THE Pension Digest

January, 2001
Published Since 1984

ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc.,
"The Pension Specialists"

Issuance of New Regulations Halted – Possible Impact on Proposed RMD Regulations

George W. Bush became President Bush at noon on January 20, 2001. He has temporarily halted the issuance of new and proposed regulations.

Such an act is fairly common for a new administration. President Bush wants to have his appointees review and decide if any changes are desired before a regulation becomes final.

This action does not appear to have an immediate impact on the proposed RMD regulations, because the RMD regulations were published in the Federal Register on January 17, 2001. The hearing and comment period set forth in the proposed regulation will apply. The regulation does authorize an IRA accountholder or beneficiary to use these proposed rules in 2001. We hope the new leaders of the IRS will agree that the proposed rules bring much needed simplification; such rules are nonpartisan and should be adopted essentially as proposed.◆

New RMD Rules for IRAs – as Proposed

On January 11, 2001, the IRS issued revised regulations for required minimum distributions (RMD's). For purposes of this article, these are called the "2001 rules." As is well known, the rules currently being applied are the "1987 rules." Everyone has believed the 1987 rules are too complex. For 2001, an IRA accountholder or beneficiary will be able to elect to use either the 1987 rules or the 2001 rules, even though the IRA plan agreement has not been amended to adopt the 2001 rules. The IRS has established the following tentative schedule to adopt final regulations. The IRS will accept written comments which are due by April 19; a public hearing is scheduled for June 1, 2001. The IRS is planning that the final regulations will be effective as of January 1, 2002.

RMD Rules Applying While the Accountholder Is Alive

The governing concept of the new 2001 rules is — there will be a uniform lifetime distribution period rather than a number of possible periods as under the 1987 rules. The table for determining the distribution period is produced later in this article. This table is identical to the former MDIB table. The required use of this table eliminates the need for an IRA accountholder to elect recalculation or nonrecalculation, to determine who is the beneficiary as of the required beginning date so that a single or joint life-expectancy factor can be determined and then compared to the MDIB factor, if applicable, and to apply the multiple beneficiary rules and change in beneficiary rules. There is one exception. As with the 1987 rules, the new table will not be used when the spouse is a sole beneficiary, and the spouse is more than 10 years younger than the accountholder. In this situation, the factor from Table VI will be used. The distribution schedule will be longer as measured by the joint life and last survivor life expectancy of the IRA accountholder and the spouse. The spouse is the sole designated beneficiary for purposes of determining the applicable distribution calendar year during the accountholder's lifetime if the spouse is the sole beneficiary of the accountholder's entire

Continued on page 2

New RMD Rules
Continued from page 1

interest at all times during the distribution calendar year.

The following formula is used to calculate the RMD for 2001 (and subsequent years): Balance as of preceding 12-31/factor from the new table based on age of accountholder.

The use of the new table will have the result that most IRA accountholders will see the amount of their RMD decrease. For others (i.e. those already using the MDIB table) the distribution amount will stay the same.

Example #1. Those individuals currently required to use a single life expectancy will be much better off using the 2001 rules. For example, an IRA accountholder, age 74, who is currently required to use a single life-expectancy factor because she had designated a college as her beneficiary, will be able to use the factor of 22.7 rather than 13.2 (using recalculation) or 12.0 (using nonrecalculation.) The RMD amount for 2001 will be substantially reduced.

Example #2. Those individuals currently using a joint life expectancy based on a beneficiary who is not more than 10 years younger will also be better off using the 2001 rules. For example, an IRA accountholder, age 74, with a 69-year-old spouse beneficiary will be able to use the factor of 22.7 from the new table, rather than 19.6 (using recalculation) or 19.1 (using nonrecalculation.) Again, the RMD amount will be smaller under the 2001 rules.

Note that for purposes of determining the amount of excise tax due under Code section 4974 (currently 50% of the amount required to be distributed but which was not distributed), the required minimum distribution is determined for any year based on the actual terms of the trust in effect during the year.

