PacificCPE

COURSE
33455A

Inherited Plans, Roth IRAs, and Roth 401(k)s

Covering three important and interconnected topics, this course examines beneficiary distributions when a plan owner dies after their required beginning date, then shifts to the unique advantages and rules of Roth accounts. You'll explore Roth IRA contribution limits, MAGI calculations, phase-out ranges, and how Roth IRAs compare to other tax-advantaged vehicles. The course also covers Roth 401(k) plans, including their distinct features and governing rules. Professionals advising clients on tax-free retirement income strategies or inherited account planning will benefit from this comprehensive overview.

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Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recall the potential drawbacks of naming an estate as a beneficiary.
- Identify the types of retirement accounts that a Roth IRA can be rolled over into.
- Recognize the characteristics of a Roth 401(k) plan.

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Chapter 1: DISTRIBUTIONS TO YOUR BENEFICIARY IF YOU DIE AFTER YOUR REQUIRED BEGINNING DATE

Chapter Objective

After completing this chapter, you should be able to:

- Recall the potential drawbacks of naming an estate as a beneficiary.

Even though you're required to start taking money out of your retirement account on your required beginning date (which, for most people, is April 1 of the year after reaching their RMD age), the account might not be empty when you die. It might even be quite large, especially if you had been withdrawing only the minimum required amount each year or you die soon after your RBD. So what happens to the leftovers? The answer to that question is the subject of this chapter.

Caution!

The age at which you must begin required minimum distributions (RMDs) depends on the year you were born. If you were born in 1950 or earlier, you had to begin taking RMDs when you reached age 72. If you were born after 1950, your RMD age (known as the "applicable age" in the tax code) is 73. Under IRS proposed regulations, if you were born in 1960 or later, your RMD age will be 75. For purposes of the discussion and examples in this chapter, we will assume your RMD age is 73. (See Chapter 2 of course 33453G for information about determining your RBD.)

ADMINISTRATIVE DETAILS

Although the rules for computing required distributions after your death might vary depending on who your beneficiary is, the following administrative procedures apply almost across the board.

Name on the Account

Unless your beneficiary is your spouse, your retirement account must remain titled in your name until the account is entirely depleted. If a beneficiary other than your spouse attempts to change the name on the retirement plan account to their own name, the action could be deemed a distribution of the entire account. Worse, if the beneficiary attempts to roll over your account into the beneficiary's own IRA, not only will it be deemed a distribution, but penalties for contributing more to an IRA than is allowed could be assessed as well.

Helpful Terms

Annuity. A contract sold by an insurance company that promises to make monthly, quarterly, semiannual, or annual payments for life or for a specified period of time.

Beneficiary. The person or entity entitled to receive the benefits from insurance or from trust property, such as a retirement plan or an IRA.

Deferral period. The number of years over which distributions from a retirement plan or an IRA can be spread to defer paying taxes.

Distribution. A payout of property (such as shares of stock) or cash from a retirement plan or an IRA to the participant or a beneficiary.

Estate. All property that a person owns.

Ghost rule. A rule that requires annual RMD payments to be made over the deceased owner's remaining life expectancy had they survived.

Primary beneficiary. A person or an entity entitled to receive benefits from a retirement plan or an IRA upon the death of the original participant.

Term certain. A fixed, identifiable period, such as a specific number of years. For example, a retirement plan that's distributable over a term certain of 10 years must be completely liquidated after 10 years.

The trustee or custodian can, however, retitle the account to show that you've died. This is permissible as long as the custodian complies with certain procedures for titling the account and reporting distributions. (See Chapter 1 of course 33454G for more information about titling accounts.)

An account can also be transferred to a new IRA as long as the new IRA is titled in the name of the deceased and the funds are transferred directly from the trustee or custodian of the original plan to the trustee or custodian of the new IRA. (See "**Rollover by a Noneligible Designated Beneficiary**," below, for more information.)

A special rule allows your spouse to treat your retirement plan account as their own. See "Surviving Spouse," below, to learn how this can be done.

