



# Planning Your §403(b) Distributions





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Congratulations on your decision to set aside money in a §403(b) Custodial Account! Now it's time for another decision: How can you develop a strategy for distributions from your §403(b)(s) that takes advantage of the benefits associated with these accounts, and steers clear of the pitfalls that lie in wait for the unwary?

***The fact is, §403(b) distributions can affect your finances in two ways:***

- Taking funds out of your §403(b)(s) can trigger a variety of taxes and penalties if done at the wrong time or in the wrong way.
- The larger your distributions are, the less money you leave in the account for future distributions. This can have significant consequences over the long run for your retirement, or if you plan to leave assets to your heirs.

***Developing a sound strategy now can help you manage these consequences and their possible impact on your retirement savings.***

Whether you are relying on your account(s) to support a comfortable retirement or create a meaningful inheritance, or both, this brochure can help. Inside you'll find a discussion of your distribution options, the ramifications of each, and how to achieve common objectives.

***Regardless of your needs or the size of your Legend §403(b)(s), it makes sense to develop your distribution strategy with the help of your Legend Retirement Advisor.***

In particular, the rules and regulations surrounding required minimum distributions are very complex. If necessary, your Legend Retirement Advisor may recommend that you consult an estate-planning attorney for advice on more intricate strategies.

## Premature Distributions

### §403(b) Accounts

Salary Deferral §403(b) Accounts have been used by millions of educators, hospital employees and religious and charitable organization employees to save for retirement. However, Congress passed legislation that penalizes anyone taking a distribution of a taxable amount prematurely (unless the money is rolled over into another §403(b) account, qualified plan or IRA within 60 days). Premature distributions are subject to a 10% penalty as well as ordinary income tax.

Congress has provided several exemptions to the penalty, including any distribution made:

- to an employee who has retired in or after the year he or she attains age 55 (please note that availability of this exemption is lost if assets are rolled into an IRA)
- to meet certain medical expenses in excess of 7.5% of adjusted gross income
- as part of a series of substantially equal payments (also known as §72(t) distributions)
- to an ex-spouse under a Qualified Domestic Relations Order
- upon death or disability
- to satisfy an involuntary order for distribution from the IRS due to a levy

### Avoiding the 10% Premature Penalty - §72(t) Distributions

If you retired before age 55 and need a stream of income from your §403(b), using the “series of substantially equal payments” exemption of §72(t)

**Q. I've repaid a defaulted loan from my §403(b). How will that affect the taxation of my distributions from that §403(b)?**

**A. When both pre-tax and after-tax monies are comingled in a §403(b), a portion of every distribution from that account will be tax-free return of principal based on the ratio of your after-tax payments on the defaulted loan to your account's overall value. The Form 1099-R you receive from your §403(b) custodian should show you two figures: gross distributions and taxable distributions. Your return of principal is the difference between these two numbers.**

can avoid the 10% penalty. To take advantage of this, your Legend Retirement Advisor will figure out the payments using one of the three IRS-approved calculation methods based on your current life expectancy and the balance of your Legend retirement account.

### You will need to:

- stick to the payment schedule (monthly, quarterly, annually) you choose for at least five years or until you reach age 59½, whichever comes later; and
- withdraw the exact amount each year – not more, not less. Any variation<sup>1</sup> will result in the 10% penalty being applied retroactively to every distribution taken from the start of the stream of payments.

<sup>1</sup> In IRS Revenue Ruling 2002-62, the IRS gave any taxpayer taking a §72(t) stream of payments one opportunity during that period to switch to the Required Minimum Method. This calculation will normally produce a much lower annual distribution that will fluctuate each year. The IRS instituted this remarkable change so that taxpayers on §72(t) payouts may not completely deplete their retirement savings in the down market that was experienced at the time.

# Minimum Distributions

**Even though you can always withdraw more than your minimum required distribution in any year, the excess cannot be counted toward the next year's RMD.**

This strategy works best for §403(b) owners with sizeable accounts. It is best to set aside some assets in a separate §403(b) (if no other assets are available) for use in case of emergencies during the period the stream of payments must cover. Remember, no more amounts may be withdrawn from the §72(t) §403(b) account during this period!

