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# Estate Planning for Retirement Assets: Taxation and Other Challenges

Maximizing Tax Benefits, Evaluating Beneficiary Designations, and  
Navigating Minimum Required Distribution Rules

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TUESDAY, NOVEMBER 1, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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# Estate Planning For Retirement Assets and Other Challenges

November 1, 2011

Strafford Publications Webinar/Teleconference

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# Required Minimum Distribution (RMD) Rules

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- **Unique Income Tax Aspects of Tax Deferred Retirement Accounts**
- **Retirement “Accounts” Subject to the RMD Rules:**
- **401(k)s, 403(b)s, IRAs, Roth IRAs, Roth 401(k)s, SEP IRAs, SIMPLE IRAs**

# Required Minimum Distribution (RMD) Rules

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- **Distributions During The Account Owner's Lifetime**
- **Charitable IRA Rollovers**

# Required Minimum Distribution (RMD) Rules

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- **Distributions After The Account Owner's Death**
- **Spouse As Beneficiary (Spousal Rollover)**
- **“Designated Beneficiary” (Individuals and Certain Trusts)**
- **Non-Designated Beneficiary (Charities, Estates, and Other Trusts)**



# Required Minimum Distribution (RMD) Rules

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- **Non-Spouse Rollovers**
- **Roth IRAs and Roth 401(k)s**

# Required Minimum Distribution (RMD) Rules

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- **Separate Accounts and Multiple Beneficiaries**
- **Charities as Beneficiaries**

# Questions?

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- **If you have any other questions or would like a copy of my latest outline on this topic, please feel free to email me or connect with me on LinkedIn.**

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**Welcome**

**IRA Beneficiary Designations and  
Surviving Spouse Strategies**

*Why Many IRA Owners Should Use  
a Retirement Plan Trust*

# IRA Workshop

## How This Workshop Came About

- ◆ Qualified Retirement Plans create numerous estate planning problems
- ◆ Most people have no idea how it complicates their estate planning
- ◆ There are a lot of mistakes that are devastating
- ◆ Mistakes on QRPs are usually fatal and can't be reversed
- ◆ Relatively recent laws create new options that more people should use

# Bolinger & Hogue, LLP

- ◆ IRA – Traditional and Roth
- ◆ IRA's are a big problem asset in your estate
- ◆ We also mean -- 401K, 403B, 457, Keough, and any other qualified retirement plan
- ◆ These work even better when rolled into an IRA
- ◆ If not rolled into an IRA, these are even bigger problem assets for your estate!

# What We Will Cover

## Retirement Plan Trust

- ◆ Avoids the tax problems with IRAs
- ◆ Avoids the 5 Blow-out problems
- ◆ Avoids the 7 problems with individual beneficiaries
- ◆ 7 ways it protects beneficiaries
- ◆ 3 reasons why it is a better beneficiary than a normal living trust
- ◆ 7 situations where you should *absolutely* use a RPT
- ◆ Common questions regarding use

# Avoiding Tax Problems

## Three plans available:

- ◆ *Option 1* – pay the income tax (35%) immediately and have complete control over what is left
- ◆ *Option 2* – take the distribution in a trust and take the assets out over 5 years and pay the income tax each year (1/5, 1/4, 1/3, 1/2, and all)
- ◆ *Option 3* – “stretch” it -- take only RMDs throughout life



# Avoiding Tax Problems

- ◆ Stretch out not new
  - ◆ Stretch IRA, stretch out IRA, inherited IRA, eternal IRA, multi-generational IRA, or dynasty IRA
- ◆ Concept -- a beneficiary takes payments over his or her lifetime, and pays the income tax as they go

# Avoiding Tax Problems

Example: Harry turns 70 and 1/2; distributions of RMDs

<b>Current Amount of IRA</b>	<b>\$250,000</b>
Distributions to Harry to 86	\$281,054
Remainder of IRA	\$327,351
Distribution to wife – 4 years	\$88,901
Remainder of IRA on wife's death	\$330,862
<b>Total Distributions husband and wife</b>	<b>\$369,955</b>

