PKF PERSPECTIVES

NEW RULES FOR REQUIRED MINIMUM DISTRIBUTIONS FROM QUALIFIED PLANS, IRAs, SECTION 457 PLANS AND SECTION 403(b) CONTRACTS

... Leo Parmegiani, CPA

The IRS has recently issued final regulations on the required minimum distributions (RMDs) from separate accounts in qualified retirement plans, Individual Retirement Accounts (IRAs) and other retirement contracts. The regulations were a long time in coming (18 years), clarifying tax law enacted as part of the 1984 tax legislation. The new rules apply for determining RMDs for calendar year 2003, but taxpayers may also rely upon these rules for 2002. Regulations proposed in 1987 and 2001 may also be used for 2002, but most people will find the new rules more beneficial.

Background

Individuals are required to take minimum distributions from their retirement plans (and thus be subject to tax) beginning not later than the individual's required beginning date (RBD) over the life of the individual or over the lives of the individual and a designated beneficiary. RBD means April 1 of the calendar year following the later of

- the calendar year the individual attains 70½, or
- the calendar year an individual retires from employment with the employer maintaining the plan. (5 percent owners do not have this option.)

In connection with these required distributions, complex regulations had been issued in the past to determine the amount which must be distributed each year, what happens in the event the account owner either dies before or after the RMD, and who qualifies as a beneficiary, to name a few of the issues. Some would say, the past regulations were far too complex and confusing to the point where the rules were unmanageable and clarification and simplification were necessary.

How Do You Determine the Required Minimum Distribution?

It is simple. You take the account balance as of the end of the preceding year and divide it by the distribution period as set forth in the table provided in the final regulations. *(See table at end of this article.)* For lifetime RMDs, there is a uniform distribution period for almost all employees the same age. The payout period is based on the joint life of the owner and a hypothetical beneficiary 10 years younger than the owner. However, if the employee's sole beneficiary is his or her spouse and the spouse is more than 10 years younger, the joint life and last survivor life expectancy of the employee and spouse is permitted.

More Good News

The new tables to be used spread RMDs out over a longer period, thus resulting in smaller annual required distributions than those under the 2001 proposed regulations.

EXAMPLE:
Max Martin was born on July 3, 1931. He attained age 70½ on January 3, 2002 and will attain age 71 on July 3, 2002. Under the new uniform lifetime table in the final regulations, his RMD for 2002, the year in which he attains age 70½, is found by dividing his ending IRA balance of $500,000 on December 31, 2001 by 26.5, the revised life expectancy factor for an IRA owner 71 years of age (Max's birthday in the first distribution calendar year of 2002). The result is $18,868, his required minimum distribution for 2002. Under the 2001 proposed regulations, his RMD for 2002 would be $19,763 (his ending IRA balance on December 31, 2001, divided by a table factor of 25.3).

Post-Death Payouts

The retirement plan and IRA payout rules that apply after the death of the owner vary depending upon whether the account has a designated beneficiary, whether such beneficiary is the spouse of the owner and also whether the deceased has already begun receiving RMDs (i.e., had attained age 70½).

If the account **has** a designated beneficiary, and death occurs **before** the individual's RBD, the remaining account balance is paid out either:

a within five years of the individual's death, **or**

b over the life expectancy of the beneficiary, assuming that distributions commence within one year of the individual's death.

> ***NOTE:***
> ***Under the 1987 proposed regulations, the 5-year payout was the default method unless the spouse was the sole beneficiary. The lifetime payout rule is a better option for beneficiaries who want to keep the decedent's IRA alive as a tax-shelter device for as long as possible.***

The final regulations allow beneficiaries who were saddled by the 5-year payout rule under the 1987 proposed regulations to switch to the life expectancy rule, as long as all amounts that would have been required to be distributed under that rule are distributed by the earlier of December 31, 2003 or the end of the 5-year period following the year of the employee's death.

□ If the account **has** a designated beneficiary, and death occurs **after** the individual's RBD, then distribution must be made over the longer of the remaining life expectancy of the beneficiary or remaining life expectancy of the employee.

□ If the account does **not** have a designated beneficiary and the account owner dies **after** his RBD, the balance must be distributed over the remaining life expectancy of the account owner.

□ If the account does **not** have a designated beneficiary and the account owner dies **before** his RBD, the account balance must then be paid out within five years after the owner's death.

Determination of Designated Beneficiary

Under the 2001 proposed regulations, except for certain surviving spouse situations and annuity-style payouts, the account owner's designated beneficiary is determined based on beneficiaries designated as of the last day of the calendar year following the calendar year of the account owner's death. The final regulations provide that "in order to be a designated beneficiary, an individual must be so designated as of the date of death and remain beneficiary as of September 30 of the calendar year following the calendar year of the account owner's death." So for a death on June 30, 2003, the beneficiary must be named by that date and remain a beneficiary until September 30, 2004. The revised rule leaves less time to make post-mortem changes that affect beneficiary payout schedules.

