Warner Norcross + Judd LLP

PLANNING FOR TRADITIONAL IRAS AND QUALIFIED PLAN ACCOUNTS

BACKGROUND

Your IRA or qualified plan is not taxable to you as income until distributed to you. As a result, any growth in your IRA or qualified plan is not taxed until distributed. Distributions must be made, however, at some point. The rules that determine when distributions must be made and taxes paid were significantly changed on January 11, 2001, and again on April 25, 2002. The new rules simplify calculation of distributions during lifetime and upon death.

If you die with an IRA or qualified plan, the balance will be taxed as an asset of your estate. There are special rules for determining how quickly your beneficiaries must take distributions from the plan.

If your IRA or qualified plan is a significant asset of your estate, special planning for its ultimate distribution should be an integral part of your estate plan.

INCOME TAX ISSUES

When Must Distributions Begin?

- **Distributions During Lifetime**

Generally, distributions must begin no later than your "required beginning date" (**RBD**). Generally, your RBD is the later of (1) your retirement, or (2) April 1 of the calendar year following the year in which you turn 70½.

In each year following your RBD you must take a minimum distribution from your IRA or qualified plan. If you fail to take a minimum distribution you must pay a penalty of 50% of the amount which should have been distributed.

- **Distributions After Death**

    - Death Occurring Prior to RBD

If you die prior to your RBD and you designated your spouse as beneficiary, your spouse may roll the IRA or qualified plan into his or her own IRA and begin taking distributions on their RBD, using their life expectancy. Alternatively, your spouse can elect to keep the existing plan as is and begin taking distributions when you would have attained your RBD. Typically, the surviving spouse would pick whichever option would defer the RBD for the longest period of time.

If you die prior to your RBD and you have designated an individual other than your spouse as beneficiary, he or she must begin taking distributions by December 31 of the calendar year following your death, over a 5-year period or over his or her life expectancy. If you have designated multiple beneficiaries, or a beneficiary without a life expectancy (such as a charity), the rules are more complex.

- Death Occurring After RBD

If you die after your RBD and you designated your spouse as beneficiary, your spouse may roll the IRA or qualified plan into his or her own IRA and begin distributions on his or her RBD. Alternatively, your spouse can elect to keep the plan as is and, using their life expectancy, take distributions over your life expectancy.

If an individual other than your spouse is your beneficiary, he or she must begin taking distributions by December 31 of the calendar year following your death over the longer of his or her life expectancy or your remaining life expectancy.

What Amount Must Be Distributed?

In addition to determining when distributions from your IRA or qualified plan must begin, you must also determine the amount which is required to be distributed to you each year (the "minimum required distribution" or **MRD**). This used to be a complicated task, requiring elections to recalculate or not recalculate life expectancies, and it was determined in part on whom you designated as beneficiary. Those rules are largely eliminated and the IRS has published a new, single Uniform Table to be used to calculate MRDs. In addition, your designated beneficiary no longer has any impact on the speed with which your plan must be distributed to you.

To calculate your MRD, merely take the previous year's closing account balance and divide by your "divisor" on the Uniform Table.

> **Example 1.** In 2006 Participant is 72 years old which makes her divisor 25.6. Participant's account balance on December 31 of 2005 was $1,000,000. Participant's MRD for 2006 is $39,062.50.

ESTATE TAX ISSUES

Generally, the value of your IRA or qualified plan account is includable in your gross estate for federal estate tax purposes. This means that your IRA or qualified plan will be reduced by estate taxes and income taxes and the remaining balance will pass to your beneficiaries. Because the top estate tax rate is 46% in 2006, and individual income tax rates can run as high as 44%, the combined taxes significantly reduce your IRA or qualified plan account balance.

From an income tax perspective, designating your spouse as beneficiary of your IRA or qualified plan is attractive, as it permits the maximum income tax deferral and growth in the plan. From an estate planning perspective, designating your spouse as beneficiary permits the entire account balance to pass free from estate tax under the marital deduction. The catch is that at your spouse's death, the remaining IRA account balance will be includable in his or her gross estate and perhaps subject to estate taxes. If you are married and your combined net worth exceeds $2,000,000, you should have your beneficiary designation carefully coordinated with your estate plan to fully maximize use of your estate tax-free amount.