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IRA and QRP Introduction to Beneficiary Options

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Learning Objectives

At the completion of this course you will be able to

- apply the concept of separate accounting and its deadline,
- understand when recalculation and nonrecalculation should be used,
- explain when a beneficiary may be able to roll over an inherited retirement plan to an inherited IRA, and
- list the deadlines that apply for beneficiary distribution elections.

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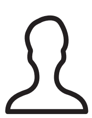
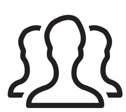

Individual Exercise


Group Exercise


Group Discussion


Example


Job Aid


Additional Information

Beneficiary Option Basics and Definitions

Distributing retirement plan or IRA assets to beneficiaries can be a complicated process. A basic understanding of beneficiary options is crucial to ensuring compliance with IRS distribution requirements.

This section explains the basic distribution options available to employer-sponsored retirement plan and IRA beneficiaries under the required minimum distribution (RMD) regulations (Treasury Regulation (Treas. Reg.) 1.401(a)(9)). Be aware, however, that plan documents may contain more restrictive provisions. Always check the governing documents regarding permissible distribution options.

Distribution Procedures

Creating well-crafted procedures for handling beneficiary distributions is essential to effective IRA and retirement plan administration. The following steps are recommended—but not required—when working with the beneficiary of a deceased account owner.

1. **Obtain Copy of Death Certificate**
   When processing a death claim, the first step is to obtain and keep on file a certified copy of the death certificate. In addition to verifying the death, the certificate will record the date of death for purposes of determining beneficiary options.

2. **Review Current Beneficiary Designation**
   An administrator should review the most current beneficiary designation associated with the decedent's IRA or retirement plan to verify the beneficiaries that are entitled to the assets. The administrator also should verify that the correct information (e.g., beneficiary's Social Security number, name, address) is on file.

3. **Set Up Computer System for Proper Reporting**
   Once notified of an account owner's death, the administrator should enter the proper information on the computer system. This will allow the administrator to properly process and report distributions. Any distributions processed after the account owner's death are reported as death distributions on IRS Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, in the beneficiary's name and tax identification number (TIN).

   In addition, any inherited IRA with a December 31 balance must be reported to the IRS on Form 5498, *IRA Contribution Information*. The Form 5498 prepared for an inherited IRA should be titled to identify the beneficiary as well as the original account owner (e.g., "Jon Baker as beneficiary of Cindy Baker").

   Ultimately, the processing system must properly generate Forms 1099-R and 5498 in the beneficiary's name and TIN. Some organizations may be able to simply update the decedent's account information; others may have to create an entirely new beneficiary ("inherited") account to generate proper reporting.

4. **Determine Distribution Options**
   The administrator should determine the beneficiary's options based on the IRA or retirement plan document provisions.

5. **Process Distribution**
   Once the beneficiary elects to take a distribution from the IRA or retirement plan, the administrator should process the distribution, making sure to capture all required information and generate proper reporting.

Definitions

Before any meaningful discussion of beneficiary options can occur, certain terms must be defined.

Primary Beneficiary

A primary beneficiary is an individual or entity intended to receive the IRA or retirement plan assets upon the account owner's death.

Contingent Beneficiary

A contingent beneficiary is an individual or entity intended to replace the primary beneficiaries if the primary beneficiaries die before the account owner, or disclaim their interest in the IRA or retirement plan.

Determination Date

The determination date is September 30 of the year following the year of the account owner's death.

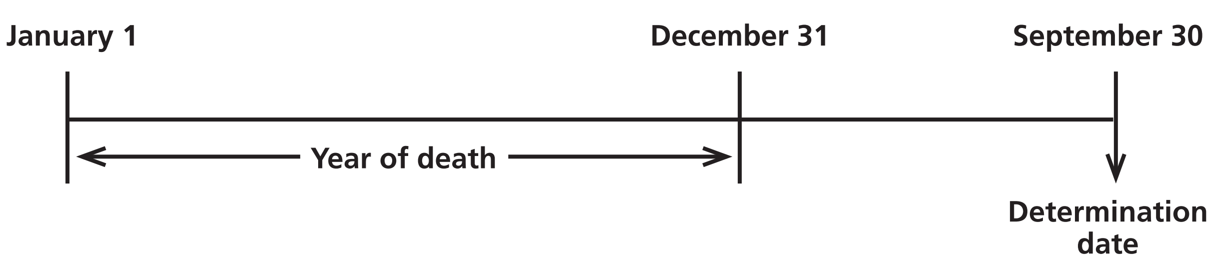
Named Beneficiary

A named beneficiary is a beneficiary who is named to inherit a portion of an IRA or retirement plan as of the date of the account owner's death .

