.07 ***Income tax aspects; effect on basis***

The QCD is excluded from the individual's gross income for all purposes. § 408(d)(8)(A). Thus it cannot be counted as part of the individual's gross income for purposes of applying the percentage-of-income limits in § 170(b) with respect to his other charitable gifts. Of course, there is no income tax charitable deduction for the QCD. IRS Notice 2007-7, A-39.

The QCD must be a distribution that would otherwise be includible in the donor's gross income. § 408(d)(8)(B). Here is the effect of this rule on:

✓ **Distributions from Roth IRAs:** A qualified distribution from a Roth IRA (see ¶ 5.2.01 of *Life and Death Planning for Retirement Benefits*) cannot be a QCD because a qualified Roth IRA distribution is nontaxable. Thus, QCDs could be made from a Roth IRA only if the Roth IRA had not yet met the requirements for a "qualified distribution." But even then it would normally not be good planning to make a QCD from a Roth IRA; see ¶ 7.6.03.

✓ **IRAs where the IRA owner has no after-tax money in any IRA:** If the traditional-IRA owner does not have any after-tax money in any of this IRAs, this rule is "no problem" since all distributions from any of his IRAs will consist 100 percent of pretax money (includible in gross income).

✓ **If the IRA owner has "basis"** (after-tax money; also called "investment in the contract") in any of his IRA accounts, then the requirement that QCDs must be all pretax money would normally pose a problem. Under the rule nicknamed the "cream-in-the-coffee rule" of § 72 (explained at ¶ 2.2.08 of *Life and Death Planning for Retirement Benefits*), any distribution from an IRA normally carries out proportionate amounts of the "pretax" and "after-tax" money in the individual's IRAs (with all of his traditional IRAs being treated as single account for purposes of determining the proportions).

To accommodate the includible-in-income requirement, there is a special "basis recovery rule" in the Tax Code for QCDs: QCDs are deemed to come out of the IRA's pretax money first. § 408(d)(8)(D).

Burton Example. Burton is a charitably-inclined individual age 71 who does not like to pay taxes. He owns a $70,000 IRA with a $20,000 basis resulting from nondeductible contributions in prior years. He owns no other IRAs. He directs the IRA provider to transfer $50,000 from his IRA directly to the Salvation Army. This is a QCD, so the $50,000 is deemed to come from the IRA's pretax money "first." Now he is left with a $20,000 IRA which is 100 percent after-tax money. He can then convert this small "stub" IRA to a Roth IRA tax-free, or cash it out tax-free.

Note that this federal rule does not necessarily have any effect on *state* tax treatment of the distribution. For example, a particular state's "basis recovery rule" for IRA distributions may or may not accommodate this special federal rule for QCDs. The client and preparer must determine the client's income tax basis (investment in the contract) both before and after the QCD occurs, for both federal and (if applicable) state purposes.

7.6.08 ***How to make a QCD and how to report it***

To effect a QCD, the IRA owner directs the IRA provider/administrator to transfer funds from the IRA to the charity. The donor-IRA owner should communicate with her IRA provider regarding its policies and preferred procedures for carrying out these transfers. One acceptable procedure is for the IRA provider to cut a check payable to the charity and have the donor physically deliver the check to the charity. IRS Notice 2007-7, A-41.

The IRA custodian is supposed to report the QCD on Form 1099-R, just as if it had paid the distribution to the individual IRA owner rather than to a charity. There is no special code or other indication on Form 1099-R signaling that the distribution is a QCD. Thus, nothing in the 1099-R will reveal that the distribution is nontaxable! As the IRS put it in the instructions for Form 1099-R (2016), p. 1, "There's no special reporting" that IRA providers have to do for qualified charitable distributions.

Instead, it's up to the IRA owner-donor to report the nontaxable status, in the following manner: First, he enters the total distribution (as shown on Form 1099-R) on Line 15a of his personal income tax return, Form 1040. Then he enters the taxable portion of the distribution (zero, if the QCD was the only distribution for the year) on Line 15b. See instructions for IRS Form 1040, 2016, p. 25, Lines 15a and 15b, Exception 3. Then the donor is supposed to "Enter 'QCD' next to line 15b."

This method of reporting QCDs presumably means that some QCD-donors will not get the benefit of the income tax exclusion. This will happen if the IRA owner-donor simply turns over all his 1099-Rs to his tax preparer without alerting the preparer to the fact that there was a QCD. The preparer will then presumably simply report the entire distribution as taxable, and if the client doesn't notice that discrepancy but simply signs and files the return, the U.S. Treasury will collect a bit more money than it's entitled to.

7.6.09 ***Using QCDs for the RMD; other planning uses and pitfalls***

The QCD will not save anyone millions of dollars of taxes, but it is nevertheless a safe legal tax-favored way for an over-age-70½ client to use his IRA to benefit charity. Despite a few kinks and pitfalls, the QCD is a low-tax way to fulfill the minimum distribution requirement for the charitably inclined client.

A. **Use QCD to fulfill RMD.** A QCD will count as a distribution for purposes of determining whether an individual has fulfilled the RMD requirement. IRS Notice 2007-7, A-42. This is consistent with Regs. § 1.401(a)(9)-5, A-9(a), and § 1.408-8, A-11(a), which state that, except as otherwise provided in A-9(b) or A-11(b) of such regulations, or as may later be otherwise provided by other IRS pronouncements, "all amounts distributed" from a plan or IRA "are taken into account in determining whether section 401(a)(9) is satisfied…." The charitable IRA rollover is an ideal way for a charitably-inclined individual over age 70½ to fulfill the RMD requirement.

B. **Mixing up QCDs and RMDs.** Someone who has already taken his RMD for a particular year cannot use a QCD later in the year to fulfill his RMD requirement for that year; he cannot roll the already-taken RMD back into the IRA (to enable him to use a QCD instead) because RMDs are not eligible rollover distributions. See ¶ 2.6.03 of *Life and Death Planning for Retirement Benefits*. He can still make a QCD from his IRA; it just will not be his RMD. People will get confused about the RMD/QCD relationship. The two things have nothing to do with each other (other than the fact that a QCD counts towards the RMD, to the extent the RMD has not already been taken). A person can make QCDs of up to but not more than $100,000 (in any year QCDS are permitted), *regardless* of: whether his RMD for the year is more or less than $100,000; *regardless* of whether he has already taken the RMD; and *regardless* of what other distributions he has taken or later takes from the IRA.

C. **Advantages of the QCD.** The QCD eliminates *some* of the problems that arise when making lifetime charitable gifts from an IRA (see ¶ 7.7.01). A QCD does not increase AGI and therefore does not: increase the individual's adjusted gross income for purposes of determining the extent to which his "net investment income" will be taxed (§ 1411); decrease the deductibility of medical expenses (§ 213(a)) or miscellaneous itemized deductions (§ 67(a)); increase the reduction of itemized deductions (§ 68(a)); increase the taxability of Social Security benefits (§ 86); increase Medicare premiums (42 U.S. Code §1395r(i)); or increase state income taxes (in a state that uses federal AGI as the basis for computing state income tax but does not allow a charitable deduction). Since there is no itemized charitable deduction for the QCD gift, the gift does not "count" for purposes of the percentage-of-income limits on charitable deductions in § 170(b); does not get reduced by § 68(a); and is in effect "deductible" even for someone who does not itemize deductions.

D. **Drawbacks, problems.** While it might appear desirable for an over-age 70½ individual to use QCDs to fund all of his charitable contributions, there will be practical limits on this: Presumably, IRA providers will start charging "distribution fees" or setting minimum distribution amounts if they are asked to issue dozens of tiny QCDs. Also, for an IRA owner who wants to give more to charity than just the amount of his/her RMD, the donor-owner should determine whether another form of charitable gift would be more advantageous for such additional gifting (such as gifts of appreciated stock from a taxable account).

7.7 Other Lifetime Gifts of Retirement Benefits

[portions omitted]

This ¶ 7.7 discusses charitable giving options for individuals who have money in IRAs and other retirement plans. Most of the considerations discussed here apply to both living participants and beneficiaries (with respect to inherited benefits they hold).

7.7.01 ***Lifetime gifts from distributions***

A client who has more money in his retirement plan than he expects to need may wish to give some of it to charity. Generally, the only way he can do this is to first withdraw funds from the plan and then give the funds to the charity. For one popular technique that is an exception to this general rule, see "Qualified Charitable Distributions" (¶ 7.6).