## Required §403(b) Distributions

Congress granted taxpayers the §403(b) tax deferral as an incentive to save for retirement, but also mandated that the assets you accumulated must be used in your retirement by you and your spouse. Consequently, account owners are required to start taking distributions from their §403(b)(s) each year once they attain age 70½ or retire, whichever occurs later. These distributions are called **required minimum distributions (RMDs)** and are governed by a complex set of rules and regulations. The basic rules and how they can affect you are outlined below. Consult with your Legend Retirement Advisor about your own situation.

### ***When You Must Start Your Required Minimum Distributions***

The first minimum that you are required to take is for the year you reach age 70½ or retire, whichever occurs later, although you don't actually have to take this RMD until April 1<sup>st</sup> of the following year. This April 1<sup>st</sup> is called your required beginning date

(RBD). The deadline for all subsequent RMDs is December 31<sup>st</sup>. Please note that December 31<sup>st</sup> is not a postmark deadline but the date by which the RMD must actually be distributed from your account by your §403(b) custodian.

Even though your first RMD can be delayed until the year after attainment of age 70½ or retirement, it may not be wise to wait. By postponing the distribution, you will be forced to take two RMDs in that year—one for the year you turned 70½ or retired and one for the following year. Doubling up on the RMDs might bump you into a higher tax bracket!

Furthermore, while you can always withdraw more than your minimum required distribution in any year, the excess cannot be counted toward the next year's RMD.

### ***Penalty for Not Taking Sufficient RMDs***

The Internal Revenue Code calls for a 50% penalty of the amount you should have taken, but didn't, each year the money remains in your account. For example, if your RMD was \$5,000 and you mistakenly took only \$3,000, your shortfall would be penalized \$1,000, or 50% of the \$2,000 you didn't withdraw each year you delay taking the full minimum.

### ***Simplified RMDs***

Prior to 2001, the rules and regulations for RMDs were so complex that almost no one could completely understand them, even at the IRS! In 2001, the IRS greatly simplified these rules and regulations into a more understandable, albeit still complex, set of rules. In short, most IRA owners use a ***Uniform Table*** during their lifetimes to calculate their RMDs. This table is a joint life expectancy table assuming an account owner has a beneficiary 10 years younger, regardless of whether or not he or she has a designated beneficiary or the actual age of the beneficiary. (See page 6 for the ***Uniform Table***.) If your spouse is actually more than 10 years younger than you and is your sole beneficiary, you can use the true joint life expectancy factor for your RMD calculations. Consult with your Legend Retirement Advisor or call Legend's Distribution Department at 1-800-749-4321 (in New York) or 1-800-749-4221 (outside of New York) to determine your factor each year, or obtain a copy of the applicable joint life expectancy table.

# RMD Calculations

You can change your beneficiary(ies) at any time, even after your RMDs start. Your beneficiary(ies) also has more flexible options under the new simplified rules. (See Legend's brochure *Your Choices as an IRA Beneficiary*. The same rules apply to §403(b) beneficiaries.)

## *How RMDs Are Calculated*

Congress meant for your §403(b) funds to be used by you and your spouse in your retirement. That is why RMDs are calculated by dividing the balance of your account by your applicable life expectancy factor. The *Uniform Table*, which assumes your beneficiary is 10 years younger than you, is applicable in most cases. (Life expectancies are derived from mortality and other factors. See the *Uniform Table*.)

To calculate your minimum, use the following formula:

$$\text{RMD} = \frac{\text{\$403(b) market value (as of 12/31 of previous year)}}{\text{applicable life expectancy factor}}$$

Under this formula, the longer your life expectancy, the lower your required minimum distributions – and the more money remaining in your account to continue growing tax-deferred. To summarize:

- During your lifetime you will generally use the *Uniform Table* to determine your applicable life expectancy factor each year, with one exception. If your spouse is more than 10 years younger than you and is your sole beneficiary, then your RMD can be determined based on your true joint life expectancy.

**Legend provides RMD calculations free of charge as a service to its §403(b) participants. Call the Distribution Department at 800-749-4321 (in New York) or 800-749-4221 (outside New York).**

- The *Uniform Table* provides a life expectancy factor based on your age and that of a beneficiary 10 years younger than you. You will use this table regardless of the actual age of your beneficiary, or even if you have no beneficiary at all. However, it is still very important to name a beneficiary of your §403(b).
- Only people have life expectancies. Organizations (like charities or churches) or entities (like estates or trusts) have no life expectancies. After your death, this type of beneficiary would not have any life expectancy of its own over which to spread out RMDs. (See *Naming Beneficiaries*.)