Designated Beneficiary

A designated beneficiary is a named primary beneficiary who is still alive as of the account owner's date of death and has a balance remaining in the account as of the determination date (Treas. Reg. 1.401(a)(9)-4, Q&A 4). A primary beneficiary who dies between the account owner's date of death and the determination date is still considered a designated beneficiary.

The designated beneficiary's life expectancy is used to calculate life expectancy payments (explained later). In the case of multiple designated beneficiaries, the oldest designated beneficiary's life expectancy as of the determination date is used, unless separate accounting applies (discussed later).



Separate Accounting

Separate accounting is a new entry (often called a subaccount) for each beneficiary on the financial organization's computer system. Each entry tracks the gains and losses on that beneficiary's share of the assets. (Treas. Reg. 1.401(a) (9)-8, Q&A 2 and 3).

Separate accounting allows the beneficiary more distribution options. It also permits financial organizations to report distributions and the fair market value in the beneficiary's name and TIN.

- Once the financial organization creates a separate account, it may transfer the assets from the decedent's IRA or retirement plan into each beneficiary's separate account. This is a nonreportable transaction.
- The financial organization does not need the beneficiary's permission, nor does the beneficiary sign any documents to establish the separate accounts.
- Each beneficiary may be allowed to name beneficiaries (i.e., successor beneficiaries) to their separate account.

NOTE: *While nothing in the Treasury regulations specifically prohibits beneficiaries from naming a successor beneficiary, the IRS has provided little direction on this issue. Several private letter rulings (PLRs) have allowed a beneficiary to name a successor beneficiary, as long as the previously established payout schedule is not lengthened. The PLRs, do not, however, address the issues of state trust law and IRA or retirement plan document language.*

Separate Account Deadline

Separate accounts must be established by December 31 of the year after the account owner's death.

Financial organizations may establish separate accounting for multiple beneficiaries at any time—whether the account owner died before or on or after the required beginning date (RBD). The separate accounting deadline applies for purposes of calculating life expectancy payments and for determining whether the spouse beneficiary has the option to transfer the decedent's IRA to his own IRA.

One Beneficiary or Separate Accounts Established Timely
• Each beneficiary becomes the designated beneficiary of his own separate account. • Each beneficiary may take life expectancy payments over his own single life expectancy, or if death occurs on or after the RBD, over the account owner's life expectancy (if longer). • A spouse beneficiary retains the option to delay distributions or transfer to own IRA.

Multiple Beneficiaries and Separate Accounts NOT Established Timely
• If all beneficiaries are individuals (not a nonperson, such as an entity), each beneficiary's life expectancy is based on the oldest designated beneficiary on the determination date. Payments must begin by December 31 of the year after the account owner's death. • If an account owner with a nonperson beneficiary dies before the RBD, all beneficiaries would need to take a lump-sum distribution or take payments using the five-year rule. • If an account owner with a nonperson beneficiary dies on or after the RBD, life expectancy payments are based on the account owner's life expectancy in the year of death, reduced by one. • A spouse beneficiary cannot delay distributions or transfer assets to own IRA, but may distribute and roll over assets to own IRA or retirement plan.

Beneficiary Options

The distribution options available to the beneficiary of a deceased account owner depend on whether the account owner died before the RBD or on or after the RBD. The RBD for an account owner generally is April 1 of the year following the year he attains age 70½.

Beneficiary Options Summary

RBD

Roth IRA / Traditional IRA / Retirement Plan (before RBD)	Traditional IRA / Retirement Plan (on or after RBD)
Spouse	**Spouse**
• Five-year rule	• Life expectancy payments
• Life expectancy payments	• Lump sum
• Lump sum	• Transfer to own IRA
• Transfer to own IRA	• Distribution and rollover
• Distribution and rollover	
Nonspouse	**Nonspouse**
• Five-year rule	• Life expectancy payments
• Life expectancy payments	• Lump sum
• Lump sum	
Nonperson	**Nonperson**
• Five-year rule	• Life expectancy payments
• Lump sum	• Lump sum

Beneficiary Distribution Options Summary – Death Before the RBD

The following chart summarizes a beneficiary's distribution options when an account owner dies before the RBD.