# Avoiding Tax Problems

Example: Harry turns 70 and 1/2; distributions of RMDs

<b>Total Distributions husband and wife</b>	<b>\$369,955</b>
Remainder of IRA on wife's death	\$330,862
Divided 1/2 to son; 1/2 to grandchild	
Distributions to son – 27 years	\$521,504
Distributions to grandchild – 52 years	\$1,625,412
<b>Total Distributions to family</b>	<b>\$2,516,871</b>

# Avoiding Tax Problems

Example: Harry turns 70 and 1/2; distributions of  
RMDs

<b>Income tax if paid on wife's death</b>	<b>\$115,801</b>
<b>Income and estate tax on wife's death</b>	<b>\$191,072</b>

# Avoiding Tax Problems

- ◆ 2005 PLR allowed trusts to be a beneficiary and do a “stretch out”
- ◆ Generally, a beneficiary can use his or her own life expectancy
- ◆ That ruling has been affirmed over 500 times since
- ◆ The stretch is *not* automatic
- ◆ The beneficiary has to make the right choices
- ◆ The beneficiary has to handle it the right way

# Avoiding Tax Problems

- ◆ Remember that QRPs other than IRAs are an even bigger estate problem?
- ◆ Many company sponsored QRP custodians do not allow stretches beyond 5 years
- ◆ Why don't company plans allow all the tax options?
  - ◆ Don't know rules
  - ◆ Unwilling to administer according to the law
  - ◆ Don't want the liability
  - ◆ Can't be forced to abide by what the law allows
- ◆ That's why rollovers to IRA can be important!

# Avoiding Tax Problems

- ◆ If you do nothing, you may not know that is a problem while you are alive!
- ◆ But it will handcuff your beneficiaries upon your death
- ◆ They could be forced into the “blow-out” problem!

# Avoiding Tax Problems

- ◆ With any sizeable QRP, it make no sense for a beneficiary to take more than they have to sooner than they have to
- ◆ Taking it out too early creates the “blow-out” problem
- ◆ As big a problem as the taxes are, the tax problems may pale in comparison to other problems



# Qualified Retirement Plan Trust

**Who should use a Retirement Plan Trust?** Anyone in any of these categories:

- ◆ Concerned that beneficiaries would not make good choices regarding distribution.
- ◆ Concerned that a beneficiary could lose part of the inherited IRA in a divorce, bankruptcy, or lawsuit.
- ◆ A person with a minor child who would inherit the IRA. One year's guardianship alone will more than offset the cost of using a Retirement Plan Trust.

# Qualified Retirement Plan Trust

**Who should use a Retirement Plan Trust?** Anyone in any of these categories:

- ◆ If a beneficiary could become incapacitated. One year's guardianship alone will more than offset the cost of using a Retirement Plan Trust.
- ◆ If a beneficiary qualifies for a governmental assistance program and inheriting the IRA will cause them to lose those governmental benefits.

# Qualified Retirement Plan Trust

**Who should use a Retirement Plan Trust?** Anyone in any of these categories:

- ◆ In a marriage where there are children from prior to the marriage and you don't want your surviving spouse to disinherit your prior marriage children from the IRA after your spouse dies.
- ◆ Don't set up World War III between your surviving spouse and your prior marriage children by leaving one out!

# Blow-Out Problem

## Naming individuals as beneficiaries frequently does not work well!

- ◆ Poor \$ management skills can cause IRA to be frittered away
- ◆ Beneficiary, spouse, or another third party wants to spend it
- ◆ Beneficiary can decide to cash out early
- ◆ Individual beneficiary may not be aware of the rules and choices
- ◆ Beneficiary over your IRA to his IRA

# Blow-Out Problem

Naming individuals as beneficiaries frequently does not work well!

- ◆ Poor \$ management skills can cause IRA to be frittered away

# Story

- ◆ Father left \$500,000 IRA
- ◆ Luke – Increased lifestyle; bought a lot of new stuff
- ◆ Luke paid income tax on all
- ◆ \$500k income in one year
- ◆ 2 years – nothing left



# Blow-Out Problem

Naming individuals as beneficiaries frequently does not work well!

