

MEMO# 14640

April 18, 2002

INTERNAL REVENUE SERVICE ISSUES FINAL REGULATIONS ON REQUIRED MINIMUM DISTRIBUTIONS AND NOTICE CONCERNING TRUSTEE REPORTING

[14640] April 18, 2002 TO: OPERATIONS MEMBERS No. 12-02 PENSION MEMBERS No. 17-02 PENSION OPERATIONS ADVISORY COMMITTEE No. 25-02 TRANSFER AGENT ADVISORY COMMITTEE No. 34-02 AD HOC COMMITTEE ON RMD REFORM RE: INTERNAL REVENUE SERVICE ISSUES FINAL REGULATIONS ON REQUIRED MINIMUM DISTRIBUTIONS AND NOTICE CONCERNING TRUSTEE REPORTING The Internal Revenue Service has issued final regulations concerning required minimum distributions (RMDs) under section 401(a)(9) of the Internal Revenue Code. These regulations finalize the proposed regulations issued last year,¹ and incorporate many of the suggestions included in the comment letter filed by the Institute in response to the proposed regulations.² In addition, the IRS has issued Notice 2002-27, which provides specific requirements concerning reporting by IRA trustees and custodians. Copies of the final regulations and the IRS notice are attached.

RMD Reporting by IRA Trustees The preamble to the 2001 proposed regulations stated that the IRS intended to require IRA trustees to report to the IRS and to the IRA owner the RMD for each IRA for each calendar year. The Institute opposed such a requirement in both its written comments and public testimony, noting that IRA trustees generally do not possess the personal taxpayer information necessary to the RMD calculation. Based on these and other comments, the final regulations do not require IRA trustee reporting. Instead, the final regulations authorize the IRS to determine the extent to which such reporting will be required. The reporting requirements for 2003 are described in Notice 2002-27, which requires reporting by an IRA trustee that holds an IRA as of December 31, 2002, (1) whose owner is alive at the beginning of the year; and (2) for which an RMD is required in 2003.

The requirements 1 See Institute Memorandum to Pension Members No. 2-01, Pension Operations Advisory Committee No. 3-01, Transfer Agent Advisory Committee No. 4-01, dated January 17, 2001. 2 See Institute Memorandum to Pension Members No. 19-01, Pension Operations Advisory Committee No. 31-01, and Ad Hoc Committee on RMD Reform, dated April 17, 2001. The Institute also presented testimony at the IRS public hearing concerning the 2001 proposed regulations. See Institute Memorandum to Pension Committee No. 35-01, Pension Operations Advisory Committee No. 36-01, and Ad Hoc Committee on RMD Reform, dated June 1, 2001. 2 for 2003 do not require any such reporting for section 403(b) arrangements or for IRAs of deceased owners. Any future reporting requirements for 403(b)s and IRAs of deceased owners will apply prospectively. By January 31, 2003, the IRA trustee must provide a statement to the IRA owner that either (1) states the amount of the RMD and the date by which such amount must be distributed;

or (2) informs the IRA owner that a minimum distribution is required for the calendar year and states the date by which such amount must be distributed, and includes an offer to calculate the RMD upon request. If the IRA trustee chooses the first alternative, the RMD calculation may be based on the assumption that the sole beneficiary of the IRA is not a spouse more than 10 years younger than the IRA owner and that no amounts received by the IRA after December 31 of the prior year need to be taken into account. Under both alternatives, the statement must also inform the IRA owner that the IRA trustee will be reporting to the IRS, beginning with RMDs for calendar year 2004, that the IRA owner is required to receive an RMD for the calendar year. Such reporting to the IRS will be on the Form 5498 for the immediately preceding year, and need not indicate the amount of the RMD. Further information on reporting RMD status to the IRS will be provided in the instructions for the 2003 Form 5498.

Changes to RMD Calculations The final regulations also contain a number of changes to the proposed regulations concerning the calculation of RMDs. First, as required by section 634 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the final regulations adopt new life expectancy tables based on more current mortality rates. These new tables also may be used to determine life expectancy for purposes of calculating the amount of substantially equal periodic payments under section 72(t)(2)(A)(iv) of the Code, which provides an exception from the ten-percent additional tax on early distributions. In addition, certain simplifications have been made to the calculation of RMDs. For example, under the 2001 proposed regulations, the designated beneficiary would have been required to be determined as of the end of the year following the year of the employee's (or IRA owner's) death. The Institute and other commentators suggested that an earlier date be used for this determination in order to provide adequate time to calculate and distribute the RMD. The final regulations adopt the Institute's suggested date of September 30 for this determination. Similarly, under the final regulations, the marital status of the employee (or IRA owner) for purposes of lifetime distributions will be determined on January 1 each year. Divorce or death after that date will be disregarded until the next year, and a change in beneficiary due to the spouse's death will not be recognized until the following year. Contributions and distributions made after December 31 of a calendar year generally will be disregarded for purposes of determining the minimum distribution for the following year. For example, the account balance for the valuation calendar year that is also the first distribution calendar year will no longer be reduced for a distribution on April 1 to satisfy the RMD for the first distribution calendar year, and contributions made after the calendar year that are allocated as of a date in the prior calendar year will no longer be required to be added back. December 31 amounts will be adjusted, however, in the case of rollover amounts and recharacterized conversion contributions that are not in any account on December 31 of a year.

Other IRA Rules The final regulations also eliminate the proposed requirement that an IRA must distribute the RMD amount for a taxpayer over age 70-1/2 in the event of a trustee-to-trustee transfer to another IRA. The Institute had urged the modification of this requirement as inconsistent with IRS guidance permitting a taxpayer to withdraw his or her RMD from any of his or her IRAs. In addition, the final regulations clarify that a surviving spouse may elect to treat an inherited IRA as the spouse's own IRA at any time after the IRA owner's date of death. The RMD for the calendar year of the IRA owner's death, however, is determined assuming the IRA owner lived throughout the year. Under the final regulations, the surviving spouse is required to receive a minimum distribution for the year of the IRA owner's death only to the extent that the amount required was not distributed to the owner before death.

Section 403(b) Arrangements The final regulations also include clarification of the rule that "grandfathers" pre-1987 account balances in section 403(b) arrangements from the RMD rules. Under the final regulations, a pre-1987 account balance will not lose grandfather treatment upon transfer to another 403(b), provided that the transferee 403(b)

satisfies the pre-1987 account balance recordkeeping requirements. This balance will lose grandfather treatment, however, upon a distribution and a rollover, including a direct rollover. Miscellaneous Issues The final regulations also address (1) the establishment of separate accounts; (2) trusts as beneficiaries; and (3) the default rule for post-death distributions. Regulations concerning defined benefit plans and annuity contracts were issued in temporary and proposed form. Effective Dates The final regulations apply for determining RMDs for calendar years beginning on or after January 1, 2003. For determining RMDs for calendar year 2002, taxpayers may rely on the final regulations, the 2001 proposed regulations, or the 1987 proposed regulations. Kathy D. Ireland Associate Counsel Attachments (in .pdf format) Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 14640, or call the ICI Library at (202) 326-8304 and request the attachments for memo 14640.

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