Also, the final regulations make it clear that only beneficiaries as of the date of death can be eliminated during the period between death and the beneficiary determination date. They do not allow a beneficiary (e.g., an estate) to be replaced by a beneficiary (e.g., the individual who is the sole beneficiary of that estate) who was not designated as such as of the date of death.

Separate Accounts

The 2001 proposed regulations allowed an account to be divided into several separate accounts, but didn't provide detailed guidance on how this worked. The final regulations clarify that separate accounts with different beneficiaries can be established at any time, either before or after the account owner's RBD. However, the separate accounts are recognized for RMD purposes only for years after the year the separate accounts were established, or the date of death, if later. To determine the distribution period for a separate account, the separate account must be established no later than the end of the year following the year of the employee's death. Under the final regulations, the separate accounting must allocate all post-death investment gains and losses for the period before the separate accounts' creation on a pro rata basis in a reasonable and consistent manner. The separate accounting must also allocate any post-death distribution to the separate account of the beneficiary receiving that distribution.

Uniform Lifetime Table

Age of Employee	Distribution Period	Age of Employee	Distribution Period
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115+	1.9

Trusts as Beneficiaries

Under the final regulations, an underlying beneficiary of a trust may be treated as the account owner's designated beneficiary for RMD purposes when the trust is named as the beneficiary of a retirement plan or IRA, if certain requirements are met (e.g., documentation of the underlying beneficiaries of the trust must be provided timely to the plan administrator). For individual accounts under a defined contribution plan or for IRAs (unless the lifetime distribution period for an account owner is measured by the joint life expectancy of the owner and his spouse), the deadline for providing documentation is September 30 of the year following the owner's death.

IMPACT FEES

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In 2001, the IRS announced the selection of seven issues as part of its Industry Issue Resolution (IIR) Pilot Program. This program is intended to resolve issues common to large business taxpayers, rather than relying on case-by-case audits and varying treatment of similar items. In a past issue (No. 5, February 2002) of ***PKF Perspectives***, we reported on the resolution of two issues: (1) the treatment of restaurant "smallwares" packages, and (2) certain costs incurred in golf course construction. In this issue, we discuss the tax treatment of local "impact" fees paid by real estate developers.

What are Impact Fees?

Impact fees are one-time charges imposed by a state or local government for new development or the expansion of an existing development. The funds are used to finance specific off-site capital improvements for general public use that are necessitated by such development (e.g., schools and law enforcement and fire protection facilities). Impact fees are generally refundable (in full or part) if the development is not constructed as planned.

Tax Treatment Prior to the IIR Pilot Program

In IRS Technical Advice Memorandum (TAM) 200043016 released on October 30, 2000, the IRS concluded that impact fees constitute intangible property that should **not** be added to the depreciable basis of constructed real estate because they do not have determinable useful lives. The initial view was that these fees resulted in an overall benefit to the taxpayer's business and had no relationship to the life of any tangible asset. Thus, the fees were required to be capitalized as an intangible asset with no determinable useful life. The result was that no tax deduction was available. This memorandum apparently ignored the connection between impact fees and the building being constructed.

Welcome IRS Revenue Ruling 2002-9

Earlier this year, the IRS issued guidance on the capitalization of impact fees which is reflected in Rev. Rul. 2002-9. The ruling provides what we believe is a sensible resolution of this issue: **impact fees incurred in connection with the construction of a new residential rental building are capitalized costs allocated to the building and thus depreciable. No portion of the costs are allocable to the land**.

Facts in the Ruling

The taxpayer in the ruling was in the business of developing, owning and leasing residential rental property. It purchased unimproved land located in a county on which it constructed a new residential rental building. The development plan submitted by the taxpayer to the county indicated that the building was to have many rental units. The county imposed "impact fees" on this new and expanded development.

Rationale for Decision

In the IRS ruling, various tax cases were cited which, in part, stated that impact fees are analogous to building permits, zoning variance fees and related negotiation costs since they all represent "first steps in the development of the property" and are "as much a part of a development project as digging a foundation or completing a structure's frame."

PKF OBSERVATION:
The ruling also held that impact fees are includible in the eligible basis of a qualified low income build-ing. **This will presumably increase the low-income housing tax credit available for investors.**

Application of the New Ruling

Any change in the treatment of impact fees in connection with new construction to conform to this ruling is treated as a change in accounting method. Automatic approval of this change is available by filing Federal Form 3115 which includes the statement "Automatic Change Filed Under Revenue Ruling 2002-9." The IRS has also stated that the treatment of impact fees will not be raised as an issue in any taxable year before the year of the change. If the issue has already been raised, a treatment consistent to this ruling will be pursued.

IN THE WORDS OF ...

Will Rogers (1879-1935): ***Noah must have taken into the Ark two taxes, one male and one female. And did they multiply bountifully! Next to guinea pigs, taxes must have been the most prolific animals.***

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a tax advisor. For more information, please contact Howard Pell or Leo Parmegiani at:

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