Withdrawing funds or other assets from a retirement plan generally causes the value of the withdrawn property to be included in the recipient's income. If the recipient then donates the withdrawn amounts to charity in the same year that he took the distribution, the income tax charitable deduction *theoretically* should eliminate the tax on the distribution. Unfortunately the following obstacles often prevent the income tax charitable deduction from wiping out the tax cost of the distribution:

A. **Percent-of-income limit.** The income tax deduction for charitable contributions is limited to a certain percentage (30% or 50%, depending on the type of property given and the type of recipient charity) of the individual's gross income. § 170(b). If the individual's donations exceed the deduction limit, the excess can be carried forward for a limited number of years. [See Appendix C]

B. **Deduction-reduction for high-income taxpayers.** Charitable deductions are an itemized deduction, subject to the "reduction of itemized deductions" that applies to high-income individual taxpayers in years before 2009 and after 2012. § 68. The *amount* of the reduction is a percentage of the donor's AGI—so the potential reduction is increased by the plan distribution, which increases AGI. A single individual starts to become subject to § 68 if he has more than $250,000 of AGI; for married taxpayers filing jointly, the level is $300,000. [See Appendix C]

C. **PEP for high-income taxpayers.** The personal exemption deduction is phased out under a different Code section (§ 151(d)) and schedule, again beginning at $250,000 of AGI for single taxpayers ($300,000 for married filing jointly). A retirement plan distribution, by increasing AGI, may cause loss of some or all of the taxpayer's personal exemption. The charitable contribution does not offset this. [See Appendix C]

D. **Deduction decreases taxable income but not AGI.** Because the distribution is included in the individual's gross income, it may increase his taxes in other indirect ways that are not offset by the charitable deduction, because the distribution increases his adjusted gross income (AGI) and the charitable deduction does not decrease AGI. For example, the plan distribution could decrease his medical expense deduction (limited to expenses in excess of 10% of AGI; see § 213) [See Appendix C] and miscellaneous itemized deductions (limited to expenses in excess of 2% of AGI; see § 67); increase his Medicare premiums (see Appendix B); decrease his eligibility to contribute to a Roth IRA (see ¶ 5.3.04 of *Life and Death Planning for Retirement Benefits*); and/or increase the taxability of his Social Security benefits (see § 86).

E. **Split-interest gifts are only partially deductible.** If the gift is made to a charitable remainder or lead trust, to a pooled income fund, or in the form of a charitable gift annuity, the amount of the deduction is only part of the total gift (since a portion of the gift is benefitting individuals), even though all of the plan distribution was includible in income.

F. **Penalty for pre-age 59½ distributions.** If the participant is under age 59½ at the time of the distribution, there is a 10 percent penalty on the distribution unless an exception applies. § 72(t); see Chapter 9 of *Life and Death Planning for Retirement Benefits.* The charitable deduction has no effect on this penalty. See ¶ 7.7.03 for a lifetime charitable giving strategy for under-age-59½ individuals. This penalty does not apply to beneficiaries. § 72(t)(2)(A)(ii).

G. **State income taxes.** In a state that allows no charitable deduction in computing its income tax, the participant would pay state tax on the distribution but get no offsetting deduction.

H. **Nonitemizers.** An individual who uses the "standard deduction" rather than itemizing his deductions would see no income tax benefit from the charitable contribution. [See Appendix C]

I. **Extra tax on net investment income.** An additional 3.8% tax applies to the investment income in excess of a certain threshold amount of taxpayers whose adjusted gross income exceeds $250,000. § 1411. An IRA distribution will normally increase the recipient's gross income for purposes of determining how much of his investment income is subject to the 3.8% tax, but an itemized charitable deduction will not reduce it.

Some drawbacks can be minimized by using smaller distributions and smaller gifts. In some cases QCDs can be used to avoid some of these drawbacks; see ¶ 7.6. Also, certain forms of retirement plan distributions are not subject to full normal income tax, and so may offer an opportunity for tax-effective charitable giving.

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PART D: RMD RULES FOR DEFINED BENEFIT PLANS AND "ANNUITIZED" IRAS

This Part D is excerpted from the author's seminar outline "When Insurance Products Meet Retirement Plans."

Most practitioners are familiar with the required minimum distribution (RMD) rules for Defined Contribution (DC) plans, also called individual account plans. This Part explains the completely different RMD rules that apply to defined *benefit* plans and to defined contribution plans that are annuitized.

10.1 Two Types of Retirement Plans

10.1.04 ***What a "Defined Benefit plan" is***

A Defined Benefit (DB) plan is a type of qualified retirement plan (i.e., qualified within the meaning of § 401(a)). Under a DB plan, also called a "defined benefit pension plan," the employer promises to pay the employee a specific pension, starting at retirement, and continuing for the employee's life. Social Security is similar to a DB plan.

A. **"Classic" DB plan.** Under the classic type of DB plan, the amount of the pension is based on a formula, such as "a monthly pension for life, beginning at age 65, equal to 1/12th of 1 percent of final average compensation times years of service, reduced by 10 percent for each year of service less than 10 if the employee has less than 10 years of service, and up to an annual maximum of 40 percent of career average compensation."

The formula may award a lower percentage for compensation below the Social Security tax wage base than for compensation in excess of such base. This is called the "permitted disparity." The formula will contain adjustments for early or late retirement.

The employer hires an actuary to tell it, each year, the minimum amount it *must* contribute to the plan (and how much extra it *may* contribute) (both limits being set by the tax Code) in order to amortize the employer's future obligations to retiring employees under the plan.

B. **Cash balance DB plans.** There is another type of DB plan, called a **cash balance plan**, which uses a different type of formula. "A cash balance plan is a defined benefit plan that defines benefits for each employee by reference to the employee's hypothetical account. An employee's hypothetical account is determined by reference to hypothetical allocations and interest adjustments that are analogous to actual allocations of contributions and earnings to an employee's account under a defined contribution plan." Reg. § 1.401(a)(4)-8(c)(3)(I). Under a cash balance plan, contributions are more uniform across age groups, making cash plans more attractive than classic DB plans for younger employees (and less generous for older employees). …

C. **Investment and longevity risks.** Under a DC plan, the participant owns identifiable assets held in an account with his name on it. The value of the account fluctuates depending on investment results, but no party to the proceedings has any money staked on the question of how long the participant will live. With a DC plan, the risk that the participant will outlive his money falls on the participant.

With a DB plan, the plan (or insurance company issuing the annuity contract used to fund the benefits) takes the excess-longevity risk. See Wanda Example, ¶ 10.2.05.

Under a DB plan, the plan (in theory) also takes all the investment risk. If the plan's investments go down in value, the employee's promised benefit remains the same; the employer must contribute more money to the plan to fund that benefit. There are two exceptions to this statement. First, under one type of annuity, the variable annuity, the participant also has investment risk; see PART III(A)(1). Second, the employee has the risk that the employer will default on its obligation to fund the plan. If the plan becomes insolvent and/or the employer goes bankrupt, the employee may find his benefits limited to the amount insured by the government's pension insurer, the Pension Benefit Guarantee Corporation (PBGC). The employee will not receive the full benefits promised by the plan.

10.1.05 ***What a "Defined Contribution plan" is***

A Defined Contribution (DC) plan is, along with the Defined Benefit plan, one of the two broad categories of qualified retirement plan (QRP). DC plans are also called "individual account plans." § 414(i). IRS regulations use the terms individual account plan and defined contribution plan interchangeably; thus even individual account plans that are NOT QRPs (such as IRAs and 403(b) plans) may be considered DC plans.

Under a DC plan, the employer may commit to making a certain level of contribution to the plan (such as "10% of annual compensation," an example of a Money Purchase plan formula), or (under a profit-sharing plan) may make such contributions periodically on a discretionary basis or based on profit levels. 401(k) plans and ESOPs are other examples of DC plans.

Once the employer has contributed to the DC plan, the contributions are allocated among accounts for the individual participants who are members of the plan. What the participant will eventually receive from the plan is determined by (1) how much is allocated to his account under the contribution formula and (2) the subsequent investment performance of that account. The employer does not guarantee any level of retirement benefits. If the plan's investments do well, the profits will increase the participant's account value. If the plan's investments do poorly, the participant will receive less at retirement.

The minimum distribution rules for DC plans require that, for each Distribution Year (year for which a minimum distribution is required; see ¶ 10.2.07), the participant (or beneficiary) must withdraw an amount computed by dividing the prior year-end value of the account by a factor taken from the applicable IRS life expectancy table.

10.2 RMDs for Defined Benefit Plans

As explained above, the Defined Contribution plan RMD rules are based on a simple system: Each year, the prior year-end account balance is divided by a factor obtained from an IRS table. The factors (divisors) are designed to liquidate the participant's account through annual distributions over the joint life expectancy of the participant and a hypothetical 10-years-younger beneficiary.

Under a Defined Benefit (DB) plan, in contrast, there is no account balance to be liquidated: The participant does not have an identifiable separately-tracked "account" within the plan. The plan's assets are held in a single fund for the benefit of all participants and beneficiaries. All the individual employee owns is a promise by the plan to pay a certain amount periodically (typically monthly) to the participant for his lifetime, with or without a further promise to continue the periodic payments to the participant's beneficiary after the participant's death. So the IRS had to come up with a different approach to insure that DB plans are not used to accumulate money in a retirement plan for too long a period. It accomplished this with Reg. § 1.401(a)(9)-6, issued in 2004 (well after the final RMD regulations for DC plans, issued in 2002).

Following is a summary of that 2004 regulation. This summary of the DB RMD rules is for the guidance of professionals advising individual retirees and small business owners. Most of the work involving DB and annuity RMDs is done by actuaries, plan administrators, and insurance companies, working on behalf of the employer and plan. They should consult a source designed for their use such as *The Pension Answer Book* (see Bibliography).

The structure of the DB regulation is as follows. First, the regulation defines basic terms and concepts, such as "annuity," "payment interval," and "annuity starting date" (ASD). ¶ 10.2.02. Then the regulation's core provisions tell us when the distributions must begin (¶ 10.2.06), and how benefits must be paid.

The regulation provides that the plan can offer the employee a menu of life annuities, fixed-term payouts, and combinations thereof, within limits set by the regulation. ¶ 10.2.03. Generally, the annuity payments cannot increase once the annuity payout has started, but the regulation allows several generous exceptions to that rule. ¶ 10.2.04. Once the form of annuity has been selected and the annuity payout starts, it cannot be changed, except in certain circumstances permitted by the regulation. ¶ 10.2.05.

