

Retirement Accounts: Required Minimum Distributions Suspended in 2009

The Worker, Retiree, and Employer Recovery Act of 2008 suspended required minimum distributions (RMDs) from defined contribution retirement accounts for 2009. This Client Alert will highlight some factors you may want to consider if you are currently subject to the RMD requirements.

Background. Generally, RMDs must be taken from IRAs and certain qualified retirement plans after the owner or participant reaches 70½ years of age. For some employees who work past age 70½, RMDs from qualified plans may be delayed until after retirement. Beneficiaries who inherit an interest in an IRA or qualified plan account must also take RMDs. (Roth IRA accounts are not subject to the RMD rules during the account owner's lifetime, but RMDs must be taken after the account owner's death, even though the distributions are generally not taxable.)

In most cases, RMDs are calculated by dividing the account balance at the end of the prior year by a factor based on the participant's or beneficiary's life expectancy. If an account balance declines significantly during a year, the RMD can represent a disproportionately large share of the remaining account balance. By suspending RMDs in 2009, the new law gives affected retirement accounts an opportunity to regain more of the value they have lost in the recent economic downturn.

Much of the commentary on the 2009 RMD suspension has focused on tax deferral. Distributions from retirement accounts are usually subject to income tax, so those who refrain from taking an RMD this year will have that much less taxable income in 2009. However, in deciding whether or not to take a distribution, other issues should also be considered.

- *Investment Gains.* Assets held in a retirement account are usually taxed at ordinary income tax rates upon distribution. If you anticipate that your investments may have substantial gains in the future, it may be advantageous to take distributions now (when account values are lower), pay the income tax and reinvest the "after-tax" dollars in investments that generate capital gains, rather than ordinary income. Furthermore, assuming the new investments are held until death, your heirs may be able to completely avoid the capital gains taxes because of the "step-up" in basis at an owner's death. (This assumes no change in the tax laws concerning capital gains.)

- *Reduce Double Taxation.* If an individual's estate is taxable and his or her retirement accounts pass to a non-spouse beneficiary at death, the accounts may be subject to both income and estate tax. Therefore, if you expect that your accounts will pass to a non-spouse beneficiary, you may want to reduce the portion of your estate that is subject to this double taxation by continuing to take distributions.

Because the new law was enacted late in the calendar year, you may receive a Form 5498 from your financial institution indicating that you are required to take an RMD in 2009. This information is incorrect, and you should receive a follow-up notice by March 31 explaining the change in the law.

If you would like additional information about the new law and how the RMD rules work, please feel free to contact one of the attorneys in the Trusts and Estates Department at Wiggin and Dana. Our names and telephone numbers are listed below.

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