- ◆ Beneficiary, spouse, or another third party wants to spend it

# Story



- ◆ Angie's mother left her \$400,000 in IRA
- ◆ Husband Jack talked her into buying a business
- ◆ Wanted to pay back within a year
- ◆ Business unable to pay
- ◆ \$140,000 tax
- ◆ Business went bankrupt

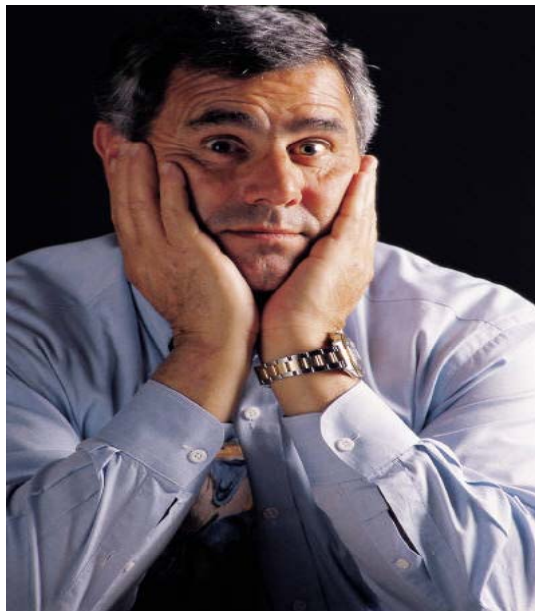


# Blow-Out Problem

## Naming individuals as beneficiaries frequently does not work well!

- ◆ Individual beneficiary may not be aware of the rules and choices
- ◆ Often believe because it isn't subject to estate tax, there is no tax on it at all

# Story



Mother -- \$300K IRA  
= to Greg and Ann  
Greg took IRA  
Gave Ann 1/2  
Following April, what  
tax result?



Ann took \$150K to pay off house and bills  
Greg has \$300K distribution, taxed at 35%  
Greg owes \$105,000 in tax on IRA / higher tax bracket

# Blow-Out Problem

## Naming individuals as beneficiaries frequently does not work well!

- ◆ Beneficiary rolls over your IRA to his IRA
- ◆ Custodians often feel they are holding a hot potato and want to get rid of it
- ◆ They don't always advise the beneficiary of the rules
- ◆ Once it goes to the beneficiary, it's not the Custodian's problem

# Story

- ◆ Fred dad - \$600K IRA
- ◆ Fred called custodian
- ◆ “Can I roll it into my own IRA?”
- ◆ Told “Yes” (true!)
- ◆ \$600,000 distribution!
- ◆ \$210,000 in tax (at 35%)
- ◆ Must withdraw from plan to pay tax
- ◆ 10% early withdrawal penalty!
- ◆ \$21,000 penalty = \$241,000 in tax – 40+%!



# Blow-Out Problem

## Solution to the Blow-Out problem:

- ◆ Stretching it out
- ◆ That is still not perfect
- ◆ If beneficiary is responsible, there are still 7 things that can go wrong when you name an individual!