The regulation also deals with special situations, such as what happens if the employee starts taking annuity payments prior to his RBD, ¶ 10.2.08. The most difficult "special situations" arise when the DC rules and the DB rules interact with each other, for example, when the employee converts his annuity benefit to a cash lump sum (¶ 10.2.07), or annuitizes benefits in a DC plan account (¶ 10.2.10).

The regulation focuses primarily on the type of annuity an employee can elect at or before his RBD, but also provides rules for death benefits paid under a DB plan. See ¶ 10.2.09.

The final regulation applies to distributions in 2006 and later years. For 2003–2005, distributions "based on a reasonable and good faith interpretation" of § 401(a)(9) will satisfy the RMD rules. Reg. § 1.401(a)(9)-6, A-17.

*10.2.01 **Differences between DB, DC plan rules***

Here are the differences between the DC and DB plan RMD rules:

A. **There is no account balance in a DB plan.** See Ralph Example, ¶ 10.2.07.

B. **The annuity payments are the RMD.** Once the participant's plan benefit has been annuitized, each year's payments under the contract apparently *are* the RMD for that year with respect to that benefit. See Reg. § 1.401(a)(9)-6, A-1(a), § 1.401(a)(9)-5, A-1(e). As RMDs, the annuity payments are not eligible for rollover. § 402(c)(4)(B), § 408(d)(3)(E), Reg. § 1.402(c)-2, A-7(c). This is true even if the participant could have elected some other form of annuity contract that would have paid him a smaller annuity. See Clyde Example, ¶ 10.2.10.

C. **RMD rules apply after ASD, even if before the RBD.** Unlike with a DC plan, the DB RMD rules will apply to the annuity prior to the RBD, if the annuity payments start before the RBD. See ¶ 10.2.08.

D. **Postponing the start of annuity distributions until the RBD does not require a "double distribution" in the second Distribution Year.** See ¶ 10.2.06.

*10.2.02 **Payment intervals; other DB terminology***

The DB plan RMD rules contemplate that benefits are paid in the form of an annuity: level payments made at regular intervals over a predetermined period of time. The interval between payments (**payment interval**) may not exceed one year (the usual interval is monthly payments), and must be the same throughout the distribution period. Reg. § 1.401(a)(9)-6, A-1(a).

The annuity may be paid to the participant (or beneficiary) directly from the plan's assets, or the plan may purchase an annuity contract from an insurance company and transfer the contract to the participant or beneficiary. Buying an annuity contract or electing a particular form of annuity benefit (i.e., "annuitizing" the participant's benefits) is an insurance transaction, involving a shifting of investment and/or longevity risk. See Wanda Example, ¶ 10.2.05.

The **annuity starting date** (ASD) is the first day of the first period for which an amount is received as an annuity. § 1.72-4(b). This is the date when the participant's accrued benefit in a DB plan (or account balance in a DC plan) is converted to an annuity payout, that is to say, is "annuitized." The ASD may be difficult to determine if the participant starts payments while he is still working and accruing further benefits, or starts receiving payments then stops them when he resumes employment, or does not start payments until some time after retiring.

*10.2.03 **Permitted forms, durations, of annuity***

The core provisions of the regulation tell us how long an annuity payout can last. Remember, the point of the RMD rules is to avoid unduly prolonged deferral of distribution of the plan benefits. Thus, the regulation could not allow a retiring employee to elect to have his benefits paid out over 1,000 years. A thousand-year payout would violate the fundamental concept of § 401(a)(9), which is that retirement benefits must be completely distributed over the life or life expectancy of the participant and (within limits) of the participant's beneficiary. Similarly, the rules could not allow a participant to choose a form of benefit that would defer all distributions until the participant's death; such a payout form would violate the principle that death benefits must be "incidental" to the primary benefit, which is a retirement pension. Reg. § 1.401-1(b)(1)(I).

The regulation permits a variety of different possible durations for the annuity payments. The payments can last for the participant's life, for a fixed term, or for life with a minimum guaranteed term. The amount of the employee's monthly pension will vary depending on which form he elects; generally, the more survivor benefits and guarantees the employee opts for, the lower his own monthly pension will be. All forms of benefits are supposed to be of equivalent value (though often they're not; see ¶ 10.3.03); those computations are a function of the plan's benefit formula and actuarial calculations, not the RMD rules.

Here are the forms of payout the IRS allows a DB plan to offer to a retiring employee who is commencing his annuity payout at approximately age 70. If the annuity starts at an earlier age, see ¶ 10.2.08. Regarding the ability to delay "annuitization," see ¶ 10.2.06.

A. **An annuity for the life of the participant, with no minimum guaranteed term.** Reg. § 1.401(a)(9)-6, A-1(a), A-2(a). This would give the participant the largest annuity payments during his life, but would provide no benefits for his beneficiaries.

B. **An annuity for the joint lives of the participant and his spouse, terminating at the death of the surviving spouse, with no minimum guaranteed term.** Reg. § 1.401(a)(9)-6, A-1(a), A-2(b). The monthly payments to the surviving spouse cannot be larger than the payments the participant receives, but can be the same amount or anything less. (The spouse's consent would be required in order for her survivor payment to be less than 50 percent of the participant's payment; see § 417 and ¶ 3.4 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011) regarding the spousal-benefit and spousal-consent requirements.) This form of benefit would provide no benefits after the death of the surviving spouse.

C. **An annuity for the joint lives of the participant and his nonspouse beneficiary, terminating when both of them are deceased, with no minimum guaranteed term.** Reg. § 1.401(a)(9)-6, A-1(a), A-2(c). This option is the same as "B," with one difference: If the nonspouse beneficiary is more than 10 years younger than the participant, the monthly payment to the beneficiary cannot exceed a certain percentage of what the participant was receiving. The percentage depends on the age difference between the participant and the beneficiary, using the Table in Reg. § 1.401(a)(9)-6, A-2(c). (If the participant is married, his spouse's consent is required for him to name a nonspouse beneficiary; see § 417 and ¶ 3.4 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011).) This "minimum distribution incidental benefit" (MDIB) rule, by forcing most of the benefits out during the participant's projected lifetime, assures that distribution of the benefits is not unduly prolonged. See "E" for how this rule interacts with a minimum guaranteed term.

D. **An annuity for a period certain, with no life component.** Reg § 1.401(a)(9)-6, A-1(a), first sentence. If the ASD is on or after the participant's RBD, the period certain must not be longer than whichever of the following is applicable. (If the ASD is before the RBD, see ¶ 10.2.08.)

1. The **General Maximum Period Certain** is the Applicable Distribution Period (ADP) from the Uniform Lifetime Table (see Appendix A) determined using the participant's age in the calendar year the ASD occurs. Reg. § 1.401(a)(9)-6, A-1(a), A-3(a), first sentence. For example, if the participant's ASD is in the year she turns 71, the General Maximum Period Certain would be 26.5 years: The participant could elect to receive annuity payments for a fixed term of 26.5 years (or any shorter term). If she lives longer than 26.5 years, or whatever shorter term she elected? Too bad. Under this option, her payments end after the fixed term of years. If she dies before the term ends, her beneficiary would receive the payments for the balance of the term certain.

2. The **Special Maximum Period Certain** is the ADP determined using the IRS's Joint and Survivor Life Expectancy Table (found at Reg. § 1.401(a)(9)-9, A-3), based on the ages the participant and spouse attain on their birthdays in the year of the ASD. The participant can elect a life annuity with survivor annuity for his spouse for a fixed term of years that is longer than the General Maximum Period Certain (see #1) and that does not exceed the Special Maximum Period Certain, but only if the participant's sole beneficiary is his spouse. Reg. § 1.401(a)(9)-6, A-1(a), A-3(a), last sentence. If either spouse lives past the fixed term, too bad—the payments will stop when the term expires.

E. **Life annuity with period certain.** The employee can elect a life annuity ("A" above) or a joint and survivor life annuity ("B" or "C" above) with a minimum guaranteed term. The minimum guaranteed term can be any term that does not exceed the General Maximum Period Certain described at "D(1)" above, namely, the ADP determined under the Uniform Lifetime Table using the participant's attained age as of his birthday in the year of the ASD. Reg. § 1.401(a)(9)-6, A-1(b), A-2(d), A-3(a). However, the Special Maximum Period Certain ("D(2)" above) *cannot* be used as a minimum guaranteed term in conjunction with a life annuity— even if the employee's sole beneficiary is his more-than-10-years-younger spouse. It can be used only as a period certain on its own.

The "E" option is the most complicated, because of the interaction of the period certain and the MDIB rule.
Which form of benefit should a participant choose? See ¶ 10.3.

10.2.04 ***Payments must be nonincreasing, except…***

The other core provision of the regulation is that the annuity payments generally may not increase after the ASD. Reg. § 1.401(a)(9)-6, A-1(a). After all, the purpose of the DB plan RMD rules is to prevent "backloading" the distributions; the government wants to collect taxes on this pension as soon as possible.

(Payments can be set up so that they *decrease* after the ASD; in fact, in the case of death benefits paid to a nonspouse beneficiary, the MDIB rule may require that payments decrease after the participant's death; see ¶ 10.2.03(C).)

The regulation permits several significant exceptions to the no-increases rule. The pension payable under a DB plan may provide for the following payment increases. All of these represent payout increases that are either built in to the annuity terms from the beginning (A–E), or added later as a result of a plan amendment (F) or the participant's accrual of additional benefits under the plan (G). For other types of changes in the annuity payout after the ASD, see ¶ 10.2.05.