New Duty of IRA Custodians/Trustees to Report Required Minimum Distributions

The IRS has concluded that because the calculation has been simplified so much, an IRA custodian should be able to calculate and inform each IRA accountholder what his or her RMD is for a given year, and also inform the IRS. That is, the IRS is adopting the express rule that the IRA custodian has this new reporting duty. No longer will IRA custodians be able to beg-off and try to argue that it does not have any responsibilities for RMDs because that is the sole responsibility of the accountholder. We understand that many brokerage firms have adopted the "we have no responsibility" approach. This new reporting duty would exist even if an IRA accountholder had elected to use the alternative certification method and was taking his or her RMD from another IRA. The IRA custodian would also have to inform the accountholder that he or she is permitted to use the alternative certification method. The IRS has not yet settled on the reporting form which will need to be furnished by the IRA custodian and when it will need to be furnished. The IRS will be soliciting comments. One would expect that the IRS might add this requirement to the January statement requirement.

2001 RMD Rules after the Accountholder Dies.

Election of Surviving Spouse to Treat an Inherited IRA as Spouse's Own IRA.

The 2001 rules would make some substantial changes to the existing rules. In general, these 2001 rules favor the government in its tax collection role and are not "be kind to spouse rules," as were the 1987 rules and the original 1980 rules.

The most significant change is that the spouse's right to elect to treat the IRA as his/her own will exist only if the spouse is the sole beneficiary; also, the spouse must have an unlimited right to withdrawal from the IRA. The purpose of this rule change is to place a limit on the effectiveness of using the IRA within a QTIP.

The spouse's right to elect to treat the IRA as his/her own will exist only after the required distribution, if any, has been distributed with respect to the deceased accountholder's IRA, for the year of the accountholder's death. And, if the spouse who is electing to treat the IRA as his or her own is age 70½ or older, then he or she will be required to take his or her RMD before rolling over the remainder of the funds.

The 2001 regulation also provides that a spouse may elect to treat a decedent's IRA as his or her own by redesignating the IRA with his or her name as an owner rather than as a beneficiary.

Rules if the Accountholder Dies before His or Her Required Beginning Date

The IRS has decided to make some minor and some major changes to the application of the five-year rule and the life-distribution rule.

The default rule (i.e. the rule if not stated otherwise in the IRA plan agreement) is now the life-distribution rule rather than the five-year rule, if the accountholder has a designated beneficiary.

The default rule (i.e. the rule if not stated otherwise in the IRA plan agreement) remains the five-year rule, if the accountholder does not have a designated beneficiary.

In order for a nonspouse beneficiary (or a spouse beneficiary who is not the sole beneficiary) to satisfy the life-distribution rule, distributions must commence on or before December 31 of the year after the accountholder's death. Under the 1987 rules, the spouse's options did not depend on whether or not he or she was a sole beneficiary.

In order for a spouse beneficiary to satisfy the life-distribution rule, distributions must commence to the surviving spouse on or before the later of (1) December 31 of the year following the calendar year in which the accountholder died; or (2) December 31 of the year in which the accountholder would have attained age 70½.

The determination of the accountholder's designated beneficiary(ies) is made as of the last day of the calendar year following the calendar year of the accountholder's death. This is a major change. Under the 1987 rules, the

Continued on page 3

The Pension Digest

New RMD Rules
Continued from page 2

determination of who was the designated beneficiary(ies) was made as of the accountholder's required beginning date.

A special rule applies when the life-distribution rule applies to a spouse beneficiary. Distributions must commence to the surviving spouse on or before the later of (1) December 31 of the year following the calendar year in which the accountholder died; or (2) December 31 of the year in which the accountholder would have attained age 70½. If such a spouse dies before such date, then the proper designated beneficiary for determining the distribution period under the life-distribution rule is the designated beneficiary(ies) of the surviving spouse.

It will be possible for certain individuals who were designated as beneficiaries as of the date of death to not qualify as such by December 31 of the following year. They could disclaim their interest or withdraw all of their portion if they are not a designated beneficiary as of the December 31 of the year following the year of death, then their age will not be considered for purposes of determining the distribution period.

Since the determination of whether there is a beneficiary is determined as of the December 31 of the year after the accountholder's death, an individual may change his or her beneficiaries after his or her required beginning date.

The 1987 rule that only individuals may be designated as beneficiaries for purposes of the RMD rules is continued, as is the rule that if an entity other than an individual is designated as a beneficiary of an IRA, then the employee will be treated as having no designated beneficiary for RMD calculation purposes.