# Bob and Pat Sample

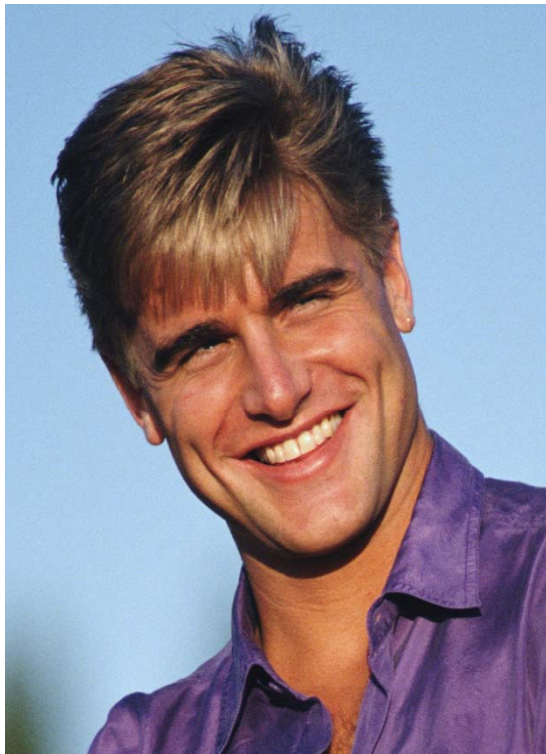


## Bob and Pat

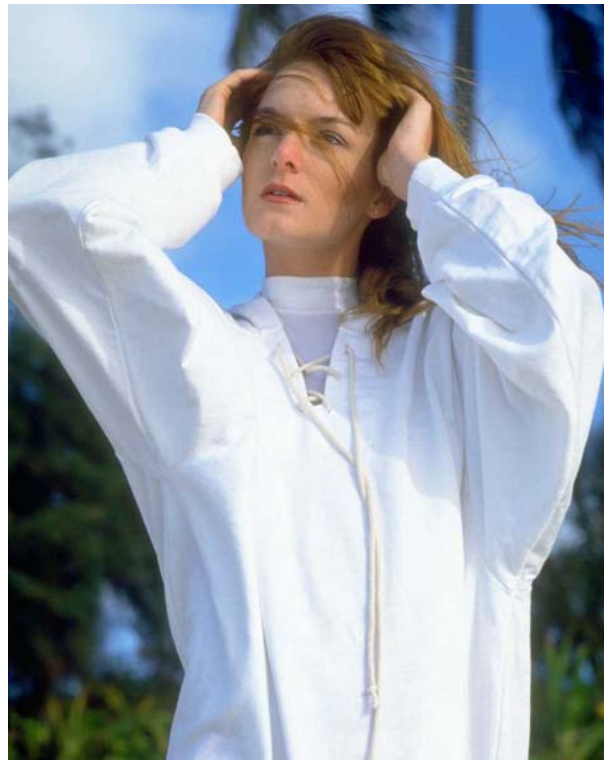
- ◆ Bob \$1,000,000 IRA
- ◆ Pat \$500,000 IRA

# Bob and Pat Sample - Case

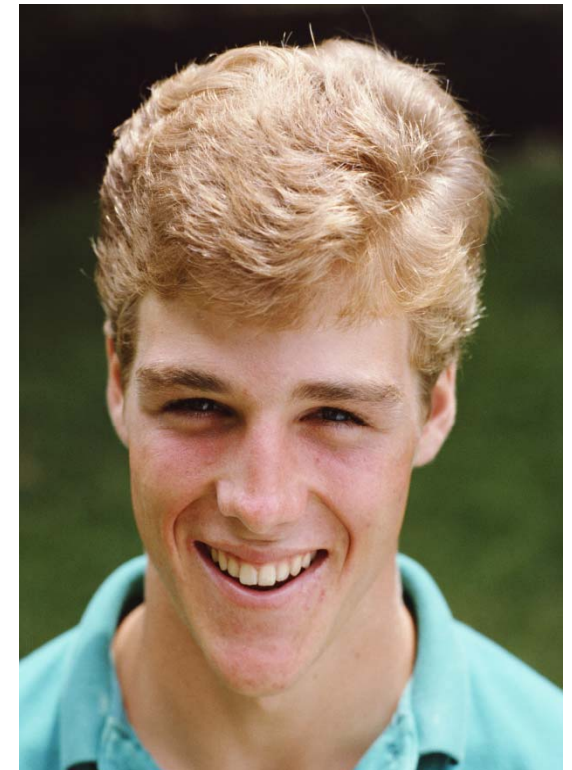
John – 30



Cheryl – 27



Peter – 21



# Bob and Pat Sample - Case 1

## Problem 1 – 2<sup>nd</sup> Marriage

- ◆ Bob – John and Peter
- ◆ Pat – Cheryl and Peter
- ◆ Pat and John have never really gotten along well
- ◆ Bob wants to benefit Pat with his IRA while she's alive, but then he wants it to go to John and Peter
- ◆ Cheryl will inherit from her father

**Solution: RPT names Pat while alive, then John and Peter**



# Bob and Pat Sample - Case 2

## Problem 2 – Incapacitated beneficiary

- ◆ Peter has a medical condition that is likely to leave him completely incapacitated within 5 years
- ◆ He already cannot work – not ever likely to be able to hold a job
- ◆ Qualifies for governmental assistance programs
- ◆ If Peter inherits directly, he will be disqualified for governmental assistance programs
- ◆ **Solution: RPT for Peter especially**

