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Reducing Required Minimum Distributions from a Defined Contribution Plan: The Spousal Rollover IRA

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During a participant's lifetime, required minimum distributions ("RMDs") from a defined contribution plan are relatively small in size. Less favorable treatment may apply after the participant's death, depending on the distribution options offered by the plan, the form of distribution elected by the participant, the age of the beneficiary and the relationship between the participant and the beneficiary.

Surviving spouses can take advantage of a special rule that permits them to create spousal rollover IRAs, which effectively allow the surviving spouse to treat the benefit as if he or she was a participant in the plan. This treatment allows the surviving spouse to elect a longer payout and to designate a beneficiary who may also be eligible for an extended distribution period.

- During the participant's lifetime, RMDs are generally calculated based upon the distribution period provided in the Uniform Lifetime Table, which is a proxy for the participant and a beneficiary who is younger by 10 years or less.

- If the beneficiary is a spouse who is more than 10 years younger, the distribution period can be determined according to the Joint and Last Survivor Table, which provides a longer distribution period than is provided under the Uniform Lifetime Table. For example, if the participant is 72 years old, his distribution period under the Uniform Lifetime Table will be 25.6 years. However, if this same 72 year old participant is married to a 50 year old, who is the beneficiary of the account, the applicable distribution period, taken from the Joint and Last Survivor Table, will be 34.9 years.

- Upon the participant's death, the RMDs become subject to distribution under the Single Life Table, which provides for a shorter distribution period than the Uniform Lifetime Table.

- In addition, beneficiaries are generally prohibited from extending the payout period by designating a beneficiary, they cannot extend distribution of the remaining account balance following their deaths. (And, because beneficiaries cannot designate a surviving spouse, they cannot benefit from the significantly longer distribution period provided in the Joint and Last Survivor Table for individuals married to spouses more than 10 years their junior.)

Accordingly, designated beneficiaries often receive a larger distribution than they would prefer. In particular, surviving spouses at or near the same age as the deceased participant find that the required minimum distributions from the account practically double in size, leaving these surviving spouses with a significantly larger taxable distribution than was received during the participant's lifetime. Further, because beneficiaries cannot designate a beneficiary, they are prevented from extending the payout period following their own deaths, as well as from remarrying and taking advantage of the longer distribution period provided under the Joint and Last Survivor Table.

Spousal Rollover IRA

When a participant dies, a surviving spouse may elect to roll over a qualified plan account to an IRA that the spouse designates as the spouse's IRA, called a "spousal rollover IRA."

- To elect to treat the account as a "spousal rollover IRA", the surviving spouse must be the sole designated beneficiary of the account and must have the right to withdraw the full amount of the account balance at any time. If these requirements are met, the spouse can roll over the remaining account balance into an IRA in the surviving spouse's name.

- As a result of such a rollover, the required minimum distributions to the surviving spouse for the calendar year of the election as well as for all future calendar years can be determined by treating the surviving spouse as the IRA owner.

- During the surviving spouse's lifetime the distribution period for calculating the required minimum distribution can be drawn from the Uniform Lifetime Table, instead of the Single Lifetime Table.

- If the surviving spouse remarries an individual more than 10 years his or her junior, the new spouse can be designated as the sole beneficiary of the account, in which case the distribution period can be determined according to the Joint and Last Survivor Table.

- In addition, because the account is treated as belonging to the surviving spouse, the surviving spouse can designate a beneficiary to receive benefits upon the surviving spouse's death. This permits the distributions to the surviving spouse to be stretched out over a longer period.

- It also means that upon the death of the surviving spouse, the remaining account balance can be distributed according to the longer of the surviving spouse's life expectancy and the life expectancy of the surviving spouse's designated beneficiary.

It is never too early to consider the "spousal rollover IRA". Indeed, given the tax benefits inherent in the "spousal rollover IRA", the participant and spouse should consider this tax deferral method when discussing estate planning. Considering the "spousal rollover IRA" *prior* to the participant's death ensures that the participant's account will be timely and properly rolled over, enabling the surviving spouse to maximize the tax benefits inherent in this tax deferral method.

James Damon co-authored this post.

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