2001 Rules if the Accountholder Dies after His or Her Required Beginning Date

If the accountholder has a designated beneficiary as of December 31 of the year after the year of death, then the applicable distribution period for years after the year of the accountholder's death will be based on the remaining life expectancy of the accountholder's designated beneficiary determined as follows. If there is a nonspouse beneficiary, then the beneficiary's remaining life expectancy is calculated using the age of the beneficiary in the year following the year of the accountholder's death, reduced by one for each subsequent year. If the accountholder's spouse is the accountholder's sole beneficiary at the end of the year following the year of death, the distribution period during the spouse's life is the spouse's single life- expectancy factor. For years after the year of the spouse's death, the distribution period is the spouse's life expectancy calculated in the year of death, reduced by one for each subsequent year.

If the accountholder does NOT have a designated beneficiary as of December 31 of the year of death, then the applicable distribution period for years after the year of death is the accountholder's life expectancy calculated in the year of death. Use the accountholder's age as of the accountholder's birthday in the calendar year of the accountholder's death, and determine the applicable life-expectancy factor by referring to Table V. For subsequent years, reduce this factor by one for each elapsed year. Note the above rule replaces the rule which required an accountholder who had elected or defaulted into a single recalculation life-expectancy factor to have a total payout by December 31 of the following year.

MDIB Life Expectancy Table
For Determining Applicable Divisor

Age of the IRA Applicable Participant	Applicable Divisor	Age of the IRA Participant	Divisor
70	26.2	93	8.8
71	25.3	94	8.3
72	24.4	95	7.8
73	23.5	96	7.3
74	22.7	97	6.9
75	21.8	98	6.5
76	20.9	99	6.1
77	20.1	100	5.7
78	19.2	101	5.3
79	18.4	102	5.0
80	17.6	103	4.7
81	16.8	104	4.4
82	16.0	105	4.1
83	15.3	106	3.8
84	14.5	107	3.6
85	13.8	108	3.3
86	13.1	109	3.1
87	12.4	110	2.8
88	11.8	111	2.6
89	11.1	112	2.4
90	10.5	113	2.2
91	9.9	114	2.0
92	9.4	115 and older	1.8

2001 Rules for Multiple Beneficiaries

If, as of December 31 of the year of the accountholder's death, the accountholder has more than one designated beneficiary, and the account or benefit has not been divided into separate accounts or shares for each beneficiary, then the beneficiary with the shortest life expectancy is the designated beneficiary. This is consistent with the 1987 rules.

Additional Comments on the 2001 RMD Regulations for IRAs

I. The 2001 regulation has the following layout. We have changed the descriptions with the hope the descriptions more easily explain the subject matter of that section of the 2001 regulation.

A. Section 1.401(a)(9)-(O) – Table of Contents

Continued on page 4

New RMD Rules
Continued from page 3

B. Section 1.401(a)(9)-(l) – RMD Requirement, In general

C. Section 1.401(a)(9)-(2) – RMD's While Accountholder Is Alive

D. Section 1.401(a)(9)-(3) – RMD's once Accountholder Has Died

E. Section 1.401(a)(9)-(4) – Determination of the Designated Beneficiary

F. Section 1.401(a)(9)-(5) – RMD's from Defined Contribution Plans

G. Section 1.401(a)(9)-(6) – RMD's from Defined Benefit Plans

H. Section 1.401(a)(9)-(7) – Rollovers and Transfers

I. Section 1.401(a)(9)-(8) – Special Rules

J. Section 1.403(b)-(2) – Special rules for 403(b) Annuities and accounts

K. Section 1.408-(8) – RMD's for IRAs

L. Section 54.4974-2 – Excise Tax on Accumulations in IRAs and Pension Plans

II. Additional Discussion of Topics Related to the Effective Date

It is important to understand what the IRS has said so far in the 2001 regulation and what the IRS has not said.

The IRS has stated that the final regulations would apply for determining RMD's beginning in the 2002 calendar year, but RMD's for 2001 may be calculated using the new proposed regulations (i.e. the 2001 regulations) or the 1987 proposed regulations. To the extent final regulations are more restrictive, they will not be applied retroactively.

