THE Pension Digest

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IRS Responds to 70-1/2 and Beneficiary Questions

On June 7, 1991 CWF wrote the IRS with questions regarding required minimum distribution payments for IRA accountholders and beneficiaries. The letter was originally addressed to Marjorie Hoffman, the chief writer of the proposed regulation, who is located in the national office. Her associate, Mr. Larry Heben called us in early July with the IRS responses.

We wish to emphasize that the IRS responded promptly to our request.

Question #1: Is the right of a surviving spouse to elect to treat the deceased spouse's IRA as his or her own, or to roll over the IRA funds, unlimited?

Stated another way: Can a spouse elect (or be deemed to have elected) either the five-year rule or the life distribution rule, and then later elect to treat the IRA funds as his or her own? The effect of this is would be to stop distributions until he or she must comply with the minimum distribution rules.

Could a spouse age 33, entitled to receive $100,000, take out substantially equal payments for 12 years and then elect to treat the remainder as their own? Again, the spouse has access to some of the money over a period greater than five years, but not all of the money, and he or she has avoided the 10% excise tax.

Mr. Heben's Response. The right of a surviving spouse to treat the deceased spouse's IRA as his or her own is unlimited. Thus, it can be made at any time even if distributions have commenced under one of the other distribution methods. The IRS still considers the regulation to be the primary authority for electing to treat as one's own. He stated that the IRS has an unwritten policy of trying to be as favorable to the surviving spouse as possible.

For those of you who use the Beneficiary Election form of Collin W. Fritz and Associates, Ltd., please be advised that we are modifying this form to clearly indicate that a surviving spouse can elect to treat the IRA as his or her own even if one of the other methods was originally elected.

Question #2. If the spouse beneficiary is past 70-1/2 when he or she establishes an IRA (elects to treat the deceased's IRA as his or her own) for the first time, what rules apply for determining the surviving spouse's required minimum distribution amounts for future years?

Example, assume an IRA accountholder dies at 75. His wife who is past 70-1/2 is his beneficiary. He had elected to use recalculation so she wants to treat his IRA as her own. She has never had an IRA. What beneficiary do you use for her? What is her required beginning date or deadline for making the elections?

Mr. Heben's Response. Although he hedged on his answer, he thought the required beginning date would be the December 31st after the year of death. Thus, the spouse would have until next year's December 31 to make the elections and to take his or her first required distribution.

Question #3. If a nonspouse beneficiary elects the life distribution option, when, if ever, would the 10% pre-59-1/2 excise tax apply if the beneficiary modified this schedule — took out more money?

Would it make any difference if the change took place during the five-year period? For example, a child beneficiary age 35 originally elects to have the IRA balance of $100,000 paid out to her using the life distribution rule. At age 46 she decides she needs more money from the account.

Would only the additional amount (total distribution amount less scheduled amount) be subject to income taxation and the 10% excise tax, or would the then entire account balance be subject to taxation? And would there be any type of look-back rule for purposes of the 10% excise tax?

Mr. Heben's Response. He indicated that the IRS' current position is that any beneficiary could speed up the distribution and not be subject to the 10% excise tax.

Question #4. When an accountholder attains age 70-1/2, he or she must take a required minimum distribution for that year. To calculate the required minimum amount, some elections are in order: single vs. joint life expectancy and recalculation versus nonrecalculation (one year reduction). Must the accountholder specifically elect single or joint or must he or she use the joint method for RMD purposes if there is a validly named beneficiary? The IRS Model Form seems to indicate that there is an election to be made but the regulation seems to infer that no election is necessary and that the joint factor is to be used if there is a validly named beneficiary.

Mr. Heben's Response. The joint factor automatically applies if the person has a qualifying beneficiary. The IRS form contains methods for taking distributions which will comply with

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IRA Legislation Continues to Loom

Overview

For the past two years IRA proponents have waited and hoped for substantial regulatory changes in IRA law that would expand the attractiveness and benefits of these plans to more American workers. Chief among the reasons for such reform is the stimulus it might give to the U.S. savings rate, which ranks far below its major industrialized trading partners and competitors.

There have been flurries of publicity and numerous bills proposed, each one with somewhat differing provisions. Liberalizing deductible contribution rules, or increasing accessibility or "distribution-without-penalty" options have been the major focal points of most such bills. Mixed in with these IRA proposals have been the Bush administration's efforts to ease capital gains taxes, and his proposed Family Savings Plan.

So far nothing significant has passed through the legislative/executive gauntlet to become law. Hope, then resigned pessimism, have become a pattern that has made many observers skeptical that meaningful IRA changes will take place in the near future. But still there are optimists who believe that landmark legislation is just weeks or months away.