## Planning Your §403(b) Distributions

# Uniform Life Table

Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
10	86.2	45	51.5	80	18.7
11	85.2	46	50.5	81	17.9
12	84.2	47	49.5	82	17.1
13	83.2	48	48.5	83	16.3
14	82.2	49	47.5	84	15.5
15	81.2	50	46.5	85	14.8
16	80.2	51	45.5	86	14.1
17	79.2	52	44.6	87	13.4
18	78.2	53	43.6	88	12.7
19	77.3	54	42.6	89	12.0
20	76.3	55	41.6	90	11.4
21	75.2	56	40.7	91	10.8
22	74.3	57	39.7	92	10.2
23	73.3	58	38.7	93	9.6
24	72.3	59	37.8	94	9.1
25	71.3	60	36.8	95	8.6
26	70.3	61	35.8	96	8.1
27	69.3	62	34.9	97	7.6
28	68.3	63	33.9	98	7.1
29	67.3	64	33.0	99	6.7
30	66.3	65	32.0	100	6.3
31	65.3	66	31.1	101	5.9
32	64.3	67	30.2	102	5.5
33	63.3	68	29.2	103	5.2
34	62.3	69	28.3	104	4.9
35	61.4	70	27.4	105	4.5
36	60.4	71	26.5	106	4.2
37	59.4	72	25.6	107	3.9
38	58.4	73	24.7	108	3.7
39	57.4	74	23.8	109	3.4
40	56.4	75	22.9	110	3.1
41	55.4	76	22.0	111	2.9
42	54.4	77	21.2	112	2.6
43	53.4	78	20.3	113	2.4
44	52.4	79	19.5	114	2.1
				115 +	1.9

### Naming Beneficiaries

It's important to understand that different types of beneficiaries are subject to different distribution and tax consequences and there is more than one way to pass your assets to a particular person. This is a part of estate planning that is frequently mishandled, resulting in a higher tax burden for either the estate or your §403(b) beneficiary.

The standard designations in naming beneficiaries include:

- A spouse
- Non-spouse(s) (e.g., children, relatives, friends, etc.)
- Organizations (e.g., charities, churches, non-profits, etc.)
- Trusts
- Your estate

### Spousal Beneficiaries

Because Congress considers your §403(b) as assets for you and your spouse's retirement, your spouse has special rights as a beneficiary of your account. Upon your death, he or she may take ownership of the §403(b) (if qualified to do so), or roll the assets to an IRA or other retirement account in his or her name. This enables the spouse to make additional contributions (if qualified to do so) and name his or her own beneficiary(ies). Once the spouse attains age 70½, the spouse must begin taking RMDs.

**Please note:** in order for a spouse to take over a §403(b) or roll over a §403(b) into his or her own §403(b), IRA or other eligible retirement account, he or she must be the sole beneficiary of an account and must be named directly, not through a trust.

## Planning Your §403(b) Distributions

**Q. Won't my §403(b) be inherited by those persons named in my will?**

**A. No. Only your §403(b) Beneficiary Designation determines how your assets are distributed. Your will has no impact on your §403(b) distributions. Therefore, if your §403(b) assets make up the major portion of your estate, your beneficiary designations are a crucial part in your estate planning.**

However, if the spouse has not yet attained age 59½, taking ownership right away may not be such a good idea. Any premature withdrawal that does not qualify for a §72(t) exemption would be subject to the 10% premature penalty. Therefore, a younger widow or widower might wish to leave the §403(b) in a beneficiary registration (i.e., in the owner's name for the benefit of the beneficiary) until after he or she attains age 59½. In this way, death distributions can be taken (which are not subject to the 10% penalty) at any time and subsequent beneficiaries can be named in the interim. The only downside to this strategy is the amount of time the spouse beneficiary's subsequent beneficiary would have to spread payments over in the event of the spouse beneficiary's death prior to age 59½.

A spouse beneficiary who leaves the assets in a beneficiary registration can also delay taking distributions until you would have attained age 70½. Actually leaving the account in a beneficiary registration this long is not recommended because it hampers the spouse beneficiary's subsequent beneficiary's ability to spread out the distributions after the spouse beneficiary's death.