We believe the IRS' statements are clear as they apply to IRA owners. The new 2002 rules will apply to all living IRA accountholders on or after January 1, 2002, and the use of the old 1987 rules will no longer be possible.

They are not so clear as they apply to IRA beneficiaries; the IRS should clarify some issues. The IRS should make clear that the rules to be applied would be determined by use of the rules in effect as of the date of death of the IRA owner.

If the IRA owner dies in 2001, then an IRA beneficiary will have the choice of electing between the 2001 rules or the 1987 rules. Presumably the 2002 rules will be the same as the 2001 rules, but if not, the 2001 rules will be used.

If the IRA owner dies on or after January 1, 2002, then the IRA beneficiary will be required to apply the 2002 rules.

What is not so clear are the rules that apply if the IRA owner died before January 1, 2001. It appears that the 1987 rules will continue to govern, but this should be clarified. For example, an IRA accountholder died in 1999; he had designated his wife as one of four primary beneficiaries, and she originally elected to use the five-year rule, but she decides to treat this IRA as her own. Can she do so in 2001? The rules would seem clear she could. Can she do so in 2002? The proposed rules are not so clear in this situation.

III. IRAs are subject to the standard rules set forth in section 1.401(a)(9)-l to 8 plus the following special rules found in section 1.408-8.

A. The IRA custodian/trustee is substituted for the plan administrator and the IRA accountholder or grantor is substituted for the employee/participant.

B. Employer contributions under a SEP or a SIMPLE are treated as contributions to an IRA.

C. There is a special definition of the required beginning date for IRAs, but when one primarily works with IRAs, one tends to think of this as the standard definition. The required beginning date is April 1 of the year following the year the accountholder attains age 70½. This definition does differ from the definition for qualified plan purposes.

D. There is a special definition of the fair market value to use in the calculation of the RMD for IRAs. It is the preceding year's December 31 fair market value with very limited adjustments.

The standard rules (i.e. the QP rules) provide for a number of adjustments. The main one being – adding to such value any contributions designated for the prior year. The regulation seems to be clear (as was the 1987 regulation) that such adjustments are not to be made for IRAs. The reason for not making these adjustments seems to be for ease of calculation purposes, which seems to be a good reason. For whatever reason, the IRS, in writing its Publication 590 (Individual Retirement Accounts) the past few years, has chosen to adjust the balance. However, the December 31 balance will continue to be adjusted for outstanding rollovers (and transfers) as under the 1987 rules.

E. The IRS has chosen to modify the alternative method rules set forth in Notice 88-38. The rule is unchanged that the RMD must be calculated separately for each IRA which an individual owns. Such RMDs Must then be totaled, and such total may be taken from just one of the IRAs, or it can be taken from any combination of the IRAs. However, the IRS has created a new rule – only the RMDs of "like-kind" IRAs may be aggregated for purposes of this special distribution rule. Examples of "like-kind" IRAs;

1. Traditional IRAs of a person who holds them as an accountholder;

2. Traditional IRAs of a person who holds them as a beneficiary as long as related to the same deceased IRA accountholder (i.e. an inherited IRA);

3. Roth IRAs of a person who holds them as an accountholder;

4. Roth IRAs of a person who holds them as a beneficiary of the same deceased IRA accountholder (i.e. an inherited Roth IRA):

The regulation makes clear that distributions from

Continued on page 5

The Pension Digest

New RMD Rules
Continued from page 4

an IRA which is not of the same type may not be used to satisfy the RMD requirement of another type of IRA. For example, if John Doe inherits two IRAs from his dad and one IRA from his mom, then he may aggregate the two IRAs he inherited from his dad, but he may not aggregate these two with the IRA he inherited from his mom.

CWF Observation. The IRA regulation expressly discusses traditional IRAs, Roth IRAs and section 403(b) plans as being three different types; therefore the three may not be aggregated. The QP regulation states that this aggregation rule does not apply to QPs. There must be a separate distribution from each, and a distribution from an IRA can never be used to satisfy an RMD for a QP, or vice versa.

The regulation does not discuss how a SEP-IRA or a SIMPLE-IRA is to be treated for the application of these rules. This author believes that a SEP-IRA and a SIMPLE-IRA should and will be treated as any other traditional IRA. Thus, they may be aggregated with other traditional IRAs. The IRS should clarify this.