Timing of Distributions

If you die after your RBD and before you've taken the entire required distribution for the year of your death, your beneficiary must take the remainder of that year's RMD before the end of the year.

In subsequent years, the amount and pace of required distributions depend on the category of beneficiary you've named. Nondesignated beneficiaries, designated beneficiaries, and eligible designated beneficiaries are each subject to different distribution rules.

Yet another set of rules will apply if your spouse is the beneficiary and elects to treat the account as their own. In that case, required distributions will be determined as if the spouse had been the original owner of the account. (See "Surviving Spouse," below, for more about this strategy.)

Beneficiaries

Recall that you can name any person or organization you choose as the beneficiary of your retirement plan or IRA. When determining how your retirement assets should be distributed after your death, however, the law gives more favorable treatment to designated beneficiaries. (See Chapter 2 of course 33453G for more information about designated beneficiaries.) If one or more of your beneficiaries isn't a designated beneficiary, you're deemed to have no designated beneficiary.

As described in detail in Chapter 2 of course 33453G, there's a subcategory of designated beneficiary known as an eligible designated beneficiary. When you die, eligible beneficiaries, such as surviving spouses, minor children, or individuals with a disability, might be able to spread distributions from your retirement account over a longer period of time than other designated beneficiaries. Whether or not a designated beneficiary qualifies as an eligible designated beneficiary is determined as of the date of your death. For example, disabled individuals will be eligible designated beneficiaries only if they're disabled (as described in Chapter 1 of course 33452G) at the time of your death. But beneficiaries who become disabled sometime after the date of your death wouldn't become eligible designated beneficiaries at that later date, even if they're otherwise qualified.

Note, too, that if you name multiple designated beneficiaries, some who are eligible designated beneficiaries and some who aren't, then you're generally considered to have no eligible designated beneficiaries, unless you're able to correct the problem as described below.

Deadline for Determining Designated Beneficiary

For purposes of computing postdeath required distributions, your designated beneficiary is determined as of September 30 of the year after your death. That doesn't mean someone else can name a new beneficiary of your retirement plan after you die. In fact, no new beneficiaries can be added after you die. Therefore, it's important that you carefully consider and then formally select a beneficiary before you die (using the plan's designation of beneficiary form).

Changing Beneficiaries Before the Deadline

The IRS allows this extended deadline for determining beneficiaries specifically to give those beneficiaries an opportunity to do some postmortem planning: to make administration of the retirement plan easier or to clean up any complex situations that were left behind. For example,

suppose you name your spouse as primary beneficiary and your daughter as contingent beneficiary. After your death, your spouse might decide she has no need for the assets in your retirement plan. She might "disclaim" (renounce) her interest in those assets. If she does, the plan assets would go to your daughter as though she had been named primary beneficiary.

Reporting Distributions

If you're the beneficiary of an IRA or another retirement plan, it's up to you to compute the required distribution each year and report it on your tax return. In the case of an IRA, the custodian will send you a Form 5498 reporting the value of the IRA each year, but you're responsible for the RMD calculation if the custodian doesn't provide you with it.

If you had been the original owner of the IRA, the law would require the custodian to help you compute the proper amount. (See Chapter 2 of course 33453G.) However, the law doesn't extend this benefit to beneficiaries.

DISTRIBUTION METHODS

If you die after your RBD, your retirement plan benefits will be distributed using one of four methods: the 10-year rule, the life expectancy rule, the "at-least-as-rapidly" rule, or a spousal rollover. Read on to learn more about each of those methods.

Ten-Year Rule

If the designated beneficiaries of your retirement plan aren't eligible designated beneficiaries, they must withdraw all of the assets of your retirement plan within 10 years of your death. Specifically, the account must be emptied by December 31 of the tenth year following the date of your death. For example, if you die on March 3, 2025, your retirement plan must be entirely distributed by December 31, 2035.