# Bob and Pat Sample - Case 3

## Problem 3 – Divorce

- ◆ John has a high maintenance wife
- ◆ Bob and Pat consider her a gold digger
- ◆ She comes from a family of takers with means to get expensive lawyers
- ◆ They don't want her to end up with any of their IRAs they intend to go to John
- ◆ Know 40-60% of the time some IRA lost in divorce
- ◆ **Solution: RPT for IRAs to John**

# Bob and Pat Sample - Case 4

## Problem 4 – Beneficiary sued

- ◆ John is a medical doctor
- ◆ Lawsuits in his specialty field are on the rise
- ◆ Under *Jarboe*, inherited IRAs are not protected from lawsuits
- ◆ Changed by Texas Legislature in 2011, but only applies to children living in Texas
- ◆ **Solution: RPT for IRAs to John**

# Bob and Pat Sample - Case 5

## Problem 5 – Beneficiary has existing creditors

- ◆ Cheryl's husband is very irresponsible with money
- ◆ He negatively influences Cheryl in money matters
- ◆ Solution: RPT for IRAs to Cheryl

# Bob and Pat Sample - Case 6

## Problem 6 – Beneficiary dies early

- ◆ Who receives IRA if beneficiary dies early?
- ◆ John's gold digger wife or his kids?
- ◆ Cheryl's worthless husband or her kids?
- ◆ Peter's unknown spouse or his kids

Solution: RPT for IRAs guarantee that Bob and Pat's IRAs go to their grandchildren, in trust, to avoid the next problem.

# Story

## Jake and Priscilla

- ◆ Make 5 and 3 YO grandchildren ea beneficiary of \$100,000 IRA
- ◆ \$50,000 each
- ◆ 5YO – Receive \$696K by age 65
- ◆ Age 65 - \$805K in IRA



## Problem: Minor guardianship

- ◆ Parents (divorcing) not appointed guardian
- ◆ Cost of guardianship destroyed IRA in 12 years!
- ◆ Kids received \$0

# Individual Beneficiary Problems

- ◆ Leaving it to responsible beneficiaries to do the stretch-out and make good decisions may sound good
- ◆ Leaving it in trust makes a lot more sense
- ◆ So why not in a testamentary trust in a will or a regular living trust?
- ◆ Because both create the same problems, with one noted exception

# Better than a Living Trust

## Issue 1 – Provisions required in the Retirement Plan Trust often contradict good planning in the living trust

- ◆ You have a lot more latitude in doing things for beneficiaries in the living trust
- ◆ No RMDs in living trust
- ◆ Beneficiaries must be ascertainable upon death for RPT, but not necessarily for living trust
- ◆ Biggest problem – Does the custodian agree the trust meets the requirements?



# Better than a Living Trust

## Issue 1

- ◆ Trust must be valid at death
- ◆ A living trust clearly is valid, but a testamentary trust in a will may not be
  - ◆ Wills not valid until probated
  - ◆ Might not be probated in time
  - ◆ Could be successfully challenged in probate
    - ◆ Trusts far less likely to be successfully challenged

# Better than a Living Trust

## Issue 1

- ◆ Trust must be irrevocable at death
- ◆ Living trust usually become irrevocable upon death
- ◆ Living trusts often distribute assets to common or pot trusts – that requires the payout to be on the oldest beneficiary instead of each bene's age
- ◆ Beneficiaries must be individuals – living trusts often name charities, trusts, or entities
- ◆ Custodian must agree trust meets requirements
- ◆ Custodians don't understand living trusts

# Better than a Living Trust

## Issue 2

- ◆ RPT alerts beneficiaries of special treatment
- ◆ Remember Fred? Trust provisions don't help if a trust isn't named as the beneficiary
- ◆ A trust beneficiary would have stopped Fred and the Custodian cold until they could get advice
- ◆ Custodians also have notice of special treatment
- ◆ Even an uncooperative custodian can authorize change to another custodian
- ◆ RPT allows processing much quicker than probate!

# Better than a Living Trust

## Issue 3

- ◆ Separate RPT easier for Custodian to read
- ◆ It ONLY covers QRPs
- ◆ We've never had a Custodian who accepted the beneficiary designation say the trust didn't meet the requirements
- ◆ The RPT is a special trust for retirement plan assets only!