The regulation does not discuss as clearly as it should how this aggregation rule interrelates with the deadline rules for taking the distributions. The deadlines are April 1 of the following year and each December 31 thereafter. That is, the regulation should expressly state that RMDs may be transferred and do not need to be satisfied first.

CWF Comment. The regulation does not discuss as clearly as it should how this aggregation rule interrelates with the ability of one to transfer his or her IRA.

F. The rule that an IRA distribution, to the extent that it is a RMD, is not eligible to be rolled over remains unchanged.

The QP rule set forth in Q & A-7 of section 1.401(c)-2 is to be used to determine an IRA's RMD amount for this purpose.

The rule that all distributions from an IRA are considered to be RMDs until the total required distribution amount has been distributed has not changed.

However, the regulation makes clear that the aggregation rules will apply to this situation. That is, if an individual has two IRAs, IRA #1 with an RMD of $700 and IRA #2 with an RMD of $1100, and the individual wishes to roll over IRA #1 into a new IRA #3, then the individual must take (or be considered to have taken) her RMD amount of $700 before the rollover.

Note that the 2001 regulation no longer discusses the subject that impermissible rollovers of RMDs constitute excess contributions. The IRS should again discuss this topic.

G. The rules governing transferring funds from one IRA to another IRA have been changed drastically.

The 1987 rules provided that if one transferred an RMD, he or she then owed the 50% excise tax.

The 2001 rules do not provide for the assessment of the 50% excise tax in this situation.

The 2001 regulation sets forth the approach that the transferring of IRA funds will not affect the calculation of the RMD of either a transferor IRA or a transferee IRA. And because of the aggregation rules, the RMD amount may now be transferred. That is, there is no longer the rule that the RMD must be distributed before any amount may be transferred.

The IRA custodian/trustee which has the IRA as of December 31 will calculate the RMD for the upcoming year. It will notify the accountholder of the RMD amount. If an accountholder wishes to transfer an IRA amount, which includes an RMD, he or she is now free to do so.

CWF will be modifying its forms (transfer forms and the IRA plan agreement) so that an IRA custodian/trustee (whether the transferor or the transferee) may put an accountholder on notice that he or she is responsible to take his or her RMD and should not look to the IRA custodian/trustee if he or she fails to do so. The IRA accountholder should be given the opportunity to be distributed his or her RMD.

H. A surviving spouse will still be able to elect to treat his or her interest as a beneficiary in his or her deceased spouse's IRA as his or her own IRA. This is true even if distribution has commenced to the surviving spouse as a beneficiary. The effect of this election is that the surviving spouse's interest in the IRA is now subject to the RMD rules set forth in Code section 401(a)(9)(A) – the "while alive" RMD rules – and not the rules of Code section 401(a)(9)(B) which apply after the accountholder dies.

The 2001 regulation adopts restrictions that the 1987 regulation or prior regulation does not have.

A surviving spouse will most likely wish to use the 1987 rules for making his or her election in 2001 rather than the 2001 rules.

The surviving spouse makes such an election when he or she redesignates the IRA to be his or her IRA as an owner rather than as a beneficiary. Such election is also deemed made when, if at any time, he or she fails to take an RMD within an appropriate time period or he or she contributes any additional amounts to the IRA.

This redesignation concept is somewhat inconsistent with the concept that there needs to be a final Form 5498 for the decedent's IRA for the year of death. In some ways the redesignation concept is similar to the recharacterization concept. Reporting is required.

This election may only be made if the SPOUSE is the sole beneficiary of the IRA, and the spouse must have an unlimited right to withdraw funds from the IRA. This will mean the use of IRAs within QTIP trusts may be severely reduced. The application of

Continued on page 6

New RMD Rules
Continued from page 5

these rules to a QTIP trust is illustrated by the examples at the end of this section.

