

Pension Act's Required Minimum Distribution waiver for calendar year 2009



Late last year, Congress passed a law that helps individuals who are taking or about to take required payouts from employer-sponsored tax-qualified retirement plans or IRAs. In essence, the law waives these required payouts (called "required minimum distributions" or RMDs) for calendar year 2009. Had the waiver not been granted, many individuals with retirement accounts invested in beaten-down assets such as stocks or mutual funds would have had to sell assets at a loss this year to generate RMDs for 2009. But the new law change helps even those people who would otherwise have to make RMDs from retirement plan accounts and traditional IRAs invested in "bulletproof" assets such as government-insured CDs. If they can afford to skip this year's RMD, they can lower their tax bill for 2009. The new law change has an impact on three distinct groups of people—here's how you or a family member may be affected.

(1) Older individuals who are retirement plan account and traditional IRA owners. Required payouts from IRAs must begin when you attain age 70 1/2 (but the first year's payout may be deferred until the following April). If you are a regular employee, the first required payout from a company sponsored retirement plan in which you have a separate account (such as a 401(k) or a profit-sharing plan) is for the year you retire, or the year you reach age 70 1/2, whichever is later (but that payout may be deferred until the following April). If you own more than 5% of the company, you're subject to the same rule as IRA owners. Once they begin, RMDs must be made following an IRS schedule over your life (or life expectancy) or over the lives (or combined life expectancies) of you and the person you designate as beneficiary of the retirement account or IRA. The overall purpose of the RMD rules is to make sure retirement accounts and IRAs are used primarily for the owner's retirement, rather than as a tax-sheltered nest egg for the family; a prohibitively expensive IRS penalty rule applies if an RMD isn't made. Distributions from retirement plans or IRAs are fully taxed as ordinary income (unless you made nondeductible contributions).

The new law allows older individuals to skip the RMD that would otherwise be required for calendar year 2009.

For example, suppose Dad retired a few years ago and rolled over his 401(k) plan account balance into an IRA. He's age 74 this year and his IRA had an ending balance of \$650,000 at the end of 2008. Without the new law change, under the IRS's rules, Dad would have had to withdraw 4.2% of that balance —\$27,300—this year, whether or not he needs that money for living expenses, and regardless of how well or how poorly his IRA investments are doing. Thanks to the new law change, Dad can skip the 2009 RMD (and reduce his income subject to tax), or withdraw less than \$27,300, if he has other resources to draw on for retirement income. However, the new law doesn't waive a 2008 RMD that was deferred to April 1 of 2009. For example, suppose IRA owner Jeff turned 70 1/2 last year but decided not to take his first year's RMD (the one for calendar year 2008) last year because his IRA's stock market holdings were depressed in value and he was hoping for a recovery. Jeff must take his first year's RMD (for 2008) by April 1 of this year. But thanks to the new law, he does not have to take the second year's RMD (for 2009).

(2) Beneficiaries of retirement plan accounts or traditional IRAs. If a person dies before exhausting the funds in his or her employer retirement plan account or IRA, the balance may be left to an individual designated as a beneficiary (there may be a group of beneficiaries). If you are a designated beneficiary, you also must make minimum annual withdrawals (which generally are fully taxable) from your inherited retirement plan account or IRA. The pace of the withdrawals depends on a host of factors, such as the decedent's age when he or she died, how the retirement plan or IRA is set up, and whether you are

the spouse of the decedent. The new law allows designated beneficiaries of retirement plans or IRAs to skip the annual payout that would otherwise be required for calendar year 2009.

For example, suppose Ed designated his son, Jack, as the sole beneficiary of his IRA. Ed died last year at the age of 74, and at the end of 2008, his IRA account balance was \$300,000. Jack will be age 48 in 2009. Without the new law change, under the IRS's rules, Jack would have had to withdraw 2.77% of that balance —\$8,333—this year, whether or not he needs that money for living expenses, and regardless of how well or how poorly the inherited IRA's investments are doing. Thanks to the new law change, Jack can skip the 2009 RMD (and reduce his income subject to tax).

(3) Beneficiaries of Roth IRAs. The new law doesn't affect owners of Roth IRA accounts for the simple reason that they do not have to make lifetime RMDs from these accounts. However, it does affect beneficiaries of Roth IRAs, who must make minimum annual withdrawals after the account owner dies. Thanks to the new law change, designated beneficiaries of Roth IRAs don't have to make a minimum withdrawal for 2009 from their inherited Roth IRAs. This won't affect their income tax, since distributions to designated beneficiaries of Roth IRAs are tax-free. However, it will avoid having to sell reduced-in-value assets to make the otherwise required distributions, and it will make it possible for designated beneficiaries to leave more money at work within the tax-shelter of the Roth IRA.