

Qualified Retirement Plans
Practice Alert
July 2008

A Recent Twist in an IRA Stretch

A recent private letter ruling shed light on the effect of taking late distributions from an inherited IRA. The IRA account owner died at age 66 prior to reaching his required beginning date naming his daughter as the sole beneficiary. She properly titled the account in the name of the deceased IRA owner in accordance with new regulations. Current rules would require the beneficiary to begin taking distributions in the year following the year of the IRA account owner's death over the beneficiary's life expectancy. For reasons unknown the beneficiary did not take distributions for the two years following the owner's death but took distributions in the third year for all three years to make up for the missed distributions. These distributions were in accordance with the life expectancy rule, i.e. distributions over the life of the beneficiary, rather than the five year rule, a lump sum in the year of the fifth anniversary of the death of the account owner. In a later year the beneficiary paid the 50% excise tax on the missed distributions for the first two years. This excise tax applies to beneficiaries from all IRA distributions including Roth IRAs. Even though distributions from Roth IRAs are tax free the RMD rules still apply to the beneficiary although not to the Roth IRA owner.

The question before the IRS was whether the delay of distributions would prevent the beneficiary from taking distributions over life expectancy and default to the five year rule. The answer was no. The IRS ruled that missing the RMDs would not cause the distribution to default to the five year rule. In addition the custodial agreement from the financial institution holding the IRA account provided that distributions would be in accordance with the life expectancy rule.

Final regulations now provide that the default form of distribution is the life expectancy rule. The only exception would be if the custodial agreement from the financial institution provides for the five year rule. Your clients should be advised to check their custodial agreements to avoid accelerated distributions from their IRA accounts. Also remember that the first distribution date, the April 1st following the year in which the account owner reaches age 70½, is for the prior calendar year. Consider it an administrative extension for the first distribution. A second distribution is required by December 31st of that same year. To avoid a double distribution in one tax year do not wait until April 1st but make the distribution in the year the account owner reaches age 70½ rather than the following year. All the information needed to make an earlier distribution is available since the amount of the distribution is based on the value of the account at the end of the prior year, i.e. December 31st.

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