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BENEFICIARY DESIGNATION FOR RETIREMENT PLANS

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These materials will focus on critical issues to address in beneficiary designation and estate planning for IRAs and retirement plan benefits from §401(a) qualified plans ("qualified plans") and individual retirement accounts ("IRAs"). For the most part, planning applicable to an IRA will apply equally to §401(a) qualified plan benefits. However, distribution options available under a qualified plan following the death of a plan participant will many times be more restrictive than those available through an IRA. In addition, distributions under a qualified plan could be accelerated by the employer's termination of the qualified plan which could occur upon the sale or merger of the employer or at the employer's own business determination. This could create problems after the participant's death for a beneficiary that is not a spouse (including a trust for the spouse), because only the spouse can make a tax free rollover of benefits from a qualified plan to an IRA. As a result, it is often better for estate planning purposes and distribution deferral purposes to recommend that a participant roll benefits out of an employer's qualified plan and into a rollover IRA in the name of the participant during the participant's life. Because of this, these materials will focus on planning primarily within the context of an IRA. However, this same planning can be implemented also in the context of a qualified plan (at least for individual account plans), provided that the qualified plan permits it.

Like qualified plan benefits, IRAs are subject to federal income tax upon distribution, and are subject to minimum required distribution ("MRD") rules under IRC §401(a)(9), as well as federal estate taxation. In addition to the MRD rules and federal income tax rules, it is significant to note that individual states have laws that sometimes affect compliance and administration of an individual's IRA. Furthermore, the institution sponsoring the IRA as trustee or custodian will have its own rules and administrative polices that can affect the IRA beneficiary designation planning and implementation.

I. The Minimum Required Distribution ("MRD") Rules.

The MRD rules are provided by statute under §401(a)(9) of the Internal Revenue Code ("IRC"), which become applicable to an IRA under IRC §408 and the Treasury regulations thereunder.

A. Distributions Commencing During A Participant's Lifetime.

The beneficiary designation put in place for an IRA owner will have no effect on MRDs to the IRA owner during his or her life. An IRA owner is required to commence receiving MRDs no later than the IRA owner's required beginning date ("RBD"). Treasury Regulation §1.401(a)(9)-2, A-1. An IRA owner's required beginning date ("RBD") with respect to an IRA is April 1 following the close of the calendar year in which he or she attains the age of 70½ years. Treasury Regulation §1.401(a)(9)-2, A-2, A-3 This RBD deadline is not subject to any extension.

MRDs are determined on a calendar year basis (a "distribution calendar year"). The first distribution calendar year is actually the calendar year in which the IRA owner attains age 70½, despite the fact that he or she is given a grace period until April 1 of the next calendar year (i.e., the IRA owner's RBD) to receive the MRD for the first distribution calendar year. MRDs for each subsequent distribution calendar year must be made by December 31 of such year. Treasury Regulation §1.401(a)(9)-5, A-1.

With one exception, for MRDs during the IRA owner's lifetime, for all distribution calendar years up to and including the distribution calendar year that includes the IRA owner's date of death, use the Uniform Lifetime Table, using the IRA owner's attained age in the distribution calendar year (or the age the IRA owner would have attained had he or she lived throughout the distribution calendar year for the year of death). Treasury Regulation §1.401(a)(9)-5, A-4(a). The Uniform Lifetime Table provides joint and survivor life expectancy distribution factors based upon the age of the participant and a hypothetical beneficiary who is ten years younger than the IRA owner, redetermined each year beginning after the first distribution calendar year. Treasury Regulation §1.401(a)(9)-9, A-2.

There is one exception to the required use of the Uniform Distribution Table for MRDs during the life of the IRA owner who is married with a spouse who is more than ten years younger. In that case, the IRA owner may elect to instead use the MRD factor based upon the longer joint and survivor life expectancy of the IRA owner and spouse contained in a separately published Joint and Last Survivor Table. Treasury Regulation §§1.401(a)(9)-5, A-4(b), 1.401(a)(9)-9, A-3.

Recalculation is always available for each distribution calendar year for distributions up to and including the distribution calendar year that includes the IRA owner's date of death. Treasury Regulation §1.401(a)(9)-5, A-4.