Within the last 6 years, the IRS had issued a number of private letter rulings which had taken a "be kind to spouse" approach. In those PLR's, the IRS had been posed with the following situation. The IRA accountholder had designated his or her revocable or irrevocable trust as the beneficiary of his or her IRA. However, because the surviving spouse was the sole trustee and sole beneficiary of this trust, the IRS had been asked if the surviving spouse could treat the decedent's IRA as his or her own. The IRS had said "yes." The IRS is now saying they will no longer say "yes." By definition, the naming of a trust or an estate as the IRA beneficiary will mean that the spouse has not been named as the sole beneficiary, and thus the right to "elect as own" will not be available.

The regulation also takes the approach that this election may be made by the surviving spouse only after the RMD for the year of the spouse's death has been distributed to such surviving spouse. In addition, if the surviving spouse is subject to the RMD rules himself or herself, then his or her RMD with respect to this IRA must also be distributed.

CWF Observation. We will be commenting to the IRS on this issue. It is certainly not settled under the 1987 rules that such distributions are required to be made. In fact, early IRS positions had been that such distributions were not required. This means a spouse may wish to use the 1987 rules rather than the 2001 rules.

In the past, the IRS has taken the position that the personal representative for a person who died during year, who was otherwise eligible to make a contribution, could not make such contribution because such right is personal and lapsed on his death.

One can certainly argue that the requirement to take a distribution under Code section 401(a)(9)(A) is also personal (i.e. not required by the estate of the decedent or by the beneficiary of the IRA) and ceases upon his or her death. We do acknowledge that Code section 401(a)(9)(B) may require a distribution to a beneficiary.

Applicable state law is to be used to determine if an individual is a spouse or a surviving spouse, and the determination of whether or not a person is a spouse or a surviving spouse is determined as of the date of the employee/participant's death.

IV. Determination of the Designated Beneficiary

The 2001 regulation makes clear that a designated beneficiary for RMD purposes must be an individual who is designated as a beneficiary under the terms of the IRA plan document. The IRA plan document may define who is or are the beneficiaries of the accountholder as long as identifiable, or the plan document may authorize the accountholder (or the accountholder's surviving spouse in one situation) to expressly specify who is the beneficiary.

Note, the regulation apparently limits who may designate beneficiaries to the accountholder or the accountholder's spouse when the surviving SPOUSE has elected to use the life-distribution rule. That is, the regulation does not expressly state that a beneficiary can designate a beneficiary, but this is discussed later.

To be a designated beneficiary, the designated person must be an individual who is entitled to a portion of the employee's benefit, contingent on the employee's death or another specified event.

The application of state law (i.e. intestacy law) does not make an individual a designated beneficiary for RMD purposes unless the plan document would define such person to be a be a beneficiary.

If an entity other than an individual is designated as a beneficiary, then, for RMD purposes, the employee is treated as not having a designated beneficiary. Under the 2001 rules, this lack of an individual as a beneficiary really has no impact on distributions to an accountholder while he or she is alive, but it will have implications after his or her death. In general, when there is not a beneficiary, then the distribution period applying after the accountholder's death will either be the five-year rule (if the accountholder died before his or her required beginning date), or the accountholder's remaining life expectancy if the accountholder died after his or her required beginning date.

The RMD regulation adopts a novel approach as to when the determination is made as to whether or not there is a designated beneficiary, and if so, who the beneficiary is for RMD purposes. The determination is to be made as of December 31 of the calendar year following the year of the accountholder's death. The determination is not made as of the accountholder's date of death, as had been the case under the 1987 regulation. An individual who is a beneficiary as of the date of death will not be a beneficiary for purposes of determining the distribution period which will apply for distributions to beneficiaries if he or she withdraws his or her portion or disclaims his or her interest.

A special rule applies when the surviving spouse is the accountholder's beneficiary, the life-distribution rule is being applied, and the spouse dies before distributions must commence (i.e. December 31 of the year the accountholder would have attained age 70½). In this situation, the surviving spouse will designate a beneficiary.

However, the determination date for RMD distribution period purposes will be the December 31 of the calendar year following the year of the surviving spouse's death. If there is not a beneficiary as of such date, then the distribution period applying after the surviving spouse's death will

Continued on page 7

New RMD Rules
Continued from page 7

the trust instrument are inconsistent with what has been furnished, as long as it was reasonable for the IRA custodian to rely on such information, and the actual trust is used for RMD purposes for the year after the mistake is discovered.