Spouse Is Sole Designated Beneficiary	• Five-year rule • Life expectancy payments – **Payments must begin** by the later of December 31 of the year following the year of the account owner's death or December 31 of the year the account owner would have attained age 70½. – **Life expectancy is determined** each year using the spouse beneficiary's single life expectancy, recalculated. • Treat IRA as own (transfer) • Distribute and roll over assets to own IRA, to an inherited IRA, or to an eligible retirement plan
Nonspouse Beneficiary or Spouse NOT Sole Beneficiary	• Five-year rule • Life expectancy payments – **Payments must begin** by December 31 of the year following the year of the account owner's death. – **Life expectancy is determined** the first year using the oldest beneficiary's single life expectancy in the year following the year of the account owner's death. If separate accounting applies, each beneficiary may use his own single life expectancy. Subsequent years' payments are determined using nonrecalculation (spouse may use recalculation if there is separate accounting). • Nonspouse beneficiary may directly roll over **plan assets to an inherited IRA** • Spouse beneficiary may roll over assets to own IRA, to an inherited IRA, or to an eligible retirement plan
Nonperson Beneficiary (estates, entities, and certain trusts)	• Five-year rule

NOTE: *IRA or plan document language may modify available distribution options.*

Beneficiary Distribution Options Summary – Death On or After the RBD

If an account owner dies on or after the RBD, the final regulations require that distributions continue using the longer of the designated beneficiary's remaining life expectancy, or the account owner's remaining life expectancy fixed in the year of death and nonrecalculated in subsequent years.

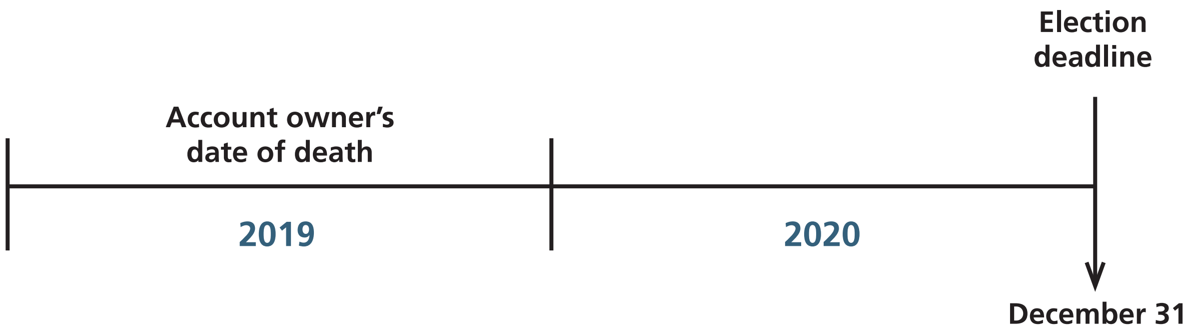
The following chart summarizes beneficiary distribution options when the Traditional IRA or retirement plan account owner dies on or after the RBD.

Spouse Is Sole Designated Beneficiary	• Life expectancy payments taken annually – **Payments must begin** by December 31 of the year following the year of the account owner's death – **Life expectancy for first year** is the longer of • the spouse beneficiary's single life expectancy in the year following the year of the account owner's death, or • the account owner's single life expectancy in the year of death, reduced by one. – **Life expectancy for subsequent years** is determined using recalculation if using the spouse beneficiary's life expectancy and nonrecalculation if using the account owner's life expectancy. • Treat IRA as own (transfer) • Distribute and roll over assets to own IRA, to an inherited IRA, or to an eligible retirement plan
Nonspouse Beneficiary or Spouse NOT Sole Beneficiary	• Life expectancy payments taken annually – **Payments must begin** by December 31 of the year following the year of the account owner's death – **Life expectancy for first year** is the longer of • the oldest designated beneficiary's single life expectancy (unless separate accounting applies) in the year following the year of the account owner's death, or • the account owner's single life expectancy in the year of death, reduced by one. – **Life expectancy for subsequent years** is determined using nonrecalculation (spouse may use recalculation if separate accounting applies). • Nonspouse beneficiary may directly roll over plan assets to an inherited IRA • Spouse beneficiary may roll over assets to own IRA, to an inherited IRA, or to an eligible retirement plan
Nonperson Beneficiary (estates, entities, and certain trusts)	• Life expectancy payments taken annually – **Payments must begin** by December 31 of the year following the year of the account owner's death. – **Life expectancy for first year** is the account owner's single life expectancy in the year of the account owner's death, reduced by one. – **Life expectancy for subsequent years** is determined using nonrecalculation.

