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WITHDRAWALS FROM INDIVIDUAL RETIREMENT ACCOUNTS (IRAS)

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Individual Retirement Accounts (IRAs) have been available to all wage earners since 1982, created by Congress as an incentive program to save for retirement. They are available even if you have another retirement plan. IRAs are sold by banks, credit unions, savings and loan associations, insurance and mutual fund companies and brokerage firms.

Traditional IRAs. If you have income from working you can contribute up to 100% of a year's earnings or $2,000, whichever amount is less, to a traditional IRA. This amount is reduced by the amount of any contributions to a Roth IRA (see below). With a traditional IRA, state, local and federal taxes on contributions and earnings are deferred until the money is withdrawn. Starting in 1998, if you have earnings of $30,000 or less you are eligible for fully deductible contributions to a traditional IRA. This eligibility limit will gradually rise to $60,000 by the year 2005 for an individual, and to $100,000 for joint filers by 2007.

Spousal IRAs. If your spouse has no income from working, a spousal IRA may be opened with a limit of $4,000 total combined contributions to both "traditional" IRAs and Roth IRAs for the year. The $4,000 must be split between two accounts, with neither one exceeding $2,000 annually.

Roth IRAs. A new type of IRA was created with the Taxpayer Relief Act of 1997. Contributions to a "Roth" are made with after-tax dollars. However, all withdrawals, including accumulated earnings on contributions, are tax-free, provided the owner is age 59½ or older and has owned the account for five years. Congress designed Roths to be much like a traditional IRA with some important exceptions. They are only available to singles with incomes up to $110,000 and married couples with incomes up to $160,000. With a traditional IRA, no contributions are permitted after age 70½. However, you may make contributions to a Roth after age 70½ as long as you have earned income and your adjusted gross income doesn't exceed the limits described above. Withdrawals from a traditional IRA prior to the owner turning age 59½ are subject to a 10% excise tax. However, early withdrawals from a Roth IRA can be made for college expenses, qualified unreimbursed medical expenses, payment of health insurance premiums by an unemployed person and first-time home buyer expenses (up to a lifetime maximum of $10,000), as long as the account has been in existence for five or more years. If you have a traditional IRA, you must begin required distributions on or before your required distribution date, usually age 70½. If you have a Roth IRA, you are not required to withdraw any amount during your lifetime.

Rollovers from a traditional to a Roth IRA. Starting in 1998, IRA owners with adjusted gross incomes of less than $100,000 could roll over part or all of the money in their existing traditional IRA into a Roth IRA. However, to do so, the owner must pay income taxes on the earnings plus deductible contributions of the amount rolled over. So the traditional IRA owner must decide whether it is better to pay some income taxes now and be able to withdraw future earnings tax-free during retirement (assuming the Roth is held at least five years and the owner is age 59½ or older) or leave the money in the traditional IRA where it will continue to grow tax-deferred until withdrawal. Generally, the longer the period until you starting taking the money out of a traditional IRA and the higher the expected rate of return, the more advantageous it may be to roll over money from a traditional IRA into a Roth. But if you are nearing retirement, it may not be worthwhile. Also, the larger the amount being rolled over, the more cash is needed to pay the income taxes due.

✦ **Withdrawals before age 59½.** Because Congress intended IRAs to be a retirement savings vehicle, there is a 10% excise tax on any withdrawal when the owner is under age 59½ unless she or he falls under the following exceptions. Remember, if you qualify under an exception, only the 10% excise tax is excused. The money withdrawn is reported as income on your tax return and you pay income taxes on it. The first exception is death; none of the funds distributed from your IRA after you die will be subject to the early distribution tax as long as the account is still in your name when the distribution occurs. If you become disabled, all distributions from your IRA are free of the early distribution penalty. Another exception is triggered if you spread distributions from your IRA in substantially equal annual installments and those payments are designed to be spread out over your entire life or the joint life of you and your beneficiary. Under these circumstances, the payments will not be subject to the 10% early distribution tax. If you withdraw money from your IRA to pay medical expenses for yourself, your spouse or your dependents, they are deductible to the extent they exceed 7.5% of your adjusted gross income. Distributions you use to pay higher education expenses will not be subject to the early distribution tax as long as they are paid on behalf of you, your spouse, child or grandchild. You may make a penalty-free early withdrawal to buy or build your first home (up to a lifetime maximum of $10,000). You may also make an early withdrawal for health insurance premiums for yourself or your dependents if you are unemployed or were recently unemployed for 12 consecutive weeks.

