

## **HOW IS THE REMAINING BALANCE IN A TRADITIONAL IRA PAID OUT AFTER THE LAST ACCOUNT BENEFICIARY DIES?**

Although many individuals fear they (and their beneficiaries) will outlive distributions from their traditional IRAs, the reverse is an equally likely scenario if an IRA holds substantial assets. There may be a balance remaining in the traditional IRA after the death of the account owner and the death of the last beneficiary of the IRA. What happens to the account balance? It may be paid to the estate of the last beneficiary of the IRA or perhaps it will be distributed to those individuals (or institutions) named by the last beneficiary to inherit the account balance. Key question: What is the maximum length of time over which the remaining IRA balance can be distributed? The longer the payout period, the longer the IRA continues to generate tax-deferred earnings. Additionally, if the IRA balance is substantial, staggering payouts over a period of years could result in a lower overall tax than would be paid if the amount were distributed in one lump sum.

### **DIGGING INTO THE PAST**

The planner will have to do some forensic research and determine how the original IRA owner calculated his required minimum distributions (RMDs), which commenced no later than his required beginning date (April 1 of the year following the year in which he attained age 70-1/2). In many instances, the IRA owner's RMD method will determine how the remaining balance in the IRA can be paid out. In some cases, however, the determining factor will be the way payouts were made to the designated beneficiary of the IRA.

### **BACKGROUND ON REQUIRED MINIMUM DISTRIBUTIONS**

Required minimum distributions must be taken, in accordance with regulations, over the account owner's life or the lives of the account owner and a designated beneficiary or over a period not extending beyond the life expectancy of the account owner or the life expectancy of the account owner and a designated beneficiary.

If the account owner dies after required distributions have begun but before his entire interest is distributed, the remaining account balance must be distributed at least as rapidly as under the method of distribution that was being used until that point.

IRA owners can choose between two basic methods in figuring their required minimum distributions:

- (1) the term-certain method, or
- (2) the recalculation method.

Under the term-certain method, distributions for the first year are figured using the account owner's life expectancy (or the account owner and designated beneficiary's joint life expectancy) from tables in the regulations. In each succeeding year, distributions are figured by subtracting one from the originally determined life expectancy. Thus, distributions will not extend beyond the originally determined life expectancy.

Under the recalculation method, the life expectancy tables in the regs must be used each year to determine the account owner's life expectancy (or the account owner and his spouse-beneficiary's joint life expectancy) instead of subtracting one year from the originally determined life expectancy. The recalculation method can't be used for a non-spouse beneficiary's life.

Here's a review of the basic permutations, assuming in each case the IRA owner died after he attained his required beginning date and began taking non-annuity-type payouts.

#### **SITUATION #1 – RMDS OVER JOINT AND LAST SURVIVOR LIFE EXPECTANCIES OF IRA OWNER AND SPOUSE-BENEFICIARY USING RECALCULATION METHOD**

If the IRA owner died first, payments continued to his spouse-beneficiary based on the spouse's life expectancy alone, and were recalculated each year to reflect the spouse's changed life expectancy. Any amount remaining in the IRA account when the spouse dies must be paid out no later than the end of the year following her death. Reason: Upon the death of the IRA owner (or his spouse), the recalculated life expectancy of the owner (or spouse) is reduced to zero in the year following the year of death. When the last applicable life expectancy is reduced to zero (when both IRA owner and spouse have died), the entire remaining IRA balance must be distributed before the end of that year.

In this situation, consider withdrawing part of what remains in the IRA in the year of the spouse-beneficiary's death and withdrawing the balance in the following year. Doing this will often result in the IRA balance being taxed at a lower average rate.

This result could have been avoided had the spouse chosen to treat the IRA as his or her own following the IRA owner's death. This way, the spouse could have named his or her own beneficiaries and chosen a separate payout method.

#### **SITUATION #2 – RMDS TAKEN OVER THE JOINT AND LAST SURVIVOR LIFE EXPECTANCIES OF IRA OWNER AND SPOUSE-BENEFICIARY USING TERM CERTAIN METHOD**

When the IRA owner died, payments continued to the spouse-beneficiary based on the initial combined life expectancy factor, less 1 for each passing year. Upon the spouse-beneficiary's death, IRA payments may continue to be made under the term certain method until the term expires.

The results would be the same if the beneficiary (1) wasn't the IRA owner's spouse, and (2) wasn't more than 10 years younger than the IRA owner (in other words, if the minimum distribution incidental benefit (MDIB) rules didn't apply).

#### **SITUATION #3 – RMDS OVER JOINT AND LAST SURVIVOR LIFE EXPECTANCIES OF IRA OWNER AND NONSPOUSE-BENEFICIARY USING TERM CERTAIN METHOD, MDIB RULES APPLY**

If the beneficiary was more than 10 years younger than the account holder the term-certain distributions would have been limited by the minimum distribution incidental benefit (MDIB) rules. In that case, following the IRA owner's death, the remaining account balance was distributed

to the nonspouse beneficiary over the joint life expectancy that would have applied if it hadn't been limited by the MDIB rules, reduced by 1 for each year that required distributions were made.

*Illustration:* When Jack reached his required beginning date at age 71, he designated Rex, his 44 year old son, as his beneficiary and began to take distributions over their joint lives using the term certain method. Their joint life expectancy at that time was 39.1 years, but was limited to 25.3 years by the MDIB rules. Jack died after having received distributions for 10 years, and Rex took required distributions of the remaining account balance based on a remaining joint life expectancy of 29.1 years (i.e., the 39.1 year joint life expectancy that would have applied if not reduced by the MDIB restrictions, less 10). If Rex dies ten years later, the remaining IRA balance is paid out over a period of 19.1 years.

#### SITUATION #4 – RMDs OVER IRA OWNER'S LIFE EXPECTANCY ALONE, USING THE RECALCULATION METHOD

Where an IRA owner dies after beginning required distributions, the tax code requires later distributions to be made at least as rapidly as under the method being used at death. Prop Regs, on which taxpayers may rely, provides that if the life expectancy of an IRA owner is being recalculated, the recalculated life expectancy is reduced to zero at the end of the calendar year following the year of the IRA owner's death. For a long time, it was thought that if an IRA owner took RMDs over his life alone using the recalculation method, this reg required the full IRA account balance to be distributed to the beneficiaries by the end of the year following the year of the IRA owner's death. In several private rulings, however, IRS concluded a designated nonspouse beneficiary could take distributions over his life expectancy using the term certain method, even though the deceased IRA owner had been taking required distributions based on single life expectancy using the annual recalculation method. The IRS reached a similar result where the spouse was the oldest of several beneficiaries. The IRA owner had taken distributions based on his life alone using the recalculation method. Following his death, IRS OK'd payouts to the remaining beneficiaries based on the life of the spouse (the oldest beneficiary) using the term certain method. Presumably, a sole beneficiary who was the IRA owner's spouse who chose not to treat the decedent's IRA as her own also could take distributions over his or her life using the term-certain method.

Where a nonspouse beneficiary took distributions over his life expectancy using the term certain method, the balance remaining in the IRA when he dies can be distributed (to the beneficiary's estate or to individuals who inherit the account) over what remains of the beneficiary's life expectancy.

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