Of course, any beneficiary has the choice of taking distribution of the whole §403(b) in one lump sum if so desired, or more than a minimum death distribution in any one year. Also, any beneficiary may disclaim the asset (see *Using Disclaimers* on page 9).

### *Non-spousal Beneficiaries*

If you name any other individual other than your spouse as beneficiary of your §403(b), the account must remain in your name "for the benefit of the beneficiary." This is called a beneficiary registration or inherited §403(b). Unlike a spouse beneficiary, the non-spouse beneficiary cannot roll these assets into an account in his or her own name. He or she can transfer the assets to another vendor, but the account will always be registered the same way.

If you die before your required beginning date for RMDs, your beneficiary has the option of taking

**Q. How can I make sure that my son's kids will get his portion if he predeceases me?**

**A. You can specify that you are naming your beneficiaries "per stirpes" which means, literally, per branch, as opposed to "per capita" which means per head. By specifying your beneficiaries per stirpes, you are indicating that each beneficiary represents a branch that should receive benefits in the event the actual beneficiary dies before you do.**

# Primary vs. Contingent

**A primary beneficiary is first in line to receive your §403(b) assets. If you name more than one primary beneficiary, you must specify what percentage of the account should go to each. Should none of your primary beneficiaries remain, your assets will go to your contingent (or secondary) beneficiary(ies). Contingent beneficiaries will also receive the assets if your primary beneficiary disclaims the assets. In some instances, a trust is named as contingent beneficiary and the primary beneficiary may disclaim the assets if it proves more advantageous for the assets to go into the trust.**



distribution of the §403(b) over his or her life expectancy. Distributions should start by December 31<sup>st</sup> of the year following your death. Alternatively, beneficiaries have the option to redeem the entire account within five years after your death, take distribution of the §403(b) in a lump sum, or disclaim the asset.

If you have multiple primary beneficiaries, it is best that they contact Legend prior to the end of the year in which you die in order to separate the assets into separate accounts for each beneficiary. This enables each primary beneficiary to use his or her own life expectancy for all minimum death distribution calculations. If the accounts are not separated until the following year, the first year's minimums must be calculated using the oldest beneficiary's life expectancy. Subsequent calculations revert to each beneficiary's actual life expectancy factor.

If you die after your RBD, only the life expectancy, lump sum and disclaimer options are available.

## *Organizations and Trusts*

Many individuals wish to leave assets to charities, a church, certain non-profit organizations, etc. There are certain tax advantages to bequeathing §403(b) assets to such an organization. Of course, these legal entities have no life expectancy. This means that if you die before your RBD, all of your §403(b) assets must be distributed within five years of your death. If you die after your RBD, payments may be spread out over your remaining single life expectancy (according to the *IRS Single Life Table*).

Because these entities are tax-exempt, they will usually take distribution of your §403(b) assets in one lump sum. Extended tax deferral has no meaning for them.

A trust, however, must meet several specific requirements and can, under certain circumstances, be considered to have the life expectancy of the trust's oldest beneficiary. The trust requirements are:

- The trust must be valid under state law
- The beneficiaries must be identifiable from the trust instrument
- The trust must be irrevocable either from inception or upon the death of the §403(b) owner

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- Certain documentation must be provided to the trustee/custodian of the §403(b) by October 31<sup>st</sup> of the year following the death of the §403(b) owner
- All beneficiaries of the trust must be individuals (if one of the trust's beneficiary's has no life expectancy, then the trust has no life expectancy either)
- No person shall have the power to change the beneficiary(ies) after the owner's death

If you intend to name a trust as a beneficiary, be sure to consult with an attorney who is well-versed in estate planning. Errors in the structure of a trust can throw your whole estate plan into disarray. Depending on how a trust is structured, it can:

- Give you more control over how your assets are managed and disposed of after your death
- Provide for the needs of minors or a spouse
- Avoid estate taxes
- Preserve a spouse's federal estate and gift tax exemption

The trusts most often used for these purposes are Credit Shelter trusts, Qualified Terminable Interest Property (QTIP) trusts and Charitable Remainder trusts.

## *Your Estate*

Like an organization or trust, your estate does not have a life expectancy. This means that death minimum distributions would have to be calculated based on your remaining life expectancy (if you die after your RBD), or within five years (if you die before your RBD).