Here is a recap of some of the legislative proposals aimed at revamping IRA regulations or providing an alternative savings vehicle, and their unique or shared provisions.

This review does not list bills aimed at minor simplifications, or bills for employer/business plans having limited IRA implications.

Bentsen-Roth Super-IRA (S.612)

* full tax deductibility of contributions for all taxpayers. Or...

* "back-ended" option for after-tax contributions, with NO tax on earnings if held in account five years

* penalty-free withdrawals for accountholder to pay for:

- first-time home purchase

- educational expenses

- catastrophic medical expenses

Analysis

As the legislation that has been "on the table" the longest, this bill has also had the greatest opportunity to be scrutinized and criticized for its cost in lost tax revenues, which the Joint Committee on Taxation has estimated at $25 billion over five years. Nevertheless, Bentsen says he will hold firm in supporting these changes, and will soon present his proposal for its funding.

Matsui IRA Proposal

Similar to aspects of Bentsen-Roth, except that:

* penalty-free withdrawals for higher education and first-home purchase apply not only to accountholder, but also to spouses, children or grandchildren.

Analysis

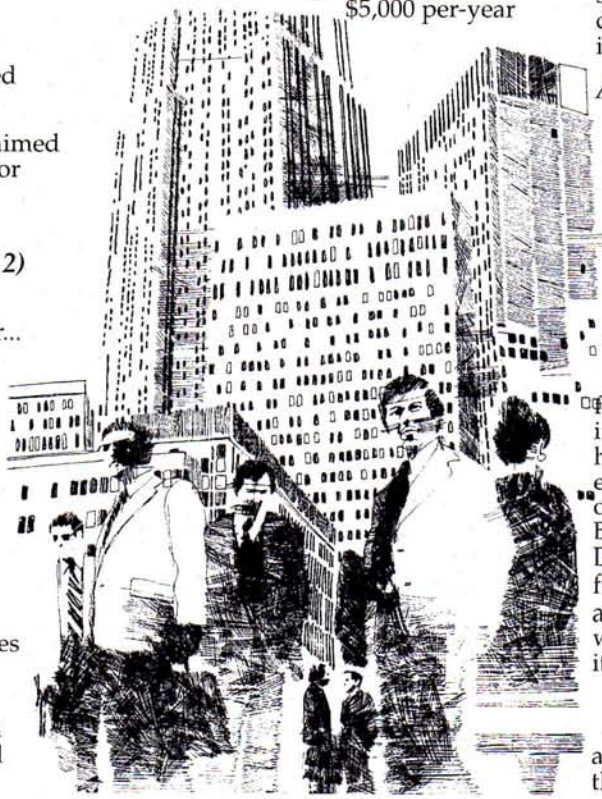
If one assumes that these IRA deposits would otherwise remain tax-sheltered and not be distributed, it can be argued that this is close to being a "revenue-neutral" piece of legislation. Matsui's proposal does not include expanding deductibility beyond current rules, the major price tag inflator of the Bentsen-Roth proposal.

Bush Administration Budget Proposal

Aspects that apply to IRAs include:

* penalty-free IRA withdrawals for first-time home purchase

* Family Savings Account (FSA) $5,000 per-year nondeductible contributions ($2,500 maximum per person) could be withdrawn tax-free including earnings after five years



D'Amato-Dodd Family Home Investment and Education Act (S.1680)

S.1680's provisions include the following, but are limited to **funds deposited prior to January, 1992**:

* An accountholder can direct their IRA assets into an equity investment (debt) for a first-time home purchase for a family member. Under existing rules, this would be a prohibited transaction, although such an investment can be made if the recipient is a non-family member. Such an investment is also more typical of a self-directed or trust-type IRA account, than the traditional custodial IRA account. Repayment period is 15 years.

* Accountholder can direct IRA assets into a higher education loan for a family member. The other comments on family eligibility for a home purchase (above) also apply. Repayment period is 10 years.

These loans would be repaid at interest rates at least equal to U.S. Treasury rates. If the account-holder should forgive repayment of either the principal or interest, such amounts would be treated as a distribution, subject to both 10% premature distribution tax, and regular income tax in the year distributed.

Analysis

Since this legislation – as now written – applies only to funds deposited before 1992, it can probably be labeled as the most "revenue-neutral" of the IRA reform bills. But as such, it does not provide an incentive for future deposits, and therefore will not positively impact the U.S. savings rate.

