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THE RETURN OF MINIMUM REQUIRED RETIREMENT PLAN DISTRIBUTIONS

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The year 2009 was unique in that, for the first time, minimum required distributions from qualified plans, tax deferred annuity plans, governmental 457(b) plans and IRA's (MRD's) were suspended by Congress. That suspension was a one-year event so we need to be familiar with how these rules may affect our clients in 2010.

In general, the MRD rules specify the latest permissible date for plan distributions to begin and the maximum time period over which they may be made. Their purpose is to ensure that retirement plans are used to provide retirement benefits rather than as mechanisms for the indefinite deferral of tax. The consequences of failing to satisfy these rules are severe. A 50% excise tax may be imposed on the plan participant or IRA owner (referred to as the "account owner") on the excess of the amount of the required distribution over that actually distributed during the year.

This article will focus on the MRD rules as they apply to defined contribution (individual account) plans and traditional IRA's (Roth IRA's are not subject to the MRD rules.). Plan participants and IRA owners are referred to as "account owners."

General Rule

Distributions to an account owner must begin by the required beginning date and must be paid over:

- the life of the account owner;
- the lives of the account owner and a designated beneficiary; or
- a period, which may be a term certain, that cannot exceed (a) the life expectancy of the account owner or (b) the life expectancy of the account owner and a designated beneficiary.

The "required beginning date" of a non-IRA account owner (other than an account owner who owns or is deemed to own at least a 5% interest in the employer sponsoring the plan ("5% owner")) is April 1 of the calendar year following the calendar year in which the participant reaches age 70 1/2 or retires, **whichever is later**. However, the required beginning date for a 5% owner or IRA account owner is April 1 of the calendar year following the year in which the 5% owner reaches age 70 1/2, even if not retired. Before the required beginning date, you need not be concerned with the operation of the MRD rules, except in the event of death.

Designated Beneficiaries

The MRD amount will depend on the person designated as the beneficiary to receive the remaining portion of your interest in the plan after your death. The following rules determine those persons eligible to be designated beneficiaries:

1. Determination

Only persons who are designated under the plan or IRA may be designated beneficiaries. A person may be designated as a beneficiary under the terms of the plan or IRA, or, if the plan or IRA provides, through an election by the account owner or his or her surviving spouse. A beneficiary named in the account owner's will or determined under intestacy is not a designated beneficiary.

Except for special rules involving trusts (described below), only individuals may be designated beneficiaries. If an entity other than an individual is designated, the rules apply to the interest of the account owner as if no beneficiary was designated. If the account passes to the account owner's estate, even if by election of the account owner or pursuant to the plan or IRA document, the account owner will be deemed not to have a designated beneficiary. The same holds true for charities named as account beneficiaries.

Trust beneficiaries will be treated as designated beneficiaries only if: (i) the trust is valid under state law or would be valid except that it lacks a corpus; (ii) the trust is irrevocable; and (iii) the trust beneficiaries who are beneficiaries of the account owner's interest are identifiable.

The designated beneficiary generally is determined as of September 30 of the calendar year following the calendar year of the account owner's death.

2. Multiple Designated Beneficiaries

If multiple beneficiaries are designated, the one with the shortest life expectancy must be used in determining the MRD amount. Each beneficiary's life expectancy can be used in determining the beneficiary's minimum distribution, however, if separate accounts or segregated shares are maintained for each beneficiary.

If a beneficiary's entitlement to a benefit after the account owner's death is contingent, the contingent beneficiary still is considered a beneficiary in determining which designated beneficiary has the shortest life expectancy. A person who is a mere potential successor to take the interest of a designated beneficiary upon that beneficiary's death is not considered a designated beneficiary. If a designated beneficiary dies after the date when beneficiaries are determined, the beneficiary's life expectancy is used without regard to the life expectancy of any subsequent beneficiary.

3. No Beneficiary Designated

If no beneficiary is properly designated, distributions to the account owner during life commencing with his or her required beginning date must be made over a period not exceeding his or her life expectancy. In other words, the benefit of using the designated beneficiary's life expectancy to lengthen the payout period is lost.

