



# WRMarketplace

An AALU Washington Report

The *WRMarketplace* is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led **by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirius, and Rebecca Manicone.** *WRMarketplace #17-07* was written by **Greenberg Traurig Shareholder Jonathan M. Forster.**

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**TOPIC: Fundamentals of Required Minimum Distributions: 7 Things You Must Know.**

**MARKET TREND:** Retirement plan participants and IRA holders frequently seek to maximize deferral of their benefits but must comply with Internal Revenue Code (“Code”) limits.

**SYNOPSIS:** To ensure that qualified plans and IRAs are used for their intended purpose of funding retirement income, and not as estate planning tools, the Code provides that plan participants, IRA holders, and beneficiaries take required minimum distributions (“RMDs”) when the participant or IRA holder reaches a certain age or after he or she dies.

Failure to take the full RMD for any year can cause the imposition of a 50% excise tax on the shortfall against a participant, IRA holder, or beneficiary.

**TAKE AWAYS:** Consultants to clients who are at or approaching age 70  $\frac{1}{2}$  and who have significant retirement plan and/or IRA accounts should ensure that they are familiar with the basic rules governing RMDs so they can ensure that these clients are not hit with an extremely harsh 50% tax penalty.

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As IRAs and qualified retirement plans can make up a significant portion of the net worth of many individuals, below are seven things retirement plan participants, IRA holders, and beneficiaries should know about RMDs.

### ***1. WHEN RMDs MUST BE TAKEN DURING LIFE***

During the life of a plan participant, RMDs generally must be taken for the calendar year in which the participant attains age 70  $\frac{1}{2}$ , or, if later, the year in which he or she retires, and each year thereafter. For IRA holders (other than Roth IRA holders<sup>1</sup>) or 5% owners of an employer sponsoring a qualified plan, RMDs must begin for the year in which the holder or participant attains age 70 $\frac{1}{2}$ , regardless of retirement status. The deadline for taking the first RMD is April 1 of the year following the year for which the first RMD is required (e.g., if the first RMD is due for 2016, it must be taken by April 1, 2017). Each subsequent RMD must be taken by December 31 of the year for which it is required.

- ***Practical Note:*** To avoid dealing with RMD compliance, which can affect the qualified status of a plan, many retirement plans require a participant to take a complete distribution of his or her account balance at the later of the time he or she terminates employment and the date he or she reaches normal retirement age under the plan (generally age 65).

To avoid taking two RMDs in the first year, and thereby possibly pushing oneself into a higher tax bracket, an individual may wish to take the first RMD by December 31 of the year for which the first RMD must be taken, rather than waiting until the following April 1.

**Example:** Amy is required to take the first RMD of \$15,000 from her IRA for 2016. If she waits until April 1, 2017 to take it, and then takes her second RMD of \$14,000 by December 31, 2017, she will have \$29,000 of income in a single year (2017), rather than spreading the RMDs out over two years.

The determination of the timing and amount of RMDs that must be taken after the death of a plan participant or IRA holder depends on whether RMDs had begun before death and who the designated beneficiary of the plan account or IRA is. These rules are discussed in greater detail at #6 below.

## **2. HOW RMDs ARE CALCULATED**

For each year, the RMD is calculated by dividing (1) the balance in the plan account or IRA as of the preceding December 31 by (2) the applicable life expectancy established under one of three tables published under Treasury Regulations issued for Code §401(a)(9) or in IRS Publication 590-B, as follows:

- **No designated beneficiary.** The “Single Life Table” applies.
- **Multiple beneficiaries or sole designated beneficiary is a non-spousal beneficiary or is a spouse less than 10 years younger than the participant or IRA holder.** The “Uniform Lifetime Table” applies (based on the joint life expectancies of a person and another person who is ten years younger).
- **Sole designated beneficiary is a spouse more than 10 years younger than the participant or IRA holder.** The “Joint and Last Survivor Table” applies.

## **3. WHO CAN BE DESIGNATED BENEFICIARIES**

An individual's designated beneficiary is generally the person(s) designated as such under the terms of the plan document or IRA contract. Generally, only an individual can be a designated beneficiary for RMD purposes. Thus, if a participant or IRA holder were to designate his estate as the beneficiary of his plan account or IRA, the participant or IRA holder would be treated as having no designated beneficiary for RMD purposes.

Notwithstanding this general rule, if a trust is designated as the beneficiary of a retirement plan account or an IRA, the individual beneficiaries of the trust will be considered designated beneficiaries for RMD purposes if: (a) the trust is a valid trust under state law, or would be but for the fact that there is no corpus; (b) the trust is irrevocable or will, by its terms, become irrevocable upon the death of the plan participant or IRA holder;

(c) the beneficiaries of the trust who are beneficiaries with respect to the plan account or IRA are identifiable from the trust instrument; and (d) documentation specified in applicable regulations and/or required by the plan administrator or IRA trustee or custodian is provided to such plan administrator or IRA trustee or custodian.

