

Q&A: 2009 Required Minimum Distribution Rule Changes

The purpose of this Q&A is to explain the effect of the law change to the required minimum distribution (“RMD”) rules, passed as part of the Worker, Retiree, and Employer Recovery Act of 2008 (“WRERA”). In particular, this Q&A discusses issues employers will face in administering plans that are making RMDs.

1. What is the new law change affecting RMDs for 2009?

WRERA adds Code §401(a)(9)(H), which provides a temporary waiver of the RMD rules for calendar year 2009. The RMD rules would normally require a retirement plan to distribute a minimum annual amount to account holders who have reached their “required beginning date” (generally April 1 of the calendar year following the calendar year in which the individual attains age 70½), and to death beneficiaries of deceased account holders.

2. To what types of plans does the WRERA 2009 RMD waiver apply?

The waiver applies to qualified defined contribution plans (e.g., 401(k) and profit sharing plans), governmental 457 plans, 403(b) plans, 403(a) plans, and individual retirement accounts (“IRAs”).

3. What is the purpose of the new law?

The new law responds to the economic downturn that has resulted in significant reductions in the value of many retirement accounts. A distribution from an account that has suffered significant losses, of course, has a long term adverse impact on the account’s ability to recover the loss in future years. The new law permits an individual who otherwise would have to take a taxable distribution from assets that have suffered substantial losses to defer any RMD for a year, hopefully giving the market time to recover to some degree and to restore some of the lost value to the retirement account. However, the new law applies without regard to whether an account has experienced a gain or a loss.

4. How do RMDs affect eligible rollover distributions (ERDs) in general?

Most retirement plan distributions are ERDs. Recipients can roll over ERDs. However, ERDs do not include distributions which are (a) RMDs, (b) hardship distributions, or (c) one of a series of substantially equal periodic payments for the individual’s life or life expectancy (or joint lives or life expectancies with a designated beneficiary), or for a specified period of 10 years or more.

Under this rule, there are many distributions which would not have been ERDs without WRERA, because they would have been RMDs. WRERA allows these distributions to

become ERDs because they are no longer RMDs. However, there are some distributions which will continue not to be ERDs. Consider the following examples:

Example 1: John turns 70½ on July 15, 2009, and retired in 2002. John elects to take a lump sum distribution of his account balance in 2009. Normally, part of the distribution would be an RMD which John could not roll over and part of the distribution would be an ERD. However, because of WRERA, the entire distribution is an ERD.

Example 2: Mary is a 5% owner and turned 70½ in 2006. She has been receiving RMDs for several years. If WRERA had not passed, she would receive a \$10,000 RMD in 2009. Mary is still working. Her employer's plan does not permit her to receive distributions in 2009 other than RMDs and hardship distributions. Mary requests a \$30,000 hardship distribution in 2009. Normally, the first \$10,000 of that distribution would satisfy the RMD rules, but that is unnecessary for 2009 because of WRERA. However, no part of the \$30,000 is an ERD because it is a hardship distribution.

Example 3: Bill turned 70½ in 2005 and retired in 2000. Bill elected to receive his 401(k) distributions in installments necessary to satisfy the RMD rules. Such a series of installments would qualify as a series of substantially equal payments over Bill's lifetime. Treas. Reg. §1.402(c)-2, A-5(a); Notice 89-25; Rev. Rul. 2002-62. Therefore, the 2009 distribution to Bill does not qualify as an ERD, notwithstanding WRERA.

Example 4: Assume the same facts as Example 3, except Bill elected to receive his distribution in 15 equal annual installments. Each installment amount will exceed the RMD amount. No part of the 2009 distribution qualifies as an ERD, notwithstanding WRERA.

Subsequent questions discuss recipient and plan treatment of distributions which (a) would have been RMDs for 2009 if Congress had not passed the WRERA waiver provision and (b) would be an ERD if it were not an RMD. We refer to such a distribution as a 2009-ERD. Example 1 is an example of a 2009-ERD.

5. If a plan makes a 2009-ERD, must the plan apply the rules that apply to an ERD?

No. WRERA also amended the Code's distribution provisions to provide that the plan does not have to treat a 2009-ERD as an ERD for purposes of: (1) the direct rollover rules; (2) the 20% withholding requirement; or (3) the 402(f) notice. Therefore, the plan does not have to offer the direct rollover option on the distribution, must apply 10% withholding to the distribution, rather than mandatory 20% withholding, and does not have to provide the "402(f)" notice of an ERD (although it may need to provide the notice for the balance of the distribution). The 10% withholding rule will apply to the distribution, even if it is eligible for rollover by the recipient when received.

6. If an individual receives a 2009 distribution from a plan that has been distributing RMDs to the individual, may the individual roll over the distribution?

Yes, provided the distribution is a 2009-ERD.

7. If an individual receives a 2009-ERD, and decides to roll over the distribution, how long does the individual have to complete the rollover?

As under the normal rules, the individual would have 60 days from the date of receipt of the distribution to complete the rollover. The IRS has authority to waive the 60-day period under some circumstances but nothing in this area specific to the new law has been announced.

8. If a plan suspends a participant's RMD for 2009, does the suspension affect the way the plan calculates the participant's 2010 RMD?

No. As under the normal RMD rules, the plan generally will determine the 2010 RMD by dividing the December 31, 2009, account balance by the Uniform Lifetime Table factor under the Treasury regulations (or by the remaining life expectancy factor in the case of a non-spouse death beneficiary). Of course, the fact that there was no 2009 RMD will have the effect of increasing the December 31, 2009 balance.

9. Must a plan that is making RMDs to an individual notify the individual, in advance of the distribution, of the 2009 waiver provision, and give the individual an opportunity to elect not to take a 2009 distribution that, but for WRERA, would be an RMD?

The RMD waiver provisions of WRERA do not include any plan notice provisions, either in advance of the distribution or with the distribution, and the IRS has not provided any guidance on this issue. (See question 11 regarding IRAs.) However, even in the absence of a notice requirement, it would seem prudent to advise participants of the law change