Calculating the Minimum Required Distribution Amount from an Individual Account

1. Distribution Period

Account owners determine their MRD amount by dividing the account balance by the distribution period. For lifetime required distributions, there is a uniform distribution period for almost all account owners of the same age under an IRS table based on the joint life and last survivor expectancy of an individual and a hypothetical beneficiary 10 years younger. However, if the account owner's spouse is the sole beneficiary and is more than 10 years younger than the account owner, a longer distribution period based upon the actual joint life and last survivor life expectancy of the spouses can be used.

For years after the year of the account owner's death, the distribution period generally is the remaining life expectancy of the designated beneficiary, calculated using the age of the beneficiary in the year following the year of the account owner's death, and reduced by one for each subsequent year. If there is no designated beneficiary, the distribution period is the account owner's life expectancy calculated in the year of death, reduced by one for each subsequent year.

A special rule applies if the account owner's spouse is the sole beneficiary. In that case, the distribution period during the spouse's life is the spouse's single life expectancy re-determined each year. This extends the distribution period as life expectancy decreases by less than 1 year for each passing year of life. For years after the year of the spouse's death, the distribution period is the spouse's life expectancy calculated in the year of death, reduced by one for each subsequent year. In addition, if the account owner died before his or her required beginning date, the spouse may elect to delay the start of distributions until the end of the calendar year in which the account owner would have attained age 70 ½.

For IRA's the account owner's surviving spouse may elect to treat his or her beneficial interest in the IRA as the spouse's own IRA. In order to make this election, the spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts from the IRA. If the spouse makes the election, he or she is treated as the IRA owner so distributions do not have to begin until he or she reaches his or her required beginning date. He or she can then name a designated beneficiary.

If the account owner dies before his required beginning date, the distribution period will be determined as described above, except if there is no designated beneficiary or if the plan or IRA provides, the entire account must be distributed no later than the end of the calendar year that contains the 5th anniversary of the account owner's date of death. The plan or IRA may also permit the account owner or designated beneficiary to elect whether the 5-year or life expectancy rule will apply. Rollovers to a spousal or inherited IRA that provides or permits use of the life expectancy method will allow the beneficiary to circumvent the 5-year rule if he or she desires.

2. Account Balance

The account balance is generally figured as of December 31st of the calendar year immediately preceding the distribution calendar year. For retirement plans other than IRA's, that balance is increased by contributions made or allocated for that year after that date. The first distribution calendar year generally is the first calendar year for which a minimum distribution is required. For lifetime distributions, however, the first distribution calendar year is the year that includes the account owner's required beginning date even though distributions need not begin until April 1 of the next year.

Distributing the MRD

For IRA's, the account owner may aggregate all IRA's owned by him or her to determine the MRD, and the required distribution may be made from any one or more of those IRA's. For other retirement plans, each MRD must be determined for the account balance in that plan alone and must be distributed from that plan. Note that the MRD for each year stands on its own. Therefore, if the amount distributed in any calendar year exceeds the minimum required, no credit is provided in later years for the excess.

An MRD for a particular calendar year must be made by December 31 of that year, unless it is for the first distribution calendar year, in which case it can be made by April 1 of the next year. Thus, if the first MRD is delayed to the following calendar year, the account owner must receive two MRD's in the second year: one on or before April 1 and a second on or before December 31.

Effect of the Waiver of 2009 MRD's

The Worker, Retiree, and Employer Recovery Act of 2008 provided a temporary waiver of the MRD rules, so that an MRD otherwise required for 2009 need not be made. As a result, a person who attained age 70½ in 2009 was not required to take a distribution by April 1, 2010. However, the MRD for 2010 must be made by December 31, 2010. Also, the temporary waiver has the effect of extending the 5-year distribution period (where applicable), and does not otherwise affect the life expectancy period. Some retirement plans, but not IRA's, may need to be amended to appropriately reflect the waiver.

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For questions or comments on this article, please contact Steve Sokolic at ssokolic@bcgbenefits.com, or (856) 368-7215. Steve is also an ERISA attorney and is available to lecture on areas of tax, compensation and retirement planning.

About the author:

Steven Sokolic, is Executive Vice President and General Counsel with Benefit Consultants Group. He has a Juris Doctor degree from George Washington University and a Master of Laws degree in Taxation from Georgetown University. Steve is a member of the Pennsylvania Bar. He worked for both the United States Department of Justice and Internal Revenue Service in the field of federal taxation. Steve was a practicing attorney for over 20 years before joining BCG as a tax and retirement plan consultant. Steve has written and lectured extensively in the areas of tax, compensation and retirement planning.