#### **4. HOW CALCULATION AND DISTRIBUTION OF RMDs FROM MULTIPLE PLANS DIFFERS FROM MULTIPLE IRAs**

If an individual is required to take RMDs from more than one qualified plan, the RMD for any year must be calculated separately for each plan and taken from the plan for which it was calculated. In contrast, if an individual is required to take RMDs from multiple IRAs, the amounts due from each IRA can be aggregated and taken from one or more IRAs, so long as the amount distributed in the year at least equals the aggregate amount of RMDs due from ***all IRAs***.

***Example:*** Assume that, in 2017, John is age 73 and his wife is age 60. John has, as of December 31, 2016: (1) an account balance of \$100,000 in Employer A's 401(k) plan, (2) an account balance of \$250,000 in Employer B's 401(k) plan, (3) \$50,000 in IRA X, (4) \$150,000 in IRA Y, and (5) \$150,000 in IRA Z. John's wife is the designated beneficiary of his accounts under the two 401(k) plans and IRA X, while his 40-year-old son is the designated beneficiary of IRA Y, and his 36-year old daughter is the designated beneficiary of IRA Z. For 2017, John's RMDs are determined as follows:

- For each of the 401(k) plans and IRA X, John must divide the account balance in each of those vehicles by 26.8, which is the joint life expectancy shown in the “Joint and Last Survivor Table” for two people, age 73 and age 60. Thus, John’s RMD for Employer A’s 401(k) plan is \$3,731.35 ( $\$100,000/26.8$ ), for Employer B’s 401(k) plan is \$9,328.36 ( $\$250,000/26.8$ ), and for IRA X is \$1,865.68 ( $\$50,000/26.8$ ).
- For IRA Y and IRA Z, John must divide the account balance in each by 24.7, which is the distribution period shown in the “Uniform Lifetime Table” for an individual who is age 73. John’s RMD attributable to each of IRA Y and IRA Z is \$6,072.88 ( $\$150,000/24.7$ ).

John must take a distribution of \$3,731.35 from Employer A’s 401(k) plan and \$9,328.36 from Employer B’s 401(k) plan. From his three IRAs, John must take a distribution of \$14,011.44 ( $\$1,865.68 + \$6,072.88 + \$6,072.88$ ), but he can take the total amount from any one or more of the IRAs, in any combination.

## **5. HOW DISTRIBUTIONS IN EXCESS OF RMDs ARE TREATED**

A participant or IRA holder is always free to take out more than the amount of his RMDs for any year. However, the participant or IRA holder **gets no credit for distributions in excess of the RMD for the purpose of calculating RMDs for subsequent years.**

## **6. HOW RMDs ARE CALCULATED AFTER A PARTICIPANT OR IRA HOLDER DIES**

As noted above, RMDs that must be taken after the death of a plan participant or IRA holder are determined based on whether RMDs had begun before death and the identity of the designated beneficiary of the plan account or IRA.

**Death Before RMDs Commence:** The RMD rules will be satisfied if the entire account balance is distributed to the designated beneficiary by December 31 of the year containing the fifth anniversary of the participant’s or IRA holder’s death. Alternatively:

- ***If spouse is sole beneficiary:*** The surviving spouse can wait until the participant or IRA holder would have attained age 70 1/2 and then begin RMDs using the surviving spouse's life expectancy. In the case of an IRA, the surviving spouse can elect to treat the IRA as his or her own and take RMDs following his attainment of age 70 1/2.
- ***If there is a non-spousal beneficiary or multiple beneficiaries:*** RMDs must commence by the end of the calendar year following the year of the participant's or IRA holder's death and are calculated using the beneficiary's life expectancy. If there are multiple beneficiaries, RMDs are calculated using the life expectancy of the oldest beneficiary.

**Death After RMDs Commence:** Regardless of the designated beneficiary's identity, post-death RMDs are generally calculated using the longer of the participant's or IRA holder's life expectancy (as if he or she had remained alive) or the designated beneficiary's life expectancy. A surviving spouse, however, may elect to treat an IRA as his or her own and take RMDs following his or her attainment of age 70 1/2.

## **7. THE CONSEQUENCES OF FAILING TO TAKE RMDs**

An individual who fails to take the full amount of any RMD is potentially subject to an extremely stiff penalty. Specifically, in addition to the ordinary taxes that may be owed on the amount distributed, the individual will also be ***subject to an excise tax of 50% of the amount that should have been distributed but was not.*** For example, if the RMD required for a year was \$100,000, and the participant, IRA holder, or beneficiary only received distributions of \$20,000 during the year in which the RMD is due, he or she would be subject to an excise tax of \$40,000 (50% of (\$100,000 - \$20,000)).

### **TAKE AWAYS**

Consultants to clients who are at or approaching age 70 1/2 and who have significant retirement plan and/or IRA accounts should ensure that they are familiar with the basic rules governing RMDs so they can ensure that these clients are not hit with an extremely harsh 50% tax penalty.

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## **NOTES**

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<sup>1</sup> RMDs are required from Roth 401(k) plans during the life of a participant, but they are required from a Roth IRA only after the death of the IRA holder.