NOTE: *In the year of the account owner's death, the beneficiary must satisfy the decedent's RMD by December 31 of that year if the account owner did not satisfy it before death.*

Beneficiary Election Deadline

A nonspouse beneficiary or a spouse who is not the sole designated beneficiary generally must elect a distribution option by December 31 of the year following the year of the account owner's death.



A spouse who is the sole designated beneficiary generally must elect a distribution option by the earlier of

- December 31 of the year in which life expectancy payments are required to commence, or
- December 31 of the year containing the fifth anniversary of the account owner's death.

Sole Designated Spouse Beneficiary Election Deadline

Cindy was born on June 19, 1952, and died on March 15, 2019, which was before her RBD. Her husband, Jon, is her only primary beneficiary. By what date must Jon elect a distribution option?

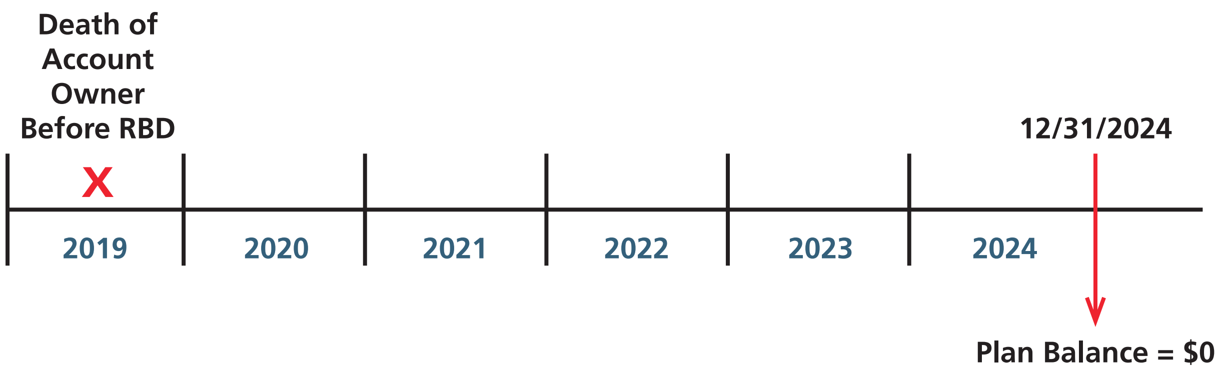
December 31, 2020 **December 31, 2022** **December 31, 2024**

NOTE: *If the beneficiary fails to make an election by the required deadline, the Treasury regulation default provision of life expectancy payments generally applies. Some IRA and retirement plan documents may contain a different election date or default provisions.*

Five-Year Rule

Under the Treasury regulations, if an account owner dies before her RBD, distributions must follow either the five-year rule or the life expectancy payment option (Treas. Reg. 1.401(a)(9)-3).

The five-year rule allows a beneficiary to take distributions in any amount at any time—as long as the beneficiary depletes her portion of the account by December 31 of the year containing the fifth anniversary of the account owner's death.



Life Expectancy Payments

The life expectancy payment option generally requires distributions to be taken over a period not extending beyond the designated beneficiary's life expectancy or the deceased account owner's life expectancy, depending on the type of account and the account owner's age at the time of death.

To calculate a beneficiary's life expectancy payment for a year, the prior year's December 31 account balance must be divided by a life expectancy factor, which the RMD regulations refer to as the "distribution period." The following represents the formula for the calculation.

$$\frac{\text{Account balance}}{\text{Distribution period}} = \text{Life expectancy payment (RMD)}$$

Recalculation vs Nonrecalculation

The distribution period is obtained from the Single Life Expectancy Table. Beneficiaries must use the Single Life Expectancy Table when calculating life expectancy payments. The distribution period is redetermined each year using either recalculation (for spouse beneficiaries only) or nonrecalculation.

