

IRA On-Death Spousal Distribution Options – An Advisor’s Perspective

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Spouses occupy a unique place in the law of distributions from IRAs. Knowing these rules and how to apply them may help advisors deliver effective solutions for their clients and strengthen their relationships. Federal tax laws are complex and subject to change. This information is based on current interpretations of the law. Neither the company nor its representatives give legal or tax advice. Please talk with your attorney or tax advisor for answers to your specific questions.

Spousal Distributions from IRAs

When an IRA owner dies and a spouse is named as the beneficiary, that surviving spouse has several distribution options to consider. Those options fall into two categories based on whether or not the IRA owner had begun taking Required Minimum Distributions (RMDs).

Category One - Spousal Distributions from IRAs Pre-RMD

If an IRA owner dies and has not begun RMDs then the surviving spouse may:

- Roll over the decedent’s IRA to a new IRA in his or her own name - a.k.a Spousal Re-registration;
- Maintain the IRA in the decedent’s name and remain the beneficiary - a.k.a Creating an account for the benefit of (FBO) the surviving spouse; or,
- Take a lump sum distribution.

Clearly a lump sum distribution would result in immediate taxation to the surviving spouse of the entire distribution; however, spousal re-registration and spousal FBO have the potential to help the surviving spouse mitigate taxes while at the same time providing access to the IRA funds the surviving spouse may need.

Pre-RMD - Spousal Re-registration

When a surviving spouse rolls over the decedent spouse’s IRA into their own name, they are using the spousal re-registration privilege, and making themselves the owner of the IRA. This new IRA could be combined with the surviving spouse’s other IRA assets or left in its own account. There are two consequence of this re-registration:

- (1) The surviving spouse’s age is now used as the determining age for the purposes of RMDs – meaning they get to use the Uniform Table to determine RMDs; and,
- (2) The 10% early withdrawal penalty tax may apply to any distributions if the surviving spouse is under age 59 ½.

Spousal re-registration is utilized in most spousal beneficiary scenarios for several reasons - the first being simplicity.

Surviving spouses re-registering the contract in their own names is easy to understand, gives the surviving spouse the control over the funds, and since many spouses who are named as the beneficiaries of the IRA are over age 59 ½ anyway, there is no 10% early withdrawal tax penalty to access the funds.

The second reason spousal re-registration is so popular is that most spouses who re-register are younger than the deceased spouse. Thus the surviving spouse is able to postpone taking RMDs than they would otherwise have been taken by the original owner.

An important planning point to consider about spousal re-registration is that it can be done at anytime – meaning the day after the owner's death or fifteen years from that time. Essentially the laws of IRA spousal distributions grant surviving spouses significant flexibility.

Pre-RMD - Creating a Spousal FBO Account

When a spouse continues an IRA in the name of the decedent, they are giving themselves access to the IRA balance without subjecting themselves to the possible 10% penalty tax when they take a withdrawal. This rule essentially gives surviving spouses who are under age 59 ½ and need money to live, the ability to access the IRA funds without penalty.

With this option the IRA account stays in the name of the original owner (titling on the IRA changes to something like: John Smith, deceased, FBO Jane Smith, spouse). Which means that RMDs are not due until the original owner would have turned age 70 ½ and are then calculated on the surviving spouse's age. So, an FBO spousal account is distinctly different from a spousal rollover account because no 10% penalty tax applies to any distributions and the RMD, while using the surviving spouses Uniform Table Life Expectancy factor, must begin when the original owner would have turned 70 ½.


Pre-RMD - Using Spousal FBO Accounts and Spousal Re-Registration Together

Let's look at a fictional example of using spousal FBO account and re-registration together. None of the hypothetical examples included herein are intended to represent any specific client or client situation. The assumptions used are for illustrative purposes; actual results will vary.

Assume we have a husband, age 50, with a \$200,000 IRA. His wife, age 49, is named as primary beneficiary. The husband dies. The wife needs to access the money in the IRA for living expenses.

What is a tax efficient way for the wife to title this IRA? Use both the spousal FBO and spousal re-registration options in succession – here's how.

First, the surviving spouse will continue the IRA in the name of the husband for her benefit – a spousal FBO account. What this titling does is allow the surviving spouse to access the funds in the IRA without a tax penalty (withdrawals still taxable, just no tax penalty) even though she's under age 59 ½. No RMDs are required from this account until the husband would have turned age 70 ½, so the wife is free to take as little or as much as she wishes.



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The second step in this income tax efficiency strategy will occur after the wife turns 59 ½ and re-registers the IRA into her own name. This re-registration will allow the surviving spouse to continue to take distributions from the IRA penalty tax free. Moreover, because she is now the owner, RMDs do not have to begin until the wife reaches age 70 ½, postponing those distributions even further than if the IRA remained in her husband's name. As you can see even though the wife was taking distributions from the IRA, this integrated strategy improves her flexibility to take discretionary distributions without penalty versus the forced distributions of RMD.

Category Two - Spousal Distributions from IRAs – Post-RMD

If an IRA owner dies after RMD has begun the surviving spouse may:

- Roll over the decedent's IRA to a new IRA in his or her own name – Spousal Re-registration;
- Create an account for the benefit of the surviving spouse (FBO account) and continue RMDs based on the greater of either the surviving spouses or decedent's single life expectancy; or,
- Take a lump sum distribution.

As with the spousal distribution options available prior to RMD, post-RMD spousal distribution rules offer the surviving spouse income tax reduction opportunities.

Post-RMD - Spousal Re-registration

With this option the surviving spouse is using the spousal re-registration privilege and becoming the IRA owner. Again, the consequences of this re-registration are the use of the surviving spouses age for RMD purposes and the application of the 10% tax penalty to distributions if the now surviving spouse owner is under age 59 ½. However, in practice when a decedent spouse who was taking RMDs dies, the surviving spouse is likely to be near or beyond age 70 ½ themselves, meaning that they will need to begin taking RMDs as well.

Provided the surviving spouse is younger than the decedent spouse, the spousal re-registration permits the decedent spouse to extend the life of the IRA because they get to use their own age under the Uniform Table factor to determine RMDs.

Post-RMD - Creating a Spousal FBO Account

This option may have some attraction if the surviving spouse is significantly older than the decedent spouse because the decedent's remaining single life expectancy, under the Single Life Table, may be greater than the surviving spouses life expectancy under the Uniform Table.

Let's look at a fictional example: Assume the IRA owning husband is age 75 and he dies. His spouse, who is beneficiary of the IRA is 88 and wants to limit distributions from this account. If the wife creates a spousal FBO account she could use the husband's Single Life Table life expectancy factor of 15.5 to determine the necessary RMD. If she were to re-register the account in her own name her Uniform Table life expectancy factor is 12.7. Thus, being able to use the husband's Single Table life expectancy factor in this situation will result in a lower RMD.

Finally, remember that spousal re-registration may be used at any time, and at some point it may become more advantageous to use the surviving spouses Uniform Table Life Expectancy versus the deceased spouses Single Life Table life expectancy, so a spousal re-registration could be done at that time.

Conclusion

As you can see the laws of distribution of IRAs offer surviving spouses significant flexibility depending on the needs of the surviving spouse, their age and the age of the decedent spouse. Your opportunity as the advisor is to understand the distribution options, and use this knowledge to provide a surviving spouse comfort in a difficult time and ultimately enhance the relationship you have with the entire family.

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