In summary, the 50% excise tax will need to be paid, but the plan will not be disqualified.

Examples of QTIP/Trust Situations:

1. John Doe maintains an IRA. He dies in 2001 at the age of 55. He had designated the trustee of his testamentary trust, (Trust P) established under his will, as his IRA beneficiary. His wife, Jane Doe, survives him and is age 51.

A copy of this trust was furnished by the December 31 deadline. The trust was irrevocable and was valid under state law. The IRA is includible John Doe's gross estate.

Under this trust, all trust income is payable annually to Jane Doe. No one has the power to appoint trust principal to any person other than Jane Doe. John Doe's children are the sole remainder beneficiaries of the trust. Jane Doe has the right, under the trust, to demand to have the trust distribute to her all income earned by the IRA. The IRA does not limit distributions to just the RMD amount. Thus, she will receive no less than the RMD amount, and will receive more if the income earned by the trust from the IRA assets is more than the RMD if she elects to be distributed the entire income.

The children must be considered for purposes of determining whether or not the spouse is the sole beneficiary, and for determining the distribution period.

Jane is the oldest, so she has the shortest life expectancy. She is not the sole beneficiary, as funds are clearly accumulated for the children. Thus, the life-distribution rule will be determined by using her age, and distribution must commence by December 31, 2002. Commencement as of the December 31 on which John would have attained age 70½ is not available.

2. The facts are the same as Example #1, except the trust instrument provides that all amounts distributed from the IRA to the trustee while Jane Doe is alive will be paid by the trustee directly to Jane Doe upon receipt. Thus, no IRA funds are accumulated for the children. In this case, Jane Doe is considered to be the sole beneficiary of the IRA. Distributions need not commence until December 31 of the year John Doe would have attained age 70½.

VI. Discussion of Assessment of Excise Tax Under Code Section 4974 and Regulation 54.4974-2.

The general rule is – a tax is imposed on the IRA accountholder or the beneficiary (i.e. the payee) to the extent he or she is distributed less than the required minimum distribution for such year. The amount of required distribution from an IRA is determined by use of the rules in 408(a)(6) or (b)(3) and section 1.408-8. The plan document should discuss these rules. If not, the default provisions of section 1.401(a)(9)-3 (A-4(a)) will apply.

As under the 1987 rules, the general rule is that the excise tax applies for each RMD year. There is an exception, however, for the first year, since the accountholder may wait until April 1 of the year after he or she attains age 70½. In this case the tax is assessed for the year containing the deadline of April 1.

The regulation has added the following rules.

If the five-year rule applies, then no amount is required to be distributed for purposes of assessing the excise tax, until the date five years after the accountholder's death.

If the entire account should have been distributed under the RMD rules, but was not, what is the RMD amount for future years? It is the entire amount.

As is also well known, Code section 4974 authorizes the IRS to may waive assessing and collecting the excise tax in certain situations.

The 1987 regulation provided, as the 2001 regulation now does, that this tax may be waived if the accountholder or beneficiary establishes, to the satisfaction of the IRS, that the shortfall was due to a reasonable error, and reasonable steps are being taken to remedy the shortfall.

The 2001 regulation, however, contains a new waiver provision; it is a type of safe-harbor provision.

The rule is – the excise tax will automatically be waived, unless the IRS determines otherwise, if: (1) the payee is an individual who is the SOLE BENEFICIARY and whose RMD is determined under the life-expectancy rule when the accountholder died before his or her required beginning date and (2) the beneficiary's entire benefit to which he or she is entitled is distributed by December 31 of the fifth year containing the anniversary of the accountholder's death.

The apparent purpose of this automatic waiver rule is – some beneficiaries entitled to use the life-distribution rule will miss one, two or three payments, and will owe the 50% excise tax. Such a beneficiary can now decide if he or she will be better off to use the five-year rule rather than the life-distribution rule. If so, the 50% excise tax is automatically waived.◆

This January Newsletter has been devoted to the subject of new rules for IRAs. A large portion of the February Newsletter will be devoted to new rules for qualified plans. The rules for qualified plans are similar to those of IRAs, but they are not identical. One major difference is that qualified plan documents will need to be amended before the new rules can be used. The IRS has furnished a model amendment to accomplish this task.◆