Leaving your §403(b) to your estate has two other disadvantages. First, it unnecessarily subjects the assets to probate, the court-supervised process of settling your estate which can be expensive and time-consuming. Second, if your death occurs before your RBD, your heirs must deplete your §403(b) within five years. However, had you named an individual—rather than the estate—as beneficiary, he or she

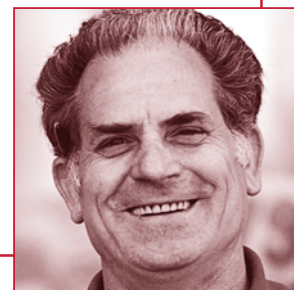
would have had an additional option: withdrawing the money based on his or her life expectancy. Losing this time to shelter the assets could severely penalize your beneficiary.

## *When Are Your Beneficiary Designations Final?*

During your lifetime, you can change your beneficiary designations as often as you like. Following your death, your beneficiary designation(s), for calculation purposes, will not become final until December 31<sup>st</sup> of the year following the year of your death. This is known as the “determination date.” Of course, no new beneficiaries can be named after your death. However, beneficiaries who disclaim or who have their benefits paid out to them prior to the determination date will not be considered when calculating death minimum distributions. This offers you and your beneficiaries substantial flexibility in estate planning.

## *Using Disclaimers*

Since your beneficiary designations don't become final until the year following your death, using a disclaimer strategy can add some flexibility to your estate planning. You might name your children as primary beneficiaries, your spouse as secondary beneficiary and a trust as tertiary (third-tier) beneficiary. This would enable your children, should your spouse outlive you, to disclaim their interest (or a portion of their interest) if your spouse needed the assets. In turn, if it would be of more benefit to your spouse to have the assets go into a trust (to take advantage of the estate tax credit), your spouse might then disclaim his or her interest too, leaving the trust as the final beneficiary. Of course, there would be no legal obligation for your children to disclaim their interest; therefore, using this strategy depends on your family's unique dynamics.



# Planning Your §403(b) Distributions

## Stretch §403(b)

The stretch or multigenerational IRA has received a lot of press in recent years. These terms refer to an IRA owner's ability to extend the tax-sheltered growth of his or her IRA through one or more generations of beneficiaries. Under the new simplified IRS rules, almost any §403(b) can be turned into a stretch §403(b) if the custodian's §403(b) agreement supports all of the new options and allows the §403(b) owner's beneficiary to name his or her own subsequent beneficiary.

To set up a stretch §403(b), all you need to do is name a young individual (your child or grandchild) as your beneficiary. When you die, the beneficiary will have his or her entire life expectancy to spread the distributions over, providing enormous tax-deferred compounding over the years.

To heighten this effect, you can name multiple young beneficiaries. At your death, your §403(b) would be split into separate accounts and each child's or grandchild's payout period would be based on his or her own life expectancy.

Individuals who have inherited a §403(b) and die before it is depleted may pass on the benefit of its tax-deferred growth to their own subsequent beneficiaries as long as the §403(b) custodian offers this option (Legend does). With this feature, a third (or fourth) generation heir may keep the inherited §403(b) intact instead of cashing it out in a lump sum.



## Tax Reporting

Any distribution from a §403(b), including a distribution to a beneficiary, is reported to the IRS in the year the check is issued. The distribution is reported on Form 1099-R. Distributions may be subject to mandatory federal income tax withholding, depending on whether the distribution is eligible to be rolled over to another retirement account or not. For a full discussion of this topic, see the Notice to Recipients in the Legend [§403\(b\) Custodial Account Distribution Book](#). You will receive your copy of Form 1099-R by the end of January of the year following the distribution.

If you are eligible to waive withholding, and if you do not want Legend to withhold taxes on your distributions, please be sure to complete the withholding section of the [Legend §403\(b\) Distribution Form](#). You may then be responsible for paying estimated taxes to the IRS and may incur penalties under the estimated tax rules if your estimated tax payment is insufficient.