✦ **Withdrawals between age 59½ and 70½.** The ages 59½ to 70½ are the "penalty free" zone. The owner of a traditional IRA can choose to withdraw the entire balance in the account or any amount as needed without paying the 10% early distribution tax. However, withdrawals from a traditional IRA are added to the owner's income for the year and taxed accordingly.

✦ **Withdrawals after age 70½.** Owners of a traditional IRA must begin taking distributions on April 1 of the year after they turn 70½. Known as the "required beginning date" (RBD), this date is crucial because it is the absolute deadline for three important tasks:

(1) You must take your first required withdrawal from your traditional IRA. Your RBD (required beginning date) marks the deadline for withdrawing the required minimum distribution amount for your first distribution year only. For all subsequent years, the deadline is December 31.

(2) You must decide whether or not to recalculate life expectancies to determine the amount of withdrawals. Recalculating means looking up your life expectancy in a table every year instead of simply reducing your life expectancy by one each year.

(3) You must name one or more "designated" beneficiaries to your retirement plan. (There are rules about who is and who is not a "designated" beneficiary.)

You must withdraw at least the required minimum from your IRA by your RBD or pay a heavy penalty. You are permitted to take the money in one lump sum, or you can take it out as you need it, for example in monthly or quarterly installments, as long as the minimum amount is removed from your account annually. So you must take

the minimum distribution between January 1 of the year you turn 70½, and April 1 of the year after you turn 70½, which gives you 15 months to make your first withdrawal. For the second and all future distribution years, you must take out the required amount between January 1 and December 31.

Calculating the amount of withdrawals. Calculating your required distribution for any given year is just a matter of determining an account balance for your IRA and dividing that balance by the appropriate life expectancy. The resulting number is the minimum amount you must withdraw from the account for that year. According to the IRS, the account balance for computing your required distribution each year is determined as of "the last valuation date in the calendar year before the distribution calendar year." For the vast majority of people, this date would be December 31 of the year before the distribution. Once you have the account balance, you must divide it by a life expectancy to arrive at your required minimum withdrawal. The life expectancy can be your own single life, or a joint life expectancy with a designated and qualified beneficiary. Withdrawals can be in one lump sum, or you may withdraw in monthly, quarterly, or semi-annually amounts. Remember, you can withdraw more than the required amount each year, but you may not withdraw less without incurring a penalty.

If you have more than one IRA, you must compute the required distribution for each IRA separately, but then you may add up all the computed amounts and take the total from only one or several IRAs as long as the total amount for each year is distributed before the deadline.

How do you recalculate your life expectancy? The IRS permits you to recalculate your life expectancy in one of two ways:

(1) For each year beginning with the year you turn 70½, you can look up your life expectancy in a table provided by the IRS. Using this method your life expectancy will not reach zero until you die.

(2) You can look up your life expectancy in the year you turn 70½ and then simply subtract one from that number each additional year thereafter without using a table. This is called the "term certain" method because life expectancy is fixed–it is not recalculated every year. Using this method, if you live beyond your term-certain life expectancy, your retirement account will be completely depleted.

Table 1. Abbreviated IRS life expectancies for single individuals

Age	Life Expectancy (in years)
59	25.0
60	24.2
61	23.3
62	22.5
63	21.6
64	20.8
65	20.0
66	19.2
67	18.4
68	17.6
69	16.8
70	16.0
71	15.3
72	14.6
73	13.9
74	13.2
75	12.5
76	11.9
77	11.2
78	10.6
79	10.0
80	9.5
81	8.9
82	8.4
83	7.9
84	7.4
85	6.9
86	6.5
87	6.1
88	5.7
89	5.3
90	5.0

As the IRA owner, you are permitted to recalculate your life expectancy every year. If your spouse is your beneficiary and you use a joint life expectancy, you can recalculate your spouse's life expectancy each year as well. You may not recalculate the life expectancy

of a non-spouse beneficiary (for example, your children), however. The life expectancy of a non-spouse beneficiary must be reduced by one every year (in other words, the term-certain method).

Once you decide whether or not you or your spouse-beneficiary will recalculate, you cannot change this decision during the remainder of your lifetime. If you choose to do nothing by your RBD, you are deemed to have elected to recalculate your life expectancy and your spouse-beneficiary's life expectancy each year.

Naming a designated beneficiary. Your RBD is also the deadline for naming a "designated" beneficiary of your IRA. You may name any person or entity (say, your local Humane Society) but not every beneficiary qualifies as a "designated" beneficiary as defined by the IRS. Any person qualifies as a designated beneficiary and so do some trusts. Charities, corporations and estates do not.