A. **Cost of living adjustment (COLA).** The payout may provide for an annual adjustment to reflect (or for periodic upward adjustments limited by) increases in certain IRS-approved cost-of-living indices. Reg. § 1.401(a)(9)-6, A-14.

B. **Elimination of survivor benefit.** If the employee's benefit payments were in a reduced amount to reflect a survivor payment payable to his beneficiary, the contract can provide that the employee's payments will be increased (eliminating the reduction prospectively) if the beneficiary either ceases to be the beneficiary "pursuant to a qualified domestic relations order" (QDRO) or dies. Reg. § 1.401(a)(9)-6, A-14(a)(3). The IRS calls this a "pop up" of benefits. T.D. 9130, 2004-1 C.B. 1082, Preamble.

C. **Lump sum conversion by beneficiary.** A beneficiary may be allowed to convert his survivor annuity benefit into a lump sum. Reg. § 1.401(a)(9)-6, A-14(a)(5).

D. **Other permitted increases: contracts purchased from insurance company.** If the benefit is funded with an annuity contract that the plan purchases from an insurance company, the contract can *also* provide for:

1. Annual percentage increases in the benefit that are not tied to a cost-of-living index;

2. A "final payment" at the employee's death equal to the difference between the "total value being annuitized" and the payments made to the employee during his life;

3. Annual dividends or adjustments reflecting "actuarial gains" in the policy; this allows use of a variable annuity contract (see PART III(A)(1) of this Report); and/or

4. "Acceleration" of the annuity.

Generally, the total value of the future expected payments under the contract must be the same, regardless of which of these extras are included. Reg. § 1.401(a)(9)-6, A-14(c). However, the regulation is not overly strict on this point because essentially the IRS is relying on the insurance company that issues the annuity contract to "police" the values. Presumably a rational insurance company would not offer the annuitant a choice of packages that have wildly differing values. If benefits are paid directly from the plan, options are more limited, presumably because the IRS does not trust private employer plans not to try to bend the rules to benefit of certain individuals; see "E." For definitions of "total value being annuitized," "actuarial gain," "total future expected payments," and "acceleration of payments," see Reg. § 1.401(a)(9)-6, A-14(e).

E. **Other permitted increases: benefits paid directly from the plan.** If the benefits are paid directly from the plan, rather than being funded with an annuity contract purchased from an insurance company, acceleration of the annuity (D(4) above) is not permitted. The plan may provide for increases similar to those described at D(1)–(3) above, but subject to additional limitations (for example, an annual increase not tied to a cost-of-living index must be less than 5%). Reg. § 1.401(a)(9)-6, A-14(d).

F. **Plan amendment.** Benefits may be increased to reflect a plan amendment. Reg. § 1.401(a)(9)-6, A-14(a)(4).

G. **Additional benefits accrued after ASD.** If the employee accrues additional benefits after the ASD, and after his RBD, the distribution of the additional accrued benefit must begin with the first payment interval ending in the calendar year immediately following the calendar year in which such amount accrues. Reg. § 1.401(a)(9)-6, A-5.

*10.2.05 **Other changes permitted after the ASD***

The theory of an annuity is that, once the terms of the payout are set, they cannot be changed. That principle is fundamental to an insurance transaction in which one side is taking a risk regarding future events; if one party to the transaction can change his mind after the facts have become known, the system won't work.

Wanda Example: Wanda, age 70, believes she is in the best of health; coming from a long-lived family, she expects to live well beyond average life expectancy. She opts for a life annuity with no minimum guaranteed term, to get the largest possible monthly payments for herself. The insurance company that issues the annuity to Wanda is simultaneously issuing annuity contracts to thousands of other 70-year-olds who want to be protected against the risk of living too long. The insurance company knows some of them will live longer than average and some will die prematurely; the company will make a "profit" on those who die prematurely, enabling the company to stay in business and pay benefits to those who live "too long." A year later, Wanda discovers she has a serious illness and is likely to die prematurely. She wants to change the type of contract she selected, to one that has a minimum guaranteed term. But if all the terminally ill people in the group are allowed to switch to a minimum guaranteed term, while the insurance company is still required to make payments for life to those who live extra long, the insurance company will go out of business.

So the question of whether an annuity payout can be changed after the ASD is usually moot. The annuity issuer usually won't allow such changes. However, in case a particular pension plan or insurance company does allow changes, the RMD rules also recognize the possibility of changes. For example, a payment can be modified in connection with plan termination or the employee's retirement or marriage. For more on permitted post-ASD modifications, see Reg. § 1.401(a)(9)-6, A-13.

*10.2.06 **When the annuity payments must commence; the RBD***

The first payment under the annuity must be made not later than the employee's Required Beginning Date (RBD). Reg. § 1.401(a)(9)-6, A-1(c)(1).

The "required beginning date" (RBD) is the deadline by which a retirement plan participant must begin taking required minimum distributions. § 401(a)(9)(A). For traditional IRAs, the RBD is April 1 of the year following the year in which the participant reaches age 70½. For 401(k) plans, 403(b) plans, and other qualified or nonIRA plans, the RBD is generally April 1 of the year following the year the participant (1) reaches age 70½ or (2) retires, whichever is later, provided the participant owns less than five percent of the employer that sponsors the plan. The post-death minimum distribution rules are different depending on whether the participant died before or after his RBD. For full details on the RBD, see ¶ 1.4 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011).

Note the following:

- Because minimum distributions are not required from a Roth IRA prior to the participant's death, this requirement simply does not apply to annuities purchased inside a Roth IRA. A Roth IRA does not have an "RBD." § 408A(c)(5); see ¶ 5.2.02 of *Life and Death Planning for Retirement Benefits*.

- The requirement that annuity payouts must begin by the RBD means it is "illegal" to purchase a "longevity annuity" (one that does not start paying out until the owner reaches his 80s) inside a traditional IRA. However, the IRS has created a limited exception to the general rule to allow a portion of an individual's traditional IRA to be used to purchase a "qualified" longevity annuity (QLAC); see ¶ 10.2.11 below.

The amount that must be paid on or before that date is whatever the regular annuity amount is. For example, if the employee is to receive $6,000 per month, he receives the first $6,000 on or before his RBD, the next $6,000 a month later, and so on until the expiration of the agreed-upon duration of the annuity.

Here we have another difference from DC plans. Under a DC plan, if the employee took no distribution from the plan in his first Distribution Year, he would have to take two years' worth of distributions in the second Distribution Year. This concept does not apply to annuity payouts. As long as the periodic payments start no later than the RBD, there is no need to take some kind of "catch-up distribution" for the first Distribution Year. Under a DB plan, there simply is no RMD for the first Distribution Year—with one major exception: If the participant takes all or part of his benefits in the form of a lump sum distribution rather than as an annuity, in or after his first Distribution Year, then there *is* an RMD for the first Distribution Year; see ¶ 10.2.07.

10.2.07 ***Converting an annuity payout to a lump sum***

Under some DB plans, the participant has a choice at retirement. Instead of taking an annuity payout, he can take a lump sum cash distribution. The amount of the lump sum equivalent of the participant's vested accrued pension is determined by the plan's actuary, using interest rates and life expectancy factors dictated by the IRS. Under a cash balance plan, the participant would be made aware of the lump sum equivalent of his benefit every year; under more traditional DB plans, he would not learn this number until he approached retirement.

The lump sum alternative is not the same as an account balance under a DC plan. The value of the lump sum equivalent fluctuates with interest rates; it goes down as interest rates go up, which can be a shock to an employee near retirement:

Ralph Example: Ralph expects to retire at age 65. Rather than take a $3,000 per month life pension, he plans to take the lump sum equivalent value, which the plan projects will be $622,000 when Ralph reaches age 65, using a four percent interest rate. However, when Ralph actually reaches age 65, the interest rate has changed to five percent. He can still elect to take a monthly pension of $3,000, but if he wants a lump sum, he will get only $553,000! Ralph is shocked and thinks he has been cheated, but unfortunately for him this is exactly what is supposed to happen. If it's any consolation, remind him the plan is not even required to offer him a lump sum distribution; many DB plans offer only the annuity benefit. If the applicable interest rate had decreased, the lump sum equivalent value of his pension would have *increased*. [Numbers in the examples in this section were made up for purposes of illustration only, and do not represent realistic actuarial values.]

If the plan allows the lump sum option, the plan will tell the employee what the lump sum equivalent value is. The minimum distribution rules have nothing to say about that computation. In fact, if the employee takes the lump sum distribution instead of a pension, the RMD rules are completely finished with him—*unless* the lump sum is to be paid to him in a year for which a minimum distribution is required. Even then, the RMD rules "don't care" about the lump sum distribution—*unless* the participant wants to roll it over! If the annuity is converted to a lump sum, *and* the lump sum is paid to the participant in or after his "first Distribution Year," then the RMD rules care about one thing and one thing only: how much of that distribution is treated as an RMD, which is not eligible to be rolled over to another plan. ¶ 2.6.04.

Reg. § 1.401(a)(9)-6, A-1(d), provides two methods whereby a DB plan can compute the nonrollable "RMD portion" of a lump sum distribution.

Method #1: Under Method #1, you compute the RMD portion using the DC plan RMD rules (see ¶ 10.1.05), "pretending" that the lump sum distribution the employee receives is the prior year-end balance.