MRDs for a distribution calendar year are calculated on the value of the IRA as of the December 31 of the immediately preceding calendar year. Treasury Regulation §1.401(a)(9)-5, A-3.

B. <u>Distributions After The Participant's Death</u>.

1. <u>Single Life Table</u>. A designated beneficiary of a deceased IRA owner may receive distributions over the life expectancy of such designated beneficiary. Treasury Regulation §1.401(a)(9)-5, A-5. Life expectancy of the designated beneficiary is determined using the Single Life Table published in the Final Regulations. Treasury Regulation §1.401(a)(9)-5, A-5(c). The beneficiary's life expectancy is determined using the age of the beneficiary at his or her birthday in the year following the year of the IRA owner's death. For a designated beneficiary who is not the IRA owner's spouse, such life expectancy factor is then reduced by one for each subsequent distribution calendar year. In order for a beneficiary who is not the spouse of the IRA owner, to use the Single Life Table, MRDs must commence to the designated beneficiary by no later than the December 31 of the calendar year immediately following the calendar year in which the IRA owner's death occurs. Treasury Regulation §1.401(a)(9)-5, A-3(a). This is the first distribution calendar year for the beneficiary.

2. Death On or After RBD. If the IRA owner dies on or after his RBD, and the beneficiary is older than the deceased IRA owner or the IRA owner does not have a designated beneficiary, the MRD under the Final Regulations can instead be the remaining life expectancy factor of the deceased IRA owner under the Single Life Table, determined at the age he or she attained or would have attained on his or her birthday in the year of death, and reduced by one for each calendar year that has elapsed after the calendar year of the IRA owner's death. Treasury Regulation §1.401(a)(9)-5, A-5(a)(2). This again requires that the MRDs commence no later than December 31 of the calendar year immediately following the calendar year in which the IRA owner dies.

3. Death Prior To RBD. Where the IRA owner dies prior to his or her RBD, with a designated beneficiary, the MRDs to the beneficiary will still be based upon the beneficiary's life expectancy at his or her birthday in the year following the year of the IRA owner's death utilizing the Single Life Table and reduced by one for each subsequent distribution calendar year. Treasury Regulation §1.401(a)(9)-5, A-5(b). This again is predicated upon the beneficiary's commencing receipt of MRDs by no later than December 31 of the calendar year immediately following the calendar year in which the IRA owner dies. However, if the IRA owner dies before his RBD and does not have a designated beneficiary, or the designated beneficiary elects not to use the life expectancy rule, then the IRA must be completely distributed by no later than December 31 of the fifth calendar year after the year in which the IRA owner's death occurs. Treasury Regulation §1.401(a)(9)-3, A-4.

C. Determination Of The Designated Beneficiary.

In most situations, the IRA owner names a beneficiary pursuant to a beneficiary designation form. If no such form is in place, the provisions of the IRA account agreement will usually provide a default beneficiary. Treasury Regulation §1.401(a)(9)-4, A-2. For purposes of the MRD requirements, the "designated beneficiary" is limited by definition in the Treasury Regulations. A designated beneficiary is a living individual who is designated as a beneficiary under the IRA who is entitled to a portion of the participant's IRA, contingent on the IRA owner's death. Treasury Regulation §1.401(a)(9)-4, A-1. Although it may be a distributee of IRA benefits, neither the IRA owner's estate nor a charity is a "designated beneficiary" for MRD purposes inasmuch as it has no measurable life expectancy. Treasury Regulation §1.401(a)(9)-4, A-3. Some trusts may qualify under the trust "look through" rules, but many will not.

1. Expandable or Contractible Class of Beneficiaries. A designated beneficiary need not be specified by name, so long as the individual is identifiable under the IRA. Members of a class of beneficiaries capable of expansion or contraction (for example, "my children, or their descendants, per stirpes") will be treated as being identifiable if it is possible, to identify the class member with the shortest life expectancy at the beneficiary determination date. Treasury Regulation §1.401(a)(9)-4, A-1.

2. Multiple Beneficiaries – Oldest Beneficiary. If there are multiple beneficiaries, the life expectancy factor of the beneficiary with the shortest life expectancy (i.e.,

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