Tip

Actually, the 10-year rule can be a bit longer than 10 years. The account must be emptied not by the tenth anniversary of your death, but by December 31 of the year containing the tenth anniversary of your death.

The 10-year rule is applied differently if you die after your RBD than if you die before your RBD.

Distributing the Account If You Die Before Your RBD

As described in Chapter 1 of course 33454G, if you die before your RBD and the 10-year rule applies, your beneficiary must distribute the entire account within 10 years. But your beneficiary can distribute the account in any amounts they want over the course of the 10 years and can even wait until the tenth year to distribute any of it.

Distributing the Account If You Die After Your RBD

If you die *after* your RBD and the 10-year rule applies, your beneficiary must start taking distributions based on their life expectancy (or over your remaining life expectancy, if longer), beginning in the year after your death. Your beneficiary must calculate the required minimum amount and distribute at least that much each year. If there's anything left in the account in the tenth year after your death, your beneficiary must distribute the remaining amount.

Caution!

The rules are different for defined benefit plans. If you have a defined benefit plan, that plan is exempt from the 10-year rule, provided benefits are being paid as an annuity. In other words, if you're receiving your defined benefit plan assets as a joint and survivor annuity, which continues after your death, your designated beneficiary won't be subject to the 10-year rule. However, if you roll over your defined benefit plan into an IRA, the assets would then be subject to the IRA rules, and the exception for defined benefit plans would no longer apply.

Life Expectancy Rule

If your beneficiary is an eligible designated beneficiary as defined in Chapter 2 of course 33453G, your beneficiary can spread distributions over their own life expectancy after your death, if all of the following conditions are met:

- The beneficiary of your plan or IRA as of September 30 is a designated beneficiary.
- That designated beneficiary was also an eligible designated beneficiary on the date of your death.
- The plan itself either permits the life expectancy rule or is silent (meaning it doesn't indicate one way or another which rule should be used).

Your eligible designated beneficiary can look up the appropriate life expectancy divisor in the Single Life Table (Table I) of Appendix C.

Caution

New life expectancy tables are effective beginning in 2022. Beginning in 2022, taxpayers must use newly revised life expectancy tables. Individuals who began taking required distributions before 2022 were able to use the old tables, which are found in Appendix B. However, you're permitted to make a one-time switch to the new (more favorable) tables. If you began taking required distributions after December 31, 2021, you should use the new tables, which are in Appendix C.

Tip

What if the plan specifies the 10-year rule? Even if the plan specifies that the retirement plan assets must be distributed to the beneficiary according to the 10-year rule, plans are required to offer a rollover or transfer option.

Distributions under the life expectancy rule generally must begin in the year after your death and continue until the entire account has been depleted. (Some unusual twists apply depending on what type of eligible designated beneficiary you name. See "Eligible Designated Beneficiaries," below.)

At-Least-As-Rapidly Rule

A clear statement in the tax code indicates that if you die after your required beginning date, your beneficiary must take distributions from your retirement plan at least as rapidly as you (the original participant) had been taking them.

This rule applies across the board, to all beneficiaries. Here's how the rule affects a few sample situations.

Older eligible designated beneficiary. If the original owner names an older eligible designated beneficiary, such as a spouse, when the owner dies, RMDs are based on the life expectancy of the beneficiary or that of the now deceased account owner, whichever is longer.

Noneligible designated beneficiary. If the designated beneficiary isn't an eligible designated beneficiary, required distributions are based on the beneficiary's life expectancy (or the remaining life expectancy of the decedent—the original owner—if longer). The entire account must be distributed by the tenth anniversary of the original owner's death (or the final year of the beneficiary's life expectancy if the beneficiary inherited the account at an old age).

Nondesignated beneficiary. If the original owner's beneficiary is not a designated beneficiary, then distributions after the owner's death would be spread over the remaining life expectancy of the original owner as if had they lived. Herein lies the "ghost rule." The ghost rule means that stretch (lifetime expectancy) payments will be calculated using the single life expectancy of the deceased account owner in the year of their death.