Method #2: Method #2 is more complicated. Essentially you treat one year's worth of pension payments as the RMD for the first year. The regulation permits "expressing the employee's benefit as an annuity that would satisfy" the RMD regulations (apparently *any* annuity that would satisfy the RMD regulations), beginning as of the first day of the Distribution Year for which the RMD is being determined. Reg. § 1.401(a)(9)-6, A-1(d)(2).

Which method is better? Method #1 is easier to calculate, and will always produce a smaller RMD. It seems extremely strange to have a "minimum required" distribution that could be any one of several different possible amounts.

Suppose the participant postpones taking her benefits until her Required Beginning Date (RBD), then receives a lump sum distribution on the RBD. How much of that distribution is treated as a nonrollable RMD? The regulation gives us the same two methods, but in this case we must compute two years' worth of RMDs, since the year of the RBD is actually the second Distribution Year.

Method #1: This is tricky! We must compute two years' worth of RMDs, using the "pretend" DC plan method. That means there are two different divisors, one for the first Distribution Year (the year the participant reached age 70½) and one for the second year (the year he reached age 71½). But the pretend "prior year-end balance" we use for both these computations is the same, the amount of the lump sum distribution. Reg. § 1.401(a)(9)-6, A-1(d)(1).

Any distributions the participant had received in the first Distribution Year would reduce the amount of the RMD for the "first Distribution Year" portion of the second Distribution Year RMD.

Method #2: If the plan uses this method it would treat two years' worth of annuity payments as the RMD for the second Distribution Year. The "annuity payments" for this purpose would be based on an annuity that started on the first day of the first Distribution Year.

10.2.08 ***If participant's ASD is prior to the RBD***

If an employee retires before age 70½, at, say, age 65, and starts receiving his pension then, he and the annuity issuer are making their insurance bargain irrevocably at that time. This situation poses another contrast to the DC plan situation, and again required the IRS to come up with different rules for DB plans.

Under a DC plan, any distributions the participant takes prior to his first Distribution Year are irrelevant to the RMD rules. The DC rules kick into action during the first Distribution Year and/or on the RBD or date of death. If the IRS tried to use this same approach for DB plans, then every DB plan participant who retired and started receiving a pension earlier than his RBD would have to calculate everything *again* when he reached age 70½, and annuities issued to participants younger than age 70½ would have to contain different death-benefit rules depending on whether the participant died before or after his RBD. The IRS did not so provide.

If the ASD is prior to the RBD, the annuity contract can provide anything it wants to with respect to distributions prior to the first Distribution Year, but must provide for distributions that satisfy the RMD rules in the first Distribution Year and subsequent years. Reg. § 1.401(a)(9)-2, A-4, last sentence. Then the ASD is treated as the RBD for certain purposes. Reg. § 1.401(a)(9)-6, A-10, first sentence. For example, if the participant dies after the ASD he is treated as dying *after his RBD*, even if his death occurred prior to April 1 of the year after the year in which he would have reached age 70½. Reg. § 1.401(a)(9)-6, A-10(a), last two sentences.

Treating the ASD as the RBD for certain purposes requires certain adjustments to the computations discussed at ¶ 10.2.03(D). For example, we know that the General Maximum Period Certain is determined using the Uniform Lifetime Table, based on the employee's age as of his birthday in the first Distribution Year, but the ULT does not have factors for ages below 70. Accordingly, the regulation provides that, for an annuity commencing prior to the year the participant reaches age 70, the maximum period certain is 27.4 (which is the ULT factor for age 70) plus the difference in years between 70 and the participant's age as of his birthday in the year of the ASD.

Curt Example: Curt retires from Acme in Year 1, taking his pension in the form of an annuity for a term certain, starting immediately. He will turn age 62 on his Year 1 birthday. The maximum term certain his annuity can last for is 35.4 years (27.4 + [70 − 62] = 35.4).

Another adjustment required if the annuity starts before age 70 has to do with the maximum benefit payable to a nonspouse beneficiary under a joint and survivor annuity (see ¶ 10.2.03(C)). Because the participant will be receiving the annuity payments for a longer time (because he is starting the annuity at a younger age), the participant will "automatically" be receiving a larger share of the joint and survivor life annuity, and the survivor's share will "automatically" be less. Accordingly, the IRS allows the survivor benefit to be a larger percentage of the participant's benefit. This is done by "adjusting" the age difference between the employee and the beneficiary for purposes of applying the table in Reg. § 1.401(a)(9)-6, A-2(c)(2).

First, determine the actual age difference between the participant and beneficiary. Then, reduce the age difference so determined by the number of years by which the participant is younger than age 70. For example, if the participant turns age 64 in the year of the ASD, and his nonspouse beneficiary is age 34 (30 years younger than the participant), the 30-year age difference is reduced by six (70 − 64), so the "adjusted age difference" is 24 (30 − 6), and the beneficiary's maximum annuity is 67 percent of the participant's annuity. Reg. § 1.401(a)(9)-6, A-2(c)(1).

10.2.09 ***RMD rules for DB plan death benefits***

The regulation provides different rules for death benefits depending on whether the participant died before or after his annuity starting date (ASD).

Regarding whether any death benefits discussed here can be rolled over to another retirement plan or to an IRA by the beneficiary, see generally ¶ 3.2 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011) regarding the ability of a surviving spouse to transfer or "roll over" inherited benefits to her own or an "inherited" retirement plan; and see § 402(c)(11) (discussed at ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011)) for the ability of a nonspouse Designated Beneficiary to transfer inherited QRP benefits to an "inherited" IRA or Roth IRA.

If the participant died before the ASD, the regulation is a little hazy on the requirements and options. It appears that the beneficiary could take the benefits in a lump sum (if that option is offered by the plan), though that option is not discussed in the regulation.

Note: Definition of "Designated Beneficiary": A Designated Beneficiary means one or more *individuals* named as beneficiary(ies) of the plan by the participant or under the terms of the plan. § 401(a)(9)(E); Reg. § 1.401(a)(9)-4, A-1, A-2. Under IRS regulations, if a *trust* is the named beneficiary, and the trust meets numerous requirements, the individual trust beneficiaries are treated as if they had been named directly as beneficiaries, and thus can be treated as "Designated Beneficiaries." For details on the rules for such so-called "see-through trusts," see Chapter 6 of *Life and Death Planning for Retirement Benefits*. However, an estate cannot be a "Designated Beneficiary" and thus can NOT use the life expectancy, life annuity, or rollover options available to a Designated Beneficiary. The same is true of a trust that is named as the participant's beneficiary but that does not qualify as a "see-through trust."

Alternatively, a Designated Beneficiary could take the benefits in any of three annuity forms:

A. **Life annuity with minimum guaranteed term.** The Designated Beneficiary can take a life annuity with a minimum guaranteed term, provided the guaranteed term may not exceed the beneficiary's life expectancy, determined using the IRS's Single Life Table. Reg. § 1.401(a)(9)-6, A-3(b)(1); § 1.401(a)(9)-5, A-5(b), (c).

B. **Life annuity.** He can take a life annuity with no minimum guaranteed term. Although the regulation does not specifically mention this form of benefit, it can be inferred from § 401(a)(9)(B)(iii)(II) and the regulations mentioned at "A."

C. **Annuity for term certain.** He can take an annuity for a period certain. The period certain may not exceed his life expectancy (see "A").

Whichever of these annuity options is chosen, the first payment must be made no later than the end of the year after the year of the participant's death (or, if later, and if the sole beneficiary is the participant's spouse, the end of the year in which the participant would have reached age 70½). Reg. § 1.401(a)(9)-6, A-1(c)(1), fourth sentence; § 1.401(a)(9)-3, A-3(a), (b).

If the beneficiary is not a Designated Beneficiary, the options are more restricted because all benefits must be distributed within five years after the participant's death. § 401(a)(9)(B)(ii), Reg. § 1.401(a)(9)-3, A-4. See ¶ 1.5.06 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011) for more on this so-called five-year rule.

Note that the above discusses the participant's death "before the ASD," rather than "before the RBD." See ¶ 10.2.08.

If the participant died <u>on or after the ASD</u>, the payout to the beneficiary is determined by the type of survivor annuity the participant selected when the annuity payout began. See the alternatives listed at ¶ 10.2.03(B)–(E). The survivor annuity can be accelerated (converted to a lump sum), if the beneficiary wishes to do so and the plan permits this option. Reg. § 1.401(a)(9)-6, A-14(a)(5).

Furthermore, "the annuity starting date will be treated as the required beginning date" for purposes of Reg. § 1.401(a)(9)-2 and § 1.401(a)(9)-6. Reg. § 1.401(a)(9)-6, A-10(a). Thus, the employee's death after the ASD is treated as death after the RBD even if it was in fact before the RBD. Similarly, if the participant died before the year he would have reached age 70½, and his surviving spouse starts a regulation-compliant annuity payout *prior* to that year (even though she could have waited *until* that year), distributions after her death must continue to be made over her life expectancy (or whatever other regulation-compliant period she elected). Her death does not trigger a new determination of Designated Beneficiary, as it would have had she died before commencing her payout. Reg. § 1.401(a)(9)-6, A-11. Compare Reg. § 1.401(a)(9)-3, A-5, A-6, § 1.401(a)(9)-4, A-4(b).

Note: Despite this rule treating the ASD as the RBD for certain purposes, it would appear that annuity payments made to the participant prior to his first distribution year should not be considered "required minimum distributions" for purposes of the rule that minimum distributions are not eligible for rollover.