Recalculation means determining the distribution period each year using the Single Life Expectancy Table and the age the spouse beneficiary will become in the distribution year. Only spouse beneficiaries may use this method.

Nonrecalculation means determining the distribution period in the first distribution year and subtracting one year from the distribution period for each subsequent year. Nonspouse beneficiaries must use this method.

Recalculation vs Nonrecalculation

Joe is the beneficiary of his wife's IRA, and Bonnie is the beneficiary of her father's IRA. Both will attain age 68 in the first year of beneficiary distributions.

	Joe (Spouse Beneficiary)	**Bonnie** (Nonspouse Beneficiary)
Attained Age in Distribution Year	Recalculation Distribution Period	Nonrecalculation Distribution Period
68	18.6	18.6
69	17.8	17.6
70	17.0	16.6
71	16.3	15.6
72	15.5	14.6

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Single Life Expectancy Table

Single Life Expectancy Table					
Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
25	58.2	54	30.5	83	8.6
26	57.2	55	29.6	84	8.1
27	56.2	56	28.7	85	7.6
28	55.3	57	27.9	86	7.1
29	54.3	58	27.0	87	6.7
30	53.3	59	26.1	88	6.3
31	52.4	60	25.2	89	5.9
32	51.4	61	24.4	90	5.5
33	50.4	62	23.5	91	5.2
34	49.4	63	22.7	92	4.9
35	48.5	64	21.8	93	4.6
36	47.5	65	21.0	94	4.3
37	46.5	66	20.2	95	4.1
38	45.6	67	19.4	96	3.8
39	44.6	68	18.6	97	3.6
40	43.6	69	17.8	98	3.4
41	42.7	70	17.0	99	3.1
42	41.7	71	16.3	100	2.9
43	40.7	72	15.5	101	2.7
44	39.8	73	14.8	102	2.5
45	38.9	74	14.1	103	2.3
46	37.9	75	13.4	104	2.1
47	37.0	76	12.7	105	1.9
48	36.0	77	12.1	106	1.7
49	35.1	78	11.4	107	1.5
50	34.2	79	10.8	108	1.4
51	33.3	80	10.2	109	1.2
52	32.3	81	9.7	110	1.1
53	31.4	82	9.1	111 +	1.0

NOTE: *This is not the complete Single Life Expectancy Table. More complete tables can be found in IRS Publication 590-B,* Distributions from Individual Retirement Arrangements (IRAs), *and in Treasury Regulation 1.401(a)(9)-09, Q&A 1.*

Spouse Beneficiary Deemed to Treat IRA as Own

If a spouse beneficiary inherits an IRA, the spouse beneficiary can treat the IRA as his own as if he were the original IRA owner at any time. Spouse beneficiaries generally transfer inherited IRA assets to their own IRAs soon after the IRA owner's death. But sometimes the spouse chooses to keep the assets in an inherited IRA.

Treas. Reg. 1.408-8, Q&A 5 indicates that the surviving spouse beneficiary is deemed to have elected to treat inherited IRA assets as his own if he

- redesignates the IRA as his own,
- fails to remove a required distribution, or
- makes a contribution to the deceased IRA owner's IRA.

The spouse beneficiary generally has to be the sole designated beneficiary to use the "treat as own" option.