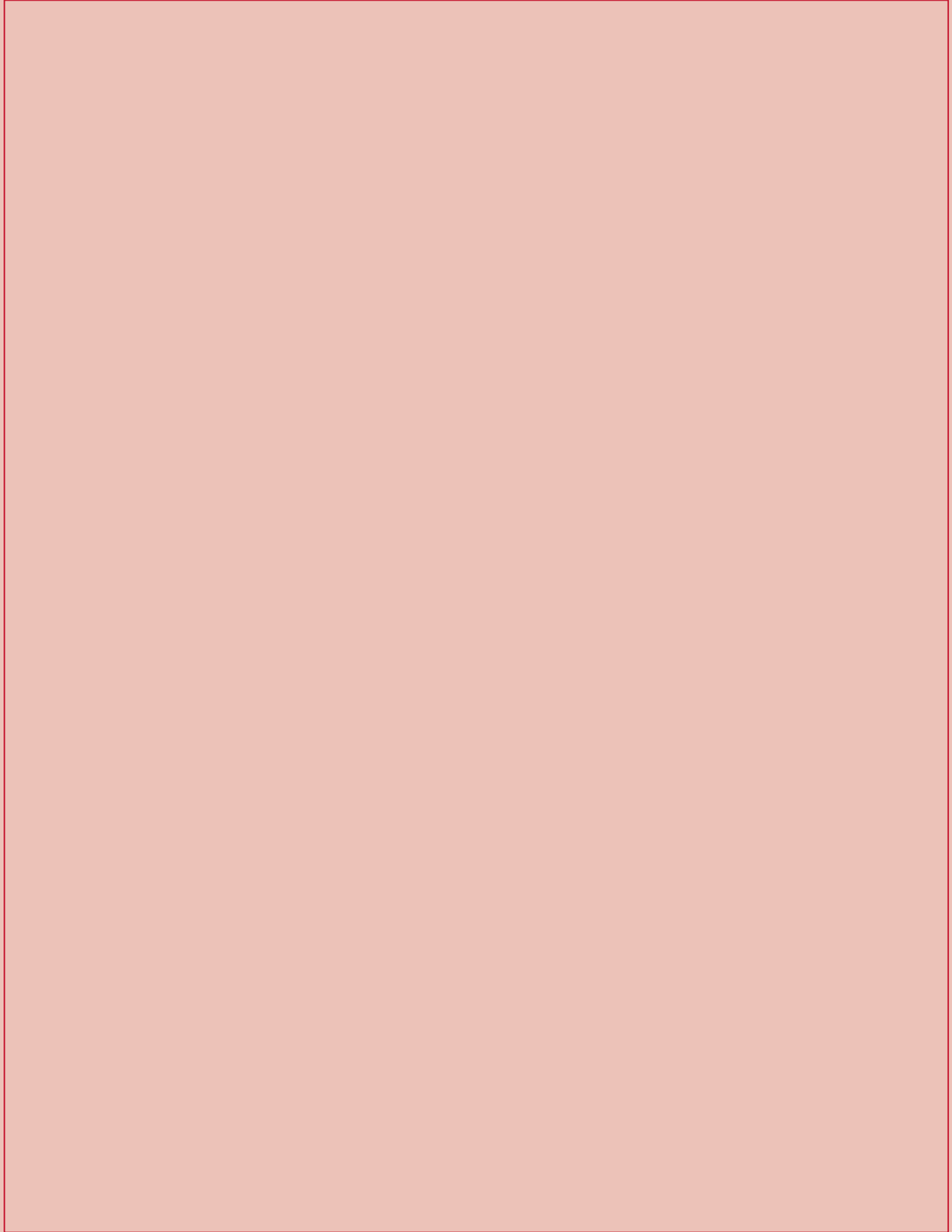
For periodic distributions, your decision to not have withholding apply will remain in effect until you cancel it. You can revoke your waiver by sending a letter of instruction to Legend. For non-periodic distributions, the withholding notice applies only to that specific distribution.

## Payments Paid Outside the United States

You may not elect against withholding on payments paid outside the U.S. if you are a U.S. citizen or resident alien, and your home address is outside the United States.

If you are not a U.S. citizen or are a nonresident alien, you must supply Legend with an IRS Form W-8BEN every three years. We will withhold at the rate of 30%, or at the rate specified by the treaty between the United States and your country of residence, if any.

*This brochure is intended for informational purposes only. Neither The Legend Group nor any of its affiliated companies provide legal or tax advice. Please consult your legal or tax advisor before any decision is made based on the information provided in this brochure.*



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