# Better than a Living Trust

## Issue 4

- ◆ When you send the Custodian the Beneficiary Designation Form, you will know while you are alive whether they will accept it or not
- ◆ If they won't, you can change Custodians BEFORE it is too late!
- ◆ Most Custodians either
  - ◆ Accept our form
  - ◆ Have their own form
  - ◆ Some will not do this – answer is to change now!

# Better than a Living Trust

## Issue 5

- ◆ Separate RPT allows your beneficiaries to get both the stretch-out and the asset protection
- ◆ Without it, the Custodian will require that either
  - ◆ IRA be taken individually which means it isn't asset protected
  - ◆ Pay-out to a trust over five years which costs the stretch-out
- ◆ Remember Jerry Jones, Deon Sanders, and pizza?

# Qualified Retirement Plan Trust

Who should use a Retirement Plan Trust? Anyone in any of these categories (6%; pay to 80 YO):

<u>IRA Amt</u>	<u>Age</u>	<u>5Yr</u>	<u>To 80</u>
\$200K	60	\$276K	\$456K
\$250K	50	\$344K	\$821K
\$300K	40	\$414K	\$1.45M
\$350K	30	\$482K	\$2.55M
\$400K	20	\$552K	\$4.4M
\$450K	10	\$621K	\$7.8M

# Common Questions

Is the \$200K threshold a bright line test?

- ◆ No – we've seen cases where much smaller RPTs made sense for much smaller IRAs – it's the issue as much as the size

Does each spouse need a RPT?

- ◆ In most cases, yes

Can I roll my company plan into an IRA?

- ◆ Depends on your individual plan

Is the IRS likely to reverse this?

- ◆ No; Congress would have to, and they won't



# Common Questions

Will the RPT make sense for me if I need to take more than RMDs in later years?

- ◆ This is a case by case situation, but normally it still makes sense – consider early death

Child inherits and dies; whose life expectancy?

- ◆ Child's, unless you named grandchildren specifically

Can a charity be a beneficiary of my IRA?

- ◆ Yes, but this should be planned for carefully!

# Thank You for Attending

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# DISCLAIMING RETIREMENT ASSETS

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# Summary of Presentation

- Reasons for Making a Disclaimer
- Result of Disclaiming
- Examples of Disclaimer
- Requirements for a Qualified Disclaimer
- What happens to the Assets Upon Disclaimer?
- Disclaimers and Minimum Distribution Rules

# Reasons for Disclaiming Assets

- Sometimes the beneficiary would like the assets to be given to someone else as they have sufficient assets from other sources
- Other times the original beneficiary does not want the assets to be part of his or her estate for tax purposes

# Result of Disclaiming Retirement Assets

Status as Beneficiary is Fully  
Annulled

Disclaiming Person  
Will Not Owe  
Federal Or Estate  
Taxes

Successor Beneficiary is  
Responsible for paying any  
taxes due

# Example of Disclaimer

James, a widower, designated his son as the sole beneficiary of his IRA. A few months after naming his son as his beneficiary, James remarries, then dies a few years after that without updating his designation to name his new wife.

Upon consulting the IRA custodian, James' son learns that the IRA document has a default provision that says the owner's spouse becomes the designated beneficiary. The son properly disclaims and James' wife becomes the beneficiary of the IRA.

# Case Upholding Disclaimer Executed By an Estate

In PLR 201125009, IRS privately ruled that a disclaimer made by a decedent's estate of her deceased husband's retirement benefits (including benefits that would have been payable under a disclaimer trust set up by his will) was a qualified disclaimer under Sec. 2518 of those benefits that were not yet accepted.

As a result, the disclaimed benefits passed outright to the couple's children.



# QUALIFIED DISCLAIMERS

A beneficiary may choose to disclaim only a percentage of the inherited assets, which is acceptable if the disclaimer meets certain requirements discussed below.

One reason to disclaim a portion is where certain funds are needed but not all and the remainder can be left to the disclaimant's beneficiaries.

# Example of Partial Disclaimer

Jane Smith wants to disclaim half of the \$600,000 IRA she inherited from her husband. Under the rules, Mary can disclaim 50% of the IRA (\$300,000).