Inherited Plan Rollovers to Inherited IRAs

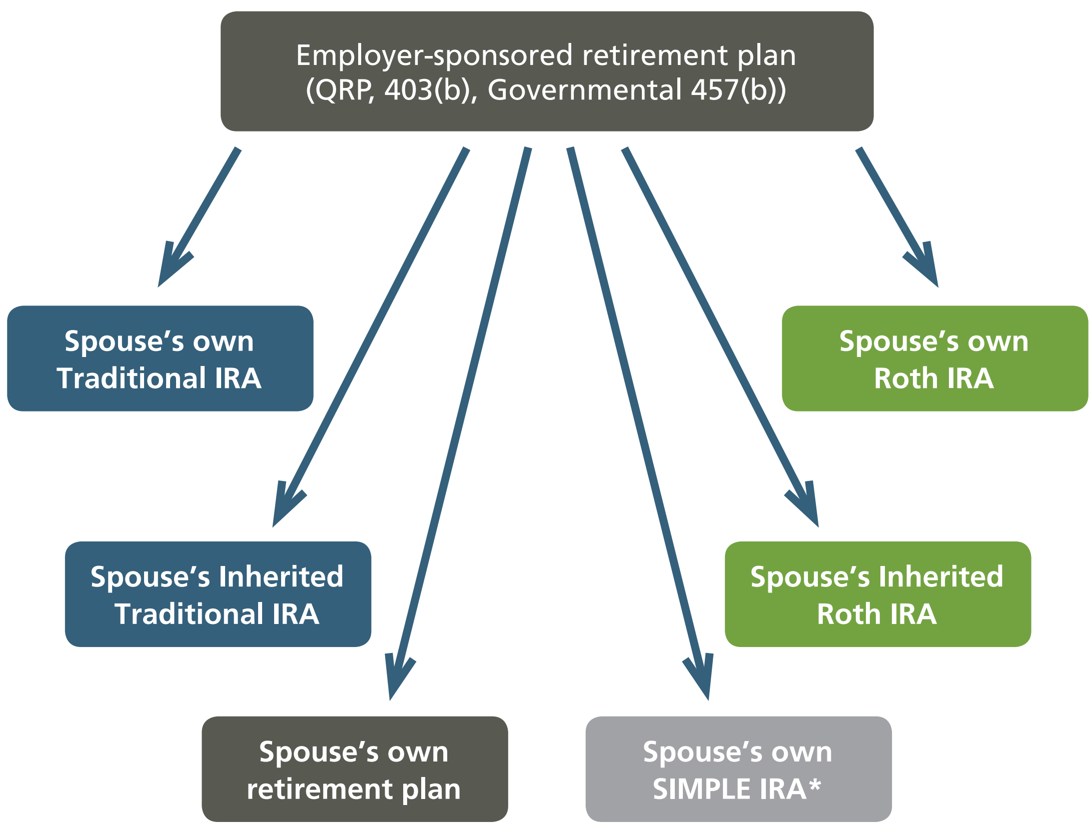
Spouse beneficiaries of employer-sponsored retirement plans may roll over inherited plan assets to their own retirement plan, IRA, or inherited IRA. Nonspouse beneficiaries of employer-sponsored retirement plans generally may roll over inherited plan assets to an inherited IRA.

Spouse Beneficiary Rollovers

For a surviving spouse of a participant in an eligible employer-sponsored retirement plan, the rollover rules generally apply as if the surviving spouse is the participant, with no restrictions.

- The spouse may directly or indirectly roll over such assets to another eligible retirement plan, to his own Traditional, Roth, or SIMPLE IRA*, or to an inherited Traditional or Roth IRA.
- All or a portion of the rollover may be taxable if the spouse beneficiary rolls over inherited pretax assets to his own Roth IRA or to an inherited Roth IRA.

NOTE: *Spouse beneficiaries who inherit designated Roth account assets may roll over those assets to their own designated Roth account, Roth IRA, or inherited Roth IRA.*



*Must have met the SIMPLE IRA two-year clock

Nonspouse Beneficiary Rollovers

Employers operating qualified retirement plans (QRPs), 403(b) plans, or governmental 457(b) plans must offer nonspouse beneficiaries the option to directly roll over eligible inherited plan assets to inherited Traditional and Roth IRAs. The following requirements apply.

- A nonspouse beneficiary may not roll over an undistributed RMD or life expectancy payment.
- The inherited IRA must identify both the deceased plan participant and the beneficiary (e.g., "Jon Baker as beneficiary of Cindy Baker").
- An inherited IRA may be established for a qualified trust that is the named plan beneficiary if the trust's beneficiaries are individuals. The trust's oldest underlying beneficiary's age or the deceased plan participant's age may be used to determine life expectancy payments.
- Rollovers of inherited pretax assets to an inherited Roth IRA are taxable in the year they are rolled over.
- If a nonspouse beneficiary is subject to the five-year rule under the plan, the entire amount of the inheritance is eligible to be rolled over within the first four years following the year of death. Any assets remaining in the account on January 1 of the fifth year are ineligible for rollover.

A special rule permits certain beneficiaries who are subject to the five-year rule under the plan to switch to the life expectancy payment method. If a beneficiary makes this switch, the beneficiary must

- distribute that year's life expectancy payment from the plan and roll over the remaining balance to an inherited IRA before December 31 of the year following the death year, and
- continue taking annual life expectancy payments from the IRA.