10.2.10 ***Buying an immediate annuity inside a DC plan or IRA***

Reg. § 1.401(a)(9)-6 applies to defined benefit plans. It also applies to "annuity contracts purchased with an employee's account balance under a defined contribution plan." T.D. 9130, 2004-1 C.B. 1082. Thus, if a retiring employee's 401(k) balance is used directly to purchase an annuity contract, the annuity contract must comply with the DB plan rules, even though a 401(k) plan is a DC plan. The same is true if the employee rolls his 401(k) plan balance over to an IRA (another form of DC plan), and uses part or all of the IRA funds to purchase an annuity contract. Reg. § 1.401(a)(9)-5, A-1(e), second sentence. In the year of the purchase, the account is still subject to the DC plan RMD rules; for that year *only,* distributions under the annuity contract will be taken into account as satisfying the RMD requirement for the account under the DC rules. Reg. § 1.401(a)(9)-5, A-1(e), third sentence.

(Note: Another approach is to take cash out of the DC plan, pay the income tax on the distribution, and use the after-tax proceeds to purchase an annuity outside the plan. That scenario is not what is being discussed here.)

If only *part* of the employee's benefit in a DC plan is used to purchase an annuity, the regulations treat the two portions of the employee's account as two separate accounts, beginning the year *after* the year of the purchase. The annuity contract must comply with Reg. § 1.401(a)(9)-6 (the DB plan rules) and the rest of the account must comply with the DC plan RMD rules (Reg. § 1.401(a)(9)-5). See Reg. § 1.401(a)(9)-5, A-1(e), § 1.401(a)(9)-8, A-2(a)(3). If the annuity contract is purchased after the RBD, all distributions received under the annuity contract are considered required minimum distributions and accordingly cannot be rolled over. Reg. § 1.401(a)(9)-5, A-1(e), third sentence; § 402(c)(4)(B), § 403(b)(8)(A)(I), § 408(d)(3)(E).

Roz Example: Roz, who turns age 73 in 2005, owns an IRA. The account balance was $2 million as of December 31, 2004, so her RMD for 2005 is $80,972 ($2,000,000 ÷ 24.7, the divisor for age 73 from the Uniform Lifetime Table). In July 2005, she uses $500,000 of the IRA balance to purchase an annuity contract which will pay her $5,000 a month for life, on the first day of each month, starting August 1, 2005. According to Reg. § 1.401(a)(9)-8, A-2(a)(3) (which is made applicable to IRAs by Reg. § 1.408-8, A-1(a)), the IRA will be treated as two separate accounts for RMD purposes, beginning in 2006: The RMDs for the "DC portion" of the IRA will be computed based on the prior year-end account balance excluding the value of the annuity contract; the RMD requirement with respect to the "annuity portion" is satisfied by the payments to Roz under the annuity contract. For the year 2005 *only*, the $25,000 of annuity payments Roz receives from the contract for August–December (five months times $5,000) count towards her $80,972 RMD for 2005; she will have to withdraw the rest of the 2005 RMD ($55,972) from the nonannuity portion of the account by December 31, 2005. Starting in 2006, the payments under the annuity contract will not count towards the RMD requirement for the nonannuity portion of the account (see Clyde Example, below).

Although it does not specifically address this point, it appears that Reg. § 1.408-8, A-9 (allowing the owner of multiple IRAs to take the aggregate RMDs for all IRAs he holds as "participant" from any one or more of such IRAs; see ¶ 1.3.04 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011)) applies only to IRAs that are DC plans, not to any IRA (or portion of an IRA) that has been annuitized.

Clyde Example: Clyde, age 70, has a $2 million IRA. He uses $500,000 of the balance to purchase a 10-year term-certain annuity that pays him $60,000 per year. Now his IRA holds $1.5 million of securities and a $60,000-per-year 10-year annuity contract. He could have purchased an annuity that would have lasted for up to 27.4 years; see ¶ 10.2.03(D). If he had elected a longer annuity term payout, his annual annuity payment under the contract would have been much smaller. Can Clyde treat the "excess" payments (i.e., the part of the annuity payment in excess of the smallest annuity payment he could have elected) as satisfying the RMD requirement for the remaining IRA balance, under the aggregation rule of Reg. § 1.408-8, A-9?

The answer unfortunately for Clyde appears to be "no." Once the participant has chosen an annuity contract with particular terms, those terms create the RMD under that annuity contract. Thus, the entire $60,000 per year payment to Clyde from his annuity contract *is* the RMD for the annuity, and there is no "excess distribution" to be applied to the DC portion of the IRA (even though he could have chosen a different annuity with smaller payments). Similarly, it appears that no part of the annuity payment can be rolled over, even though he could have purchased a longer-term annuity with smaller payments. Reg. § 1.402(c)-2, A-7(c).

10.2.11 ***One exception to the rules: "Qualified Longevity Annuities"***

Many retirees worry about running out of money in their later years. One solution is to hoard money (spend less) today because you might live beyond the average life expectancy. The problem with that solution is that it causes everyone to live below his possible standard of living even though not everyone will live long enough to have the problem.

The insurance industry's solution: For a lump sum payment that is relatively small while you are only in your 50s or 60s, buy an annuity now that doesn't start paying out until you reach your mid 80s. Such a "longevity annuity" enables you to spend more during your "young old years" without worrying that you will run out of money if you live too long. But that type of annuity could not, prior to July 2014, be purchased inside a traditional IRA (or other defined contribution/individual account plan, such as a 401(k) plan) because of the rule that payments under a plan-owned annuity contract must begin by the required beginning date (RBD) (generally approximately age 70½).

The IRS has ridden to the rescue. Under proposed regulations issued in 2012, as modified and finalized effective July 2, 2014, up to 25 percent of the participant's account balance (but not more than $125,000) can be invested in a "qualified longevity annuity contract" (QLAC) without violating the minimum distribution rules. See Regs. § 1.401(a)(9)-5, A-3, § 1.401(a)(9)-6, A-17. The $125,000 is subject to increases for inflation; it has been increased to $130,000 effective in 2018.

(A) Definition of a QLAC

Reg. § 1.401(a)(9)-6, A-17, defines the qualified longevity annuity contract. A QLAC:

- Must begin its payments no later than the first day of the month next following the 85th anniversary of the participant's birth. A-17(a)(2).

- Must satisfy all requirements applicable to annuitized defined contribution plans *other than* the requirement that payments must start by the RBD. A-17(a)(3). For detail on these other requirements, see Reg. § 1.401(a)(9)-6 and ¶ 10.2.10 above. The principal other requirements are (1) the rule that the contract must provide level payments paid annually (or more frequently) that do not increase (except within certain permitted limits, such as a COLA), (2) limitations on the survivorship benefit allowed, and (3) rules for how to compute the RMD with respect to the nonannuitized portion of the plan when only part of the account is "annuitized."

- May not provide a commutation benefit, cash surrender right, or other similar feature. A-17(a)(4).

- Must state that the contract is intended to be a QLAC. A-17(a)(6).

- Must not be a variable, equity-indexed, or "similar" contract except as may be later permitted by Treasury guidance. A-17(a)(7).

- Must limit death benefits as described below. A-17(c).

(B) Dollar and percentage limits on QLAC purchases

The amount paid for QLACs may not exceed the lesser of $125,000 or 25 percent of the account balance. A participant can buy multiple QLACs in his/her traditional IRA(s) provided the cumulative total premiums paid for them does not exceed these limits. Note the following details about these purchase limits. Citations are to subsections of Reg. § 1.401(a)(9)-6, A-17, unless otherwise noted.

✓ The $125,000 amount is to be adjusted upwards for inflation. A-17(d)(2)(I). It has been increased to $130,000 effective in 2018.

✓ Premiums paid for QLACs (or contracts intended to be QLACs) purchased in any other defined contribution plan for the participant's benefit are counted in applying the dollar limit. For example, if the participant spends $125,000 on a QLAC in her 403(b) plan account at work, she has used up her dollar limit and cannot buy any additional QLAC in the IRA. A-17(b)(2)(ii)(B).

✓ The 25 percent limitation is applied to the total account balance (including the value of any QLAC). Unlike the dollar limit, the percentage limit is apparently applied without regard to the account balance in other types of plans. A-17(b)(3). The Preamble to the regulation states that all traditional IRAs will be considered a single account for applying this limit, just as required minimum distributions taken from one traditional IRA can satisfy the distribution requirement with respect to other traditional noninherited IRAs owned by the same individual. See T.D. 9673 (7/2/14), Section II ("IRAs"), second paragraph. However, I cannot find this statement in the regulation itself.

(C) Roth IRAs

The limitations on purchases of longevity annuities do not apply to Roth IRAs during the owner's life. That's because there is no lifetime minimum distribution requirement applicable to a Roth IRA, therefore, buying an annuity that does not start payments until much later than age 70½ is "not a problem" for a Roth IRA. See § 408A(c)(5); Reg. § 1.408A-6, A-14(d).

Longevity annuities held in a Roth IRA are not considered QLACs and do not count when applying the 25 percent/$125,000 limit on QLAC purchases in the participant's traditional IRA. A-17(d)(3)(ii). This regulation also provides rules for applying the limits after a QLAC owned by a traditional IRA is converted to a Roth.

(D) Rules regarding death benefits under a QLAC

Since a QLAC is supposed to be insurance against living "too long," it makes no sense for the QLAC to provide a death benefit. The cost of providing a death benefit must necessarily reduce the true "longevity insurance" the contract can provide. But human nature being what it is, it seems that people only want to buy this product if it is heads I win tails you lose, so the regulation permits certain limited death benefits that can be provided in a QLAC. In general, the permitted death benefits must *either* be in the form of one of the following types of survivor annuity, *or*, alternatively, the contract can provide a "return of premium" guarantee-type death benefit *in lieu of* any survivor annuity. (The contract could also provide no death benefit at all.) A-17(c)(4).