If you name a designated beneficiary you may use a joint life expectancy with that beneficiary for determining your required withdrawals. If your beneficiary is not a designated beneficiary, or if you have not named a beneficiary at all, you must use your own single life expectancy when calculating the amount of withdrawals.

You may change your beneficiary at any time, but the beneficiary named as of your RBD will affect how your required distributions are calculated from that time until your death, with certain rare exceptions.

What are the benefits and consequences of recalculating your life expectancy? If you elect not to recalculate your life expectancy, you simply reduce your life expectancy by one each year after your RBD, regardless of your age or health (the "term-certain" method). On the other hand, if you recalculate, you must look up the life expectancy for your current age in the appropriate table each year.

The decision to recalculate your life expectancy remains in place after you die. If you choose not to recalculate, your life expectancy will continue to be reduced by one each year even though you are dead. That means your beneficiary will have the option of continuing to calculate withdrawals the same way you did until the divisor is reduced to one. This option saves the beneficiary of having to take a distribution of the entire amount remaining in your IRA and paying a lot of tax. A beneficiary can always accelerate withdrawals, or take more than the required amount. But if a beneficiary chooses to deplete the account as slowly as possible, the maximum period over which distributions can be spread is your remaining term-certain life expectancy.

If, however, you had been recalculating your life expectancy and using the tables each year, your life expectancy goes to zero in the year after you die, and your beneficiary receives the entire amount in the account. If your beneficiary is your spouse, they have the option to roll over your account when you die. This option is only available to spouses.

There is one big advantage to recalculating life expectancies. Recalculating allows the IRA owner to use a larger divisor when calculating required withdrawals, which produces a smaller amount that must be withdrawn each year. (Remember, your required withdrawal amount is your account balance divided by your single or joint life expectancy.) If you don't need to draw on your IRA for living expenses during retirement, but only withdraw the minimum required amount in order to keep your taxes down, recalculating allows you to leave more of your assets to grow inside the IRA.

The benefits of recalculating increase as you grow older. At 70, your life expectancy is 16 years. If you use a term-certain method for computing required distributions, your entire account will be depleted by the time you reach age 86. But if you are recalculating, when you reach age 86, you will still have a life expectancy of 6.5 years.

Recalculation might not be the best choice for you. If you use your single life expectancy to compute your withdrawals, and choose not to recalculate your life expectancy, then your account will be distributed over a term certain whether you survive the term or not. If you die before your account is depleted, your heirs may continue to take distributions from your account over the remaining years of the term, rather than all at once. If you are recalculating, your life expectancy automatically goes to zero in the year after your death and the remaining balance of the account must be paid to your beneficiaries and added to their taxable income for that year. (Although if your spouse is your beneficiary, he or she can roll it over when you die.)

Recalculating with non-spouse beneficiaries. If your beneficiary is not your spouse, you must use one of two sets of rules depending on the age of your non-spouse beneficiary. Recalculation is available only to you and a spouse beneficiary. If you have a non-spouse beneficiary who is no more than ten years your junior, you could recalculate your own life expectancy and use a term certain for your beneficiary; or you could use the term certain method for both of you. If your beneficiary is more than ten years younger than you, a special rule called the Minimum Distribution Incidental Benefit (MDIB) applies. It requires that you use a special table to find your joint life expectancy. Again this rule applies only if your beneficiary who is more than ten years younger than you is not your spouse.

Table 2. Table for Determining Applicable Divisor for MDIB* (Minimum Distribution Incidental Benefit)

Age	Applicable divisor	Age	Applicable divisor
70	26.2	86	13.1
71	25.3	87	12.4
72	24.4	88	11.8
73	23.5	89	11.1
74	22.7	90	10.5
75	21.8	91	9.9
76	20.9	92	9.4
77	20.1	93	8.8
78	19.2	94	8.3
79	18.4	95	7.8
80	17.6	96	7.3
81	16.8	97	6.9
82	16.0	98	6.5
83	15.3	99	6.1
84	14.5	100	5.7
85	13.8		

If you name a non-spouse beneficiary who is more than ten years younger than yourself, you still have to decide by your RBD whether or not you will recalculate or use term-certain. If you choose to recalculate, at your death, your young beneficiary may use his or her remaining single life expectancy to calculate the required minimum withdrawals. If you had elected not to recalculate, your young beneficiary would use your joint life expectancy as of your RBD, reduced by one each year for the remaining withdrawals.