Beneficiaries must use the same life expectancy that they would have used under the plan to calculate their IRA life expectancy payments.

NOTE: *Nonspouse beneficiaries may not roll over inherited retirement plan assets to other retirement plans.*

No Beneficiary Listed for IRA or Retirement Plan

Some account owners may fail to name a beneficiary before death. In those cases, the following guidance should help in determining how the IRA or retirement plan assets are to be paid out.

- Check the IRA or retirement plan default provisions. Most IRA and retirement plan documents provide for payment of IRA or retirement plan assets if a beneficiary is not named. Some default to the surviving spouse (if any); others provide for payment to the decedent's estate.
- If there is no plan provision specifying a beneficiary, the individual's estate generally is deemed to be the beneficiary of the IRA or retirement plan proceeds under state law. State law also will dictate the portion that surviving beneficiaries will receive, based on their relationship to the account owner (assuming that the account owner does not have a will).

IRA and QRP Introduction to Beneficiary Options

Answer the following questions.

1. Arthur Grossman died on October 14, 2019. His two primary beneficiaries are his wife, Sandy, and his son, Barry. By what date must separate accounting be established?

   What is the benefit of separate accounting?

2. Frank is the beneficiary of his wife's IRA. He will attain age 73 in 2019; the first year of beneficiary distributions. How will his beneficiary distributions be calculated each year?

   Recalculation **Nonrecalculation**

   Using the Single Life Expectancy Table on page 14, what divisors will be used in Frank's first three years of beneficiary distributions?

   Kathy is the beneficiary of her uncle's IRA. She will attain age 47 in 2019; the first year of beneficiary distributions. How will her beneficiary distributions be calculated each year?

   Recalculation **Nonrecalculation**

   Using the Single Life Expectancy Table on page 14, what divisors will be used in Kathy's first three years of beneficiary distributions?

3. May a beneficiary move inherited QRP assets to another type of account?

4. What is the election deadline for a nonspouse beneficiary or a spouse beneficiary who is not the sole designated beneficiary?

   What is the election deadline for a spouse beneficiary who is the sole designated beneficiary?

Exercise Answers

IRA and QRP Introduction to Beneficiary Options

1. Arthur Grossman died on October 14, 2019. His two primary beneficiaries are his wife, Sandy, and his son, Barry. By what date must separate accounting be established?

   December 31, 2020. Separate accounts must be established by December 31 of the year following the year of the IRA owner's death.

   What is the benefit of separate accounting?

   Separate accounting allows the beneficiary more distribution options. It also permits the financial organization to report distributions and the fair market value in the beneficiary's name and Social Security number.

2. Frank is the beneficiary of his wife's IRA. He will attain age 73 in 2019; the first year of beneficiary distributions. How will his beneficiary distributions be calculated each year?

   Recalculation **Nonrecalculation**

   Using the Single Life Expectancy Table on page 14, what divisors will be used in Frank's first three years of beneficiary distributions?

   2019 – 14.8
   2020 – 14.1
   2021 – 13.4

   Kathy is the beneficiary of her uncle's IRA. She will attain age 47 in 2019; the first year of beneficiary distributions. How will her beneficiary distributions be calculated each year?

   Recalculation **Nonrecalculation**

   Using the Single Life Expectancy Table on page 14, what divisors will be used in Kathy's first three years of beneficiary distributions?

   2019 – 37.0
   2020 – 36.0
   2021 – 35.0

3. May a beneficiary move inherited QRP assets to another type of account?

   A spouse beneficiary may directly or indirectly roll over such assets to another eligible retirement plan, to his own IRA, or to an inherited IRA. A nonspouse beneficiary may directly roll over eligible inherited plan assets to an inherited IRA.

4. What is the election deadline for a nonspouse beneficiary or a spouse beneficiary who is not the sole designated beneficiary?

   A nonspouse beneficiary or a spouse beneficiary who is not the sole designated beneficiary generally must elect a distribution option by December 31 of the year following the year of the account owner's death.

   What is the election deadline for a spouse beneficiary who is the sole designated beneficiary?

   A spouse who is the sole designated beneficiary generally must elect a distribution option by the earlier of December 31 of the year in which life expectancy payments are required to commence, or December 31 of the year containing the fifth anniversary of the account owner's death.