How to aggregate IRAs

MAR 01, 2015 | BY RUSSELL E. TOWERS, J.D., CLU, CHFC

Planning for large balance IRAs offers the possibility of using the after-tax distribution payouts as annual premiums for **life insurance** or for long-term care insurance policies. Of course, pre-59½ distributions must satisfy the "substantially equal periodic payment" (SEPP) rules of IRC Section 72(t) to avoid the additional 10 percent penalty tax for premature distributions. And post-70½ distributions must satisfy the "required minimum distribution" (RMD) rules according to the Uniform Lifetime Table to avoid the 50 percent penalty tax on "under distributions."

But what happens when a client owns multiple IRAs? How are the pre-59½ rules and the post-70½ rules impacted by the ownership of multiple IRA accounts? These multiple IRA accounts could have underlying financial assets in the form of mutual funds, deferred annuity contracts, or bank CDs.

Actually, the management of distributions from multiple accounts is fairly simple:

Pre-59½ distributions from multiple IRA accounts

For pre-59½ distributions, multiple IRAs may be aggregated for purposes of calculating SEPP. They are not required to be aggregated (See PLR 9705033). In other words, you can pick and choose which accounts to add together for purposes of selecting which of the three permitted distribution methods to use: amortization method, annuitization method, or life expectancy fractional method using either the Uniform Lifetime Table or the Single Life Table. These three permitted methods are detailed in Rev. Rul. 2002-62.

Once the dollar amount of the SEPP is calculated using one of these three methods, the actual distribution can be made from any of the aggregated accounts — or from just one of the accounts, if desired. Keep in mind that the SEPP using either the amortization method or the annuitization method is a level amount that must be paid for at least five years or until age 59½, whichever comes later.

example: Mrs. Dozier is 55 years old and has held management positions at various high-tech firms for the last 25 years. Each time she left a firm, she executed a direct transfer of 401(k) accounts to her own IRAs. She currently has two IRA accounts: Account No. 1 is worth $550,000 and is invested in various mutual funds with a well-known investment firm; account No. 2 is a bank CD worth $150,000 and is earning a low yield of 1.75 percent.

She would like to buy a flexible five pay combination life insurance/long-term care product which has a modest death benefit but provides a mid-six-figure pool of LTC benefits. The guaranteed premium is $20,000 per year for five years. In her tax bracket, she would have to withdraw about $30,000 per year to net the $20,000 needed for annual premiums. She would like to continue to invest for growth in mutual fund equities while drawing down the IRA with the bank to fund the five pay premiums for the life product with LTC rider.

By aggregating the two IRA accounts ($700,000 total), she could take a SEPP using the amortization method of $32,734 per year and avoid the 10 percent penalty tax for pre-59½ distributions. However, the actual withdrawal of $32,734 per year will be made only from the low-yielding IRA at the bank. The $550,000 mutual fund IRA will be left intact to grow into the future to help fund her retirement.

Post-70½ distributions from multiple IRA accounts

For post-70½ distributions, multiple IRAs must be aggregated for purposes of calculating RMD. In other words, it is mandatory to add up all the accounts for purposes of applying the Uniform Lifetime Table factor each year. Once the dollar amount of the RMD is calculated from the Uniform Table each year, the actual distribution can be made from any of the aggregated accounts, or from just one of the accounts if desired (See Treas. Reg. 1.408-8, Q&A 9).

example: Mr. Clark has just turned age 70 and is starting to plan for taking RMDs from his IRAs. He has a mutual fund IRA of $750,000 with a balanced portfolio of equities and fixed income funds and a fixed deferred annuity IRA of $450,000 currently earning 2.5 percent. He doesn't need the RMD that must be taken from his IRAs for retirement income. With a total IRA value of $1,200,000, his projected taxable RMD in the first year will be about $43,800.

He would like to allocate his after-tax RMD of about $30,000 into a competitive 10 pay no-lapse survivorship universal life (SUL) product for the benefit of his children to help offset state death taxes and post-death income in respect of decedent income taxes (IRD). He is age 70 (standard non-smoker) and his wife is age 69 (standard non-smoker). The $30,000 premium outlay for 10 years will purchase $722,000 of guaranteed no-lapse SUL death benefit from a competitive carrier. This death benefit is income tax free.

Aggregating the two IRA accounts ($1,200,000 total), he must take an RMD of $43,800. This will provide an after-tax amount of about $30,000.

However, the actual withdrawal of $43,800 will be made from the lower yielding annuity IRA. The $750,000 mutual fund IRA will be left intact for at least 10 years, as the annuity IRA is being drawn down to fund the 10 pay $722,000 no-lapse SUL policy.

The Internal Rate of Return (IRR) on the tax-free death benefit is 5.39 percent at joint life expectancy (21 years). In a 30 percent tax bracket, the pre-tax equivalent IRR is 7.70 percent.

Many individuals have multiple IRAs with different kinds of underlying financial products. By voluntary aggregation for pre-59½ SEPP, you can help you client plan for future needs like long-term care expenses. And by mandatory aggregation for post-70½ RMDs, you can help your clients guarantee a legacy for their heirs and to offset state death taxes and income in respect of decedent (IRD) income taxes at death.