✓ If the participant's surviving spouse is the sole beneficiary, the contract can provide a life annuity to the surviving spouse provided the annuity payments do not exceed the annuity payments the participant would have received. A-17(c)(1).

✓ If the participant died before the annuity starting date of his own annuity, a greater survivorship annuity to the spouse-sole beneficiary is permitted if necessary to satisfy the qualified pre-retirement survivor annuity (QPSA) requirements of § 417 [this would not apply to IRAs, which are not subject to this requirement], and the survivor annuity must commence no later than the annuity to the participant would have commenced had he lived. A-17(c)(1)(ii).

✓ If the participant's surviving spouse is not the sole beneficiary, the contract can provide a life annuity to the surviving beneficiary. If the beneficiary is the same age as, or older than, or not more than two years younger than, the participant, the maximum annuity is the same annuity the participant would have received. If the beneficiary is more than two years younger than the participant, the amount of the maximum survivor annuity is reduced per a table in the regulation. A-17(c)(2).

(E) Using QLAC to reduce (defer) RMDs

Like other "annuitized" portions of the IRA, the value of a QLAC is excluded from the account balance when determining the value of that account balance for purposes of computing the required minimum distribution from the nonannuitized portion of the account. See ¶ 10.2.10. This may create a minor planning opportunity for certain individuals:

Bob Example: Bob is nearing age 70½. Soon he will have to start taking required minimum distributions from his large traditional IRA. Because he is still working, his income (and his income tax bracket) are both high, so he is not feeling good about having taxable distributions from the IRA added onto that already-high income. By purchasing a QLAC now for $125,000, with payments to start at age 85, he removes $125,000 (plus the money that sum will hopefully earn in the future) from the account balance that is used to compute his required distributions. That should reduce his first year's required distribution by $4,000–$5,000 he figures, saving a couple thousand of income taxes annually. True, he is just postponing the problem, since his distributions will balloon after age 85, when the QLAC starts paying out. But by then he will be retired, he figures, so his income tax bracket will be lower.

10.3 Annuity Payouts from Plans: Putting It All Together

Which form of benefit should the participant choose? That extremely important decision should be made with the advice of a professional such as a financial planner or actuary. The answer depends on a variety of factors including the participant's health, other assets, income, and estate planning objectives, the circumstances of the beneficiary(ies), the financial health of the pension plan, and the degree (if any) to which the plan subsidizes one option or the other.

10.3.01 ***Drawback of nonspouse survivor annuities***

Retirees choose a life annuity to provide for their own living expenses in retirement and to protect against the danger of living too long, but are often loathe to accept the idea of the insurance company's (or plan's) gaining a "windfall profit" if the retiree dies prematurely. To avoid that result, a retiree may choose an annuity that provides benefits for a minimum guaranteed term. Or the participant may choose an annuity that provides a survivor annuity to his beneficiary, because he wants to provide an inheritance.

Providing a survivor benefit (either through a survivor annuity or through a guaranteed term) to a beneficiary who is not a charity and who is not the participant's spouse has gift and estate tax consequences. The value of the survivor benefit is included in the participant's estate with no offsetting marital or charitable deduction. The estate tax rules for valuing annuity benefits are considered unfavorable; see "The Booby Prize," by Noel C. Ice and Robert W. Goff, in *Trusts & Estates* (May 2006), p. 36. For this reason, a survivor annuity is not the best vehicle for wealth transfer for clients with taxable estates. There may also be a taxable gift involved, if the participant irrevocably elects a joint and survivor annuity with a nonspouse beneficiary.

The participant might better choose an annuity that provides the right level of income for himself (and his spouse, if any). If his plan benefits would provide a larger income than they need, the participant could take the excess as a lump sum distribution, roll that to an IRA, and leave *the IRA* to chosen beneficiaries as an inheritance, rather than leaving them an inheritance in the form of a survivor annuity, or a minimum guaranteed term, under the participant's annuity. This approach treats the annuity as something for the participant and spouse to consume during retirement, and as longevity insurance, and uses other assets for wealth transfer.

10.3.02 ***Illustrations: Different choices***

How do people choose among different forms of plan benefits? The best approach is to get professional advice; see factors discussed at ¶ 10.3.03. Here are examples of some of the approaches people consider.

Hugh, Stu, Lou, and Sue Example: Hugh, Stu, Lou, and Sue are all retiring from Acme Widget. The Acme DB Plan offers every type of annuity or term certain payout permitted by the RMD regulation (minimum term payout ten years), but does not offer the lump sum distribution option.

Hugh views his pension as an asset to be consumed during his life, with his other assets to be used for estate planning objectives. Since he plans to consume the pension, he doesn't mind if his premature death leaves his beneficiaries with no value from the plan; he doesn't intend them to have this particular asset in any case. Hugh chooses a single life annuity, which provides the largest payments to him.

Stu's main concern is to provide for his wife. He chooses a joint and 100 percent survivor life annuity with her as his sole beneficiary.

Lou is primarily interested in providing an inheritance for her children. She decides that the best way to do that is to take a life annuity (thus providing the largest possible payments to herself), and use those annuity payments to buy a life insurance policy (through an irrevocable trust, to keep the proceeds free of estate taxes) that will provide for her children in case of her death. Premature death would cause an economic loss under the annuity, but a gain under the insurance policy. With the combination of a life annuity and a life insurance policy, she has hedged away all risk of both premature death and living too long.

Unlike Hugh, Stu, Stu's wife, and Lou, Sue is not in good health. She would "lose" by choosing a life annuity payout, because she is likely to live less long than the "average" person her age. She is also uninsurable, so she can't use the life insurance technique Lou uses. She will choose a period-certain payout, the shortest one the plan offers so as to move the money out of the plan as quickly as possible. That way it is maximally available for her needs, or for estate planning moves such as lifetime gifts.

10.3.03 ***Expert tip: Subsidized plan benefits***

Often the retiree's decision is made complicated not merely by a variety of annuity offerings, but by the additional option of taking a lump sum distribution and rolling it over to an IRA instead of taking any annuity offered by the plan; and also by the issue of subsidized benefits.

The late Ed Burrows, who was a pension actuary and consultant in Boston, and President of the College of Pension Actuaries, liked to remind us that a retirement plan may subsidize certain options. Typically, for example, a plan may subsidize the joint and survivor spousal annuity option:

Parker Example: Parker is retiring. His plan offers him three options: a life annuity of $1,000 per month; a lump sum cash distribution of $X (which is the actuarial equivalent of a life annuity of $1,000 per month for a person Parker's age); or a joint and survivor annuity with his wife. In order for the joint and survivor annuity to be actuarially equivalent to the straight one-life annuity, the payment to Parker should be reduced to something less than $1,000, to reflect the addition of the survivor annuity. However, this particular plan (like the plan discussed in PLR 2005-50039) provides that a 60 percent survivor annuity can be provided for the participant's spouse *without any reduction of the participant's benefit* if the spouse is not more than five years younger than the participant. In effect the plan is offering Parker a "free" survivor annuity for his wife.

An early retirement pension is another type of benefit a plan might subsidize. For example, if Parker is 60 years old, and is entitled to a pension of $1,000 a month for life starting at age 65, the plan might offer him the choice of $1,000 a month for life beginning at age 60 (subsidized early retirement benefit) or a lump sum of $Y (the actuarial equivalent of the $1,000-a-month pension starting at age 65). If he takes the lump sum, he is giving up $60,000 (five years' worth of $1,000-a-month payments) and getting nothing in return.

Does this mean the participant should always choose the subsidized benefit, to avoid wasting money? No. If the participant is in poor health, or if the pension plan is in poor financial shape, any life annuity would be a "bad bet," even if it is subsidized. The point is not that one should always take the subsidized benefit; the point is that one should be aware which benefit forms, if any, are subsidized by the plan, in order to properly evaluate the choices. This point can be missed when (for example) a financial advisor who wants to manage the participant's money focuses only on the possibility of rolling over a lump sum distribution to an IRA, without evaluating the plan's annuity options.

10.3.04 ***More expert tips: How to evaluate choices***

How can the retiree tell the relative values of different benefit options? Fred Lindgren, Vice President and senior actuary with Fidelity Investments, points out that (since 2006) pension plans are required to tell retirees the relative values of the different options the plan is offering them. See Reg. § 1.417(a)(3)-1(c). This regulation, though it appears to deal with qualified annuity options that must be offered to married participants, also applies to unmarried employees.

Unfortunately, Fred says, the plan's use of different interest and mortality assumptions to calculate benefits and/or display the "relative values" of benefits (all as permitted by the IRS regulations) may create additional confusion. Accordingly, the participant should still seek outside help. A professional advisor acting on the retiree's behalf can evaluate the options using "apples to apples" comparisons, and can also consider the individual's own health and financial needs, and the financial health of the plan, factors the plan does not take into account in its "relative value" analysis. Fred also warns:

✓ **If you delay the start of your pension** (for example, because you are still working), will you get an increased pension when you eventually start taking payments, or are you giving up current monthly payments and getting nothing in return? In this situation, a "cash balance" plan would typically be more favorable than a "classic" DB plan.