Here is one place where recalculating may not make sense. If you name a beneficiary who is more than ten years younger than you, for example your grandchild, you have everything to gain and nothing to lose by using the term-certain method. During your lifetime, you must use the MDIB tables, therefore your election has no effect on withdrawals made while you are living. But after your death, your beneficiary looks up your joint life expectancy for your first distribution year and reduces the number by one for each year that has passed. If you had been recalculating, your life expectancy would go to zero after your death and your beneficiary would have to use only his or her single life expectancy when computing future required distributions, thereby depleting the account more rapidly.

Joint life with spouse beneficiary. If your spouse is your beneficiary, and you choose not to recalculate, your joint expectancy is reduced by one each year even after the death of either or both of you. So if both of you die, your beneficiaries may spread withdrawals over the remaining years of your term-certain life expectancy.

If your spouse is your beneficiary, and you choose to recalculate, you have the option of using a joint life expectancy and recalculating your life and your spouse's. But when the first of you dies, that person's life expectancy goes to zero. If your spouse dies first, then when you die (or if you both die at the same time) both life expectancies will be zero and the entire IRA must be paid out to your beneficiaries the following year. If you die first, your spouse could roll over your plan into an IRA of his or her own.

Table 3. IRA Joint Life Expectancies

Owner's	Beneficiary's Age									
Age	65	66	67	68	69	70	71	72	73	74
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6
72	22.5	21.9	21.3	20.8	20.3	19.8	19.4	18.9	18.5	18.2
73	22.2	21.6	21.0	20.5	20.0	19.4	19.0	18.5	18.1	17.7
74	22.0	21.4	20.8	20.2	19.6	19.1	18.6	18.2	17.7	17.3
75	21.8	21.1	21.5	19.9	19.3	18.8	18.3	17.8	17.3	16.9
76	21.6	20.9	20.3	19.7	19.1	18.5	18.0	17.5	17.0	16.5
77	21.4	20.7	20.1	19.4	18.8	18.3	17.7	17.2	16.7	16.2
78	21.2	20.5	19.9	19.2	18.6	18.0	17.5	16.9	16.4	15.9
79	21.1	20.4	19.7	19.0	18.4	17.8	17.2	16.7	16.1	15.6
80	21.0	20.2	19.6	18.9	18.2	17.6	17.0	16.4	15.9	15.4

Making the election. Once you decide between recalculating life expectancy and using the term certain method, how do you make the election official? The IRS is clear that if you make no election and your retirement plan is silent on the issue, then you and your spouse (if your spouse is your beneficiary) are believed to have elected to recalculate. If you do not want to recalculate, you must take some steps to show what your choice is. You could simply calculate and withdraw the appropriate amount, keeping a record of both the method used and the amount of the withdrawal. In the event of any questions, use those records to demonstrate you have consistently applied one method. Or you might show the calculation for your first distribution year in a statement attached to your tax return and filed before your RBD. The statement could read that you choose to "make recalculation inapplicable" to your life expectancy. If both you and your spouse choose not to recalculate, both of you would sign and attach similar statements to your tax return. As an extra precaution, before your RBD you could send a copy of the signed statement to your IRA administrator, indicating your intention not to recalculate.

Trusts as beneficiaries. You may name any person or entity you choose to be the beneficiary of your retirement account. However, if the beneficiary doesn't fall under the definition of a "designated" beneficiary you won't be able to use a joint life expectancy to compute withdrawals and reduce the amount of required withdrawals. A designated beneficiary must be a "natural person" as opposed to an entity like a charity or a corporation. The only exception to the natural person rule is a trust that meets certain criteria.

To determine if a trust qualifies, you must consider the trust's status as of your RBD or the date the trust is named beneficiary of your retirement account. The trust must be valid under Utah law, and irrevocable, meaning you cannot change its terms or cancel it. You could name a revocable trust your beneficiary (meaning one that can be altered or amended at any time) as long as it become irrevocable upon your death. In addition, the beneficiaries of the trust must be natural persons and identified (your spouse, your children, your grandchildren and so on).

You must provide a copy of the trust to the institution holding your IRA. If the trust is revocable, you must give the institution a copy of each subsequent change made to the trust, if any.

If the trust meets all of the above qualifications, then the beneficiaries of the trust are treated as designated beneficiaries for the purposes of calculating your required withdrawals, provided they are natural persons. If you name several beneficiaries of the trust, you must use the life expectancy of the oldest beneficiary when calculating life expectancies. If that beneficiary is more than ten years younger than you are, the MDIB rules will apply, even if the beneficiary is your spouse.

