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distribution (LSD) from a qualified plan.

Ken Berry • Feb. 03, 2023



At the end of December, 2022, Congress passed sweeping legislation affecting participants in qualified retirement plans, like 401(k) plans, and IRAs.

First, the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 made several important changes, including raising the age threshold for required minimum distributions (RMDs) from age 70½ to age 72. Now, SECURE Act

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Although this special tax law provision is restricted to the most elderly plan participants, it is also available to their beneficiaries.

How it works: Under a tax code provision that's been on the books for decades, someone born before January 2, 1936 can use ten-year income averaging to determine the tax liability of an LSD from a qualified plan. This provision is no longer available to younger participants.

The tax is based on the tax rates that were in effect for single taxpayers in 1986 and applies to the ordinary income part of the distribution. A flat 20% capital gain rate is also available for the taxable part of an LSD attributable to plan participation before 1974.

How do you qualify for the tax break? The following requirements must be met.

- The distribution must be from a qualified retirement plan or annuity. IRA distributions don't count.
- The distribution of the entire plan balance (not including employee contributions) must be made in one tax year. No rollovers are allowed.
- The plan participant must have been born before January 2, 1936. Beneficiaries can elect income averaging only if the participant meets this requirement.
- The participant must have been in the plan for at least five years before the distribution. (This rule doesn't apply to payments to beneficiaries.)
- The plan participant can't have used the income averaging provision for any previous distribution after 1986.

- The distribution must be payable due to the employee's death; after the employee

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emptied out within ten years of the account owner's death. These new rules are complex, so you should seek professional assistance.

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