✓ **If you want an annuity benefit:** Will the plan buy your annuity from an insurance company, or fund it directly from plan assets? If the latter, and your benefit exceeds the amount insured by the federal pension guaranty program, are you willing to take the risk of the plan's insolvency? Are you better off rolling over a lump sum to an IRA and buying the annuity in the IRA?

If the amount of benefits is not large enough to justify the fee for consulting a professional actuary, a "quick and dirty" method of evaluating the plan's annuity offerings is to compare the prices you would have to pay to purchase each option from an annuity company, *outside* the plan. You can obtain such annuity quotes (free) from the website www.immediateannuities.com.

10.3.05 ***Problems with the annuity rules***

Though the minimum distribution regulations assume that the world is divided neatly into annuities and nonannuity contracts, the insurance industry (in response to market demand) is busy developing more and more "hybrid" products: Contracts that provide guaranteed life income (like an immediate annuity) while preserving investment upside potential and capital access (like a nonannuity). Also, some annuity contracts sold today are combined with "long term care" benefits, so the annuity payout increases if the contract holder goes into a nursing home. Can a contract with that type of rider be purchased inside an IRA? The hybrids will challenge the IRS, plan administrators, and practitioners, as they try to figure out which set of rules governs each product.
that the deemed distribution resulting from the Current Insurance Cost is not subject to the penalty. IRS Notice 89-25, 1989-1 C.B. 662, A-11. For

10.3.06 ***The three valuation rules for annuity contracts***

Strangely, annuity contracts are valued in different ways for different purposes.

1. <u>RMD Valuation Rule for Annuity Contract Held in Plan</u>

See "PART B", ¶ 1.2.08(C), for how an annuity contract held inside a defined contribution (DC) plan is to be valued for RMD purposes.

Note: Variable vs. fixed annuities: An "annuity" is an arrangement under which one party (the issuer) is obligated to pay another (the annuitant) a series of periodic payments continuing for a certain period of time; see PART I, ¶ 10.2.02. In general, when this Report refers to an annuity, a fixed annuity is intended—one in which the payments in the series are fixed in amount—for example, $1,000 per month. However, there is another type of annuity: A variable annuity is similar to a "regular" annuity in that it represents an insurance company's promise to make periodic payments to the annuitant for life or a term of years. Under a variable annuity, however, the periodic payments are not fixed; they fluctuate in tandem with the performance of an investment portfolio. The valuation rules of Reg. § 1.401(a)(9)-6, A-12(a), apply to both kinds of annuity contracts if held in a DC plan. This section discusses "variable annuities" because those are the contracts that raise most of the valuation issues dealt with in the Regulation.

2. <u>Income Tax Treatment When a Contract is Distributed</u>

The distribution of an annuity contract (to either the participant or the beneficiary) is generally nontaxable, provided the annuity contract is nonassignable by the recipient. Reg. § 1.402(a)-1(a)(2). This includes a variable annuity contract. PLR 2005-48027. Instead, the recipient pays income tax on distributions received under the annuity contract.

3. Valuation of Contract for Roth Conversion Purposes

Until Roth IRA conversions came along, it made little difference how annuity contracts were valued upon distribution from a retirement plan, because distribution of an annuity contract is generally not a taxable event. See Rule #2. The arrival of the Roth IRA conversion changed the landscape. The lower an IRA-owned annuity contract can be valued when the IRA is converted to a Roth IRA, the less income tax the participant must pay on the conversion. Subsequent distributions from the annuity contract will go into the Roth IRA, distributions from which will be tax-free.

According to the IRS, "some advisers" sought to take advantage of this loophole, and marketed, to IRA owners, "a single premium annuity contract with significant artificial penalties that apply in the" early years, "causing the annuity to have a low cash surrender value…." The IRA owner would then convert his IRA to a Roth IRA, and report the contract's artificially low cash surrender value (CSV) as the gross income resulting from the conversion. T.D. 9220, 2005-2 C.B. 596, "Explanation of Provisions."

To stop such abuses, the IRS issued a temporary and proposed regulation providing that fair market value (FMV), not CSV, must be used to determine the participant's gross income resulting from conversion of an IRA-owned annuity contract to a Roth IRA, effective for conversions on or after (and perhaps even before) August 19, 2005.

Appendix A: Uniform Lifetime Table

Uniform Lifetime Table

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

This table must be used by all taxpayers to compute lifetime required distributions for 2003 and later years, unless the sole beneficiary is the participant's more-than-10-years-younger spouse. This table may not be used: by beneficiaries of a deceased participant (except in year of participant's death); or for years prior to 2002 (optional for 2002).

For each Distribution Year, determine: (A) the account balance as of the prior calendar year end; (B) the participant's age at the end of the Distribution Year; and (C) the Applicable Distribution Period (divisor) for that age from the above table. "A" divided by "C" equals the required minimum distribution for the Distribution Year. No distributions were required for the year 2009. § 401(a)(9)(H).

For full details regarding how to make these computations, see Chapter 1 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011).

Appendix B: Medicare “Income-Adjusted” Premiums for 2018 (Projected)

Under 42 U.S. Code §1395r(i)(3)(C), Medicare premiums are adjusted upwards based on the adjusted gross income of the covered individual. The Secretary of the Department of Health and Human Services is responsible for setting Medicare premiums based on inflation and other factors set out in the statute.

This chart shows the “income related adjustment” to Medicare premiums that is projected (as of August 2017) for 2018. Premiums will be based on adjusted gross income from the 2016 tax return. The projected *premiums* don’t change from the 2017 premiums—but the three income adjustments start at lower income thresholds, amounting to potentially substantial premium increases for anyone whose income stayed the same but who was moved into a higher bracket.

The effect is that a married couple with AGI of $321,000 in 2016 will pay $10,286.40 in Medicare premiums in 2018—$7,070.40 more than the couple with AGI of $170,000. In effect this is an additional 4.68% income tax on the couple’s additional $151,000 of income.

Your filing status and income in 2016....	Your filing status and income in 2016....	You pay in 2018....	You pay in 2018....		
Individual	**Married filing Jointly**	**Monthly Premium**	**Annual Premium**	Increase per person over prior tier	Increase for couple over prior tier
$85,000 or less	$170,000 or less	$134	$1,608.00	n/a	n/a
$85,001-$107,000	$170,000-$214,000	$187.50	$2,250.00	$642.00	$1,284
$107,001-$133,500	$214,000-$267,000	$267.90	$3,214.80	$964.80	$1,929.60
$133,501-$160,000	$267,001-$320,000	$348.30	$4,179.60	$964.80	$1,929.60
above $160,000	above $320,000	$428.60	$5,143.20	$963.60	$1,927.20

Theoretically the “income-related adjustment” for Medicare premiums of higher-income individuals is a reduction of the subsidy the federal government contributes to the program. Higher income people are supposed to get less of a “subsidy” than other Medicare participants.

Of course the government “subsidy” of the Medicare program is financed through the “Medicare” portion of the FICA tax on wages and self-employment income. A high-income individual would have paid the 2.9% (plus an additional .9% in recent years on income above a certain level) on (since 1994) an unlimited amount of compensation income. So she paid much much more IN to the Medicare system to get the same benefits as workers who earned less compensation income (and accordingly paid less Medicare tax). Then when she finally becomes eligible for Medicare she will *also* pay higher premiums for the same benefits received by those who paid less into the system.

Selma is single, age 70, enrolled in Medicare, and still working. She earned $500,000 of net self-employment income in 2016. On that amount of income she paid about $17,975 of Medicare tax, according to an online tax calculator (computing self-employment taxes is way too complicated to tackle for a seminar outline). Someone whose net compensation income was only $50,000 would pay only $1,339. Yet because she is high income Selma will pay $5,143.20 in Medicare premiums; the lower income individual pays only $1,608. Selma’s total cost this year for Medicare: Over $23,000. The other guy: $3,000.

Wouldn’t it be fairer to at least give Selma and other Medicare recipients who are still working a credit against their Medicare premiums for the taxes they are still paying into the system?

Appendix C: Proposed Changes in the Tax Law

The tax law as detailed in this Outline is subject to change at any time. The Outline is up to date only to the date on the front page.

On November 2, 2017, a bill entitled the "Tax Cuts and Jobs Act" was introduced in the House of Representatives. If enacted as written, this bill would reduce and eventually eliminate estate taxes, and would modify income tax rules by reducing tax rates for lower income levels while eliminating some deductions. For details on those proposed changes please consult other sources.

In addition to all general references to estate (and other transfer) taxes, and to particular income tax rates, statements in this outline on the following specific subjects would be rendered inaccurate to a greater or lesser degree if the Tax Cuts and Jobs Act is enacted as written. Unless otherwise noted, the following proposed changes made by the Tax Cuts and Jobs Act that impact statements made in this Outline would be effective January 1, 2018.

✓ The percentage-of-income limits on the itemized deduction for charitable gifts (§ 170(b) would be modified.

✓ "Recharacterization" of IRA contributions would no longer be permitted. This would eliminate the ability to "undo" (reverse) a Roth IRA conversion.

✓ § 68, which reduces the benefit of itemized income tax deductions for higher-income taxpayers, would be repealed.

✓ The income tax deduction for medical expenses (§ 213) would be eliminated.

✓ The "standard deduction" (§ 63(c)) would be increased.

The Tax Cuts and Jobs Act would *not* make any changes to the "minimum distribution rules," despite a number of legislative proposals in recent years to replace the life expectancy payout with a "5-year rule" for most retirement plan death benefits. Similarly, it would *not* impose required minimum distributions on Roth IRAs, another change that has been proposed in recent years.