You can change beneficiaries of your retirement account, but the method of calculating required distributions does not change. It became irrevocable on your RBD, remember, unless your new beneficiary is

older than the previous beneficiary. Then you must use the new beneficiary's shorter life expectancy when recalculating. Even if your new beneficiary is a spouse whom you married after your RBD, refiguring withdrawal amounts is not an option.

If you choose term certain, the term must be equal to or shorter than your single life expectancy or the joint life expectancy of you and your beneficiary. Once payments begin, the term certain may not be lengthened and life expectancies may not be recalculated.

What if you die before age 70½? The IRS says you must start taking money out of your IRA by your required beginning date (April 1 of the year after you turn 70½). But what if you don't make it to that date? If you die before your RBD, then a law known as the "five-year rule" applies. This rule is designed to assure that the total amount in your IRA is completely distributed within five years of your death and the taxes you have been deferring are collected. Now if your spouse is your beneficiary, he or she can defer distribution by rolling over the IRA beyond the five year period. But if someone other than your spouse is your beneficiary, they would receive the entire amount as a lump sum or in payments spread over the five years. How the account is distributed is governed by the rules of the plan, the IRS only cares that it is all paid out in five years. So the beneficiary could receive it all in the first year, in installments, or not until the end of the five years, depending on the plan.

An exception to the five-year rule occurs when you name a designed beneficiary for your plan and you specify that payments may be spread over a period that is no longer than his or her life expectancy. A minimum payment would be required every year, beginning the year after your death, and the beneficiary can always take larger payments in any given year, but must at least take the minimum.

An important caution, however, is that the financial institution holding your IRA may have more restrictive rules than the IRS and disallow the five-year option. So check with the plan's administrators to see how assets are distributed in this instance.

Why not name your estate as beneficiary of your IRA? There are some significant disadvantages to naming your estate as beneficiary. Your estate is not a "designated" beneficiary and you are considered to have no beneficiary for purposes of computing lifetime or after-death withdrawals. As a result, distributions could be accelerated under the five-year rule unless your spouse is the sole beneficiary of your estate and is permitted to roll over the account's assets.

Withdrawals from a Roth IRA. Congress designed the Roth IRA to be much like a traditional IRA, but with some attractive adjustments. All contributions to a "Roth" are made with after-tax dollars. Therefore, all distributions are potentially tax free, including any earnings realized on the account.

Roth contributions are limited to earners with incomes under $160,000 if married and $110,000 if single. And, unlike a traditional IRA, you may continue to make contributions to a Roth after age 70½ (as long as your income doesn't exceed the limits described above). Also, If you have a Roth IRA, you are not required to withdraw any amount during your lifetime. You may leave the entire account to your beneficiaries.

The portion of your Roth IRA that contains your contributions is never subject to income tax when it comes out. You have already paid tax on the money. Further, any distribution you take from a Roth is presumed to be a return on your contributions. And they are not taxable as long as the distribution is considered a "qualified" distribution.

Any distribution of returns on a Roth taken within five calendar years of when you established the account can never be a "qualified" distribution. If you die before the five years are up, your beneficiary must wait until the five-year holding period has elapsed or the distribution will not be qualified.

To be qualified (i.e., tax-free), a distribution must also be one of the following:

(3) taken after you reach 59½
(4) taken after you become disabled
(5) distributed to your beneficiary after your death
(6) taken to purchase a first home (up to $10,000).

Any withdrawals from a Roth that are not "qualified" are treated much like a traditional IRA distribution. The contributions you made will come out tax-free, but the earnings are taxable.

If you have a traditional IRA, you must begin required distributions when you reach your RBD. If you die after your RBD, a special set of distribution rules apply (see above). But because you are not required to take distributions from a Roth during your lifetime, you have no RBD for that purpose. Consequently, it is irrelevant whether you die before or after your RBD (or the date that would have been your RBD for traditional IRA purposes). Instead the five year rule or the exception to the five year rule will apply to your Roth IRA regardless of when you die.

Summary. The rules for withdrawing funds from a traditional IRA or Roth IRA are complicated. People who withdraw funds before age 59½ may have a 10% early distribution tax levied on their withdrawal unless the distribution falls within one of the special exception rules. Failure to withdraw the required minimum distribution starting the year after reaching age 70½ may result in a penalty equal to 50% of the undistributed amount.

IRA owners may require the assistance of a specialist, such as a certified public accountant, certified financial planner or attorney who specializes in taxes, to be sure they are following the rules.

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