For the \$300,000 she inherits, she will continue to make required minimum distribution payments for her life expectancy.

Her daughter, the contingent beneficiary, will inherit a \$300,000 IRA and can stretch the RMDs over her life expectancy.

# REQUIREMENTS FOR A QUALIFIED DISCLAIMER

- The beneficiary must provide an irrevocable and unqualified refusal to accept the assets.
- The refusal must be in writing.
- The document must be submitted to the retirement account custodian at the later of the following times:
  - a) Nine months after account owner dies.
  - b) Nine months after the beneficiary attains age 21 if he or she is 21 at death of owner.

# REQUIREMENTS FOR QUALIFIED DISCLAIMER CONTINUED

- The beneficiary must not have accepted any of the inherited assets prior to the disclaimer.
- The assets must pass to the successor beneficiary without any direction on the part of the person making the disclaimer.
- All of the Requirements for a Valid Disclaimer can be found in IRC Sec. 2518.

# Effect of Disclaimer

- The plan administrator or IRA custodian is the one to whom a qualifying disclaimer of retirement benefits should be directed.
- The disclaimed benefits will pass to the person who would receive them if the original beneficiary had predeceased.
- Naming contingent beneficiaries allows for disclaimers as the original beneficiary cannot choose where disclaimed property will go.

# Effect of Disclaimer Continued

Regarding the calculation of required minimum distributions (RMD's), if the beneficiary of the retirement plan properly disclaims the inherited assets after the participant's death and on or before September 30<sup>th</sup> of the year following the year of death, the disclaimant's life expectancy will not be used to determine RMD amounts.

# Where Do the Assets Go Upon Disclaimer?

- The disclaimant cannot take part in the decision of who benefits from the disclaimer.
- If there was no contingent beneficiary, you must consider the default beneficiaries listed in the contract, typically the spouse and then the surviving children.
- If no spouse or surviving children, the plan will typically default to the estate.

# The Disclaimer Trust for Spouses

- Disclaimed property will be free of tax upon the death of the surviving spouse.
- Name the trust as the contingent beneficiary of a retirement plan.
- Disclaimant spouse can permissibly have all of the income and withdraw the greater of 5k or 5% of the principal each year.
- Can serve as sole trustee but no testamentary power of appointment.
- Tax for income tax on distributions from trust.



## Example # 3

- In PLR 9630034, an IRA disclaimer was used to fully fund a trust as the trust was a contingent beneficiary.
- This case dealt with a community property state, but is still good example.
- The spouse should disclaim a fraction rather than a dollar amount. If were to disclaim a dollar amount, that amount would be immediately taxable for income tax purposes. Using a fractional disclaimer, the IRA is not taxable until distributed.

# Disclaiming IRAs and Minimum Distribution Rules

- A recent IRS revenue ruling clarifies the rules for those who inherit an IRA from a decedent who was age 70 1/2 and older at the time of death and was thus required to begin receiving money from his or her IRA.
- According to the revenue ruling, the beneficiary who inherits an IRA can disclaim it even after taking a required minimum distribution for the year of the owner's death.

## Example # 4

Joe Smith has an IRA worth \$600,000.00. His wife Jane is listed as the primary beneficiary and his daughter is the contingent beneficiary. Joe was 80 years old when he died in April 2006. He was required to take a minimum distribution during 2006. As the spouse beneficiary, Jane must complete the required minimum distribution due for 2006. With the ruling, Jane can do this and still disclaim.

# Revenue Ruling 2005-36, 2005-26

## Disclaim all/part of IRA less RMD

The taxpayer died in 2004 after his Required Beginning Date (RBD) but before taking his required minimum distribution from his IRA for the year of death.

Three situations were posited:

- 1) Spouse received the RMD after decedent's death and made a qualified disclaimer.
- 2) Spouse received the RMD after death and made a qualified disclaimer of percent of IRA
- 3) Taxpayer's child received RMD after death and made a disclaimer

# In Conclusion

- A Disclaimer can be a helpful vehicle by which estate taxes are minimized and a legacy is passed down.
- It is not too late to disclaim even if you have taken a required minimum distribution for the year of death of the plan owner.



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