In addition to the accountholder and family members who would be eligible, its major benefits would be to the housing industry and to higher education institutions. In fact, an official of the National Association of Home Builders (NAHB) has asked Senator D'Amato to expand the bill to cover future deposits. But if these provisions are applied to future deposits, then it will cease to be revenue-neutral, which its author and supporters now claim.

The Pension Digest will continue to update you on the progress of these and other IRA legislative proposals in the weeks and months to come. PD

CWF Retirement Plan Conference a Success

The first annual CWF retirement plan conference held August 4-7 at Madden's Resort near Brainerd, Minnesota is now part of history, having been enthusiastically received by attendees from Iowa, Wisconsin, Minnesota, North Dakota, Louisiana and Vermont.

Fifteen selected retirement plan topics were covered in concurrent sessions during the conference, including IRAs, Simplified Employee Pensions and Qualified Plans, marketing, software for retirement plan administration, and a number of legal issues that pertain to financial institutions and the retirement plans they administer.

The topics were developed to enhance rather than to replace the content of the traditional day and half-day education programs held throughout the remainder of the year.

Madden's Resort on Gull Lake proved to be an exceptional site, both for its outstanding meeting rooms, accommodations and support services, and its unchallenged level of quality and variety in recreational offerings, including golf, boating, tennis, and many other recreational offerings.

1992 Conference Dates Announced

The 1992 summer conference has now been scheduled for August 9-12, and will again be held at Madden's Resort. Topics will be chosen and developed throughout the year, and finalized as these dates draw near.

For further information, please call 1-800-346-3961. PD

Pensions in Perspective

Dixie Lenz
St. Ansgar State Bank
St. Ansgar, Iowa

"The conference was terrific. We got so much out of it. Your instructors hit on the key issues in concentrated fashion, and the teaching materials were very good. It was a very well prepared program."

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"Your conference was very worthwhile. The discussions were in-depth, and it was possible to get beyond just "the book," to explore both the tendencies and the technicalities of the IRS. The variety of subjects was great, and your instructors were able to pass on important personal experiences and opinions."

Beneficiary Questions—*Continued from page 1*

the required minimum distribution regulations.

Question #5. Is there a difference in electing how you wish to have your funds paid to you versus the elections you make for purposes of calculating the required minimum distribution amount?

Mr. Heben's Response. Yes. An individual can use a joint life expectancy for purposes of determining what his or her required minimum distribution amount is, and then meet this requirement by calculating the actual payment amount using his or her single life expectancy factor. Obviously, the amounts to be paid must equal or exceed the RMD or the 50% excise tax will be due.

Question #6. Does the required minimum distribution amount need to be paid out if the accountholder died before he or she was paid the RMD for that year? How do the before death and after death rules interrelate?

For example, an IRA accountholder age 73 dies on June 1, 1991. She had not yet taken her required minimum distribution. Her spouse is the sole beneficiary. The account balance is $35,000. Her required minimum distribution amount for 1991 is $1,300. Must the $1,300 be distributed to him or his estate? To whom would you generate the Form 1099-R? How much of the $35,000 could he roll over or elect to treat as his own?

Mr. Heben's Response. We are somewhat uncomfortable with his response. He cited the "be nice to surviving spouses" rule and letter ruling 8823045 for the authority that a surviving spouse could elect to treat the entire balance as his or her own and would not be required to withdraw the required minimum of the decedent for the year of death. We indicated to him that we thought there were some other private letter rulings which took a different position. He indicated that as far as he knew 8823045 was still thought to be controlling by his branch of the IRS.

Question #7. Is the MDIB rule/method only applicable while the accountholder is alive, and its use terminates on the death of the accountholder? Or, does its use affect in any way the options which a nonspouse beneficiary would have?

For example, an accountholder age 70-1/2 has named his son, age 35, as his only beneficiary. Therefore, the RMD will be determined by use of the MDIB method. The accountholder dies two years later. The son beneficiary must now continue the distribution method as established by the accountholder. But under the regular method or the MDIB method?

Mr. Heben's Response. The proposed regulation clearly states that the MDIB method is only used while the accountholder is alive. This illustrates why an IRA custodian cannot be lazy and say "I don't need the election (recalculation versus nonrecalculation) because the MDIB method applies." This election will be needed once the accountholder dies.

Question #8. In the above situation, what should be the consequence once the son beneficiary dies? When must the funds be paid out to the son's estate? By December 31st of the year of death, or by December 31st of the following year.

Mr. Heben's Response. He thought the answer to be December 31st of the following year, but he was not totally sure. We are awaiting further clarification.

We hope that this summary of our discussion with Mr. Heben of the IRS concerning 70-1/2 and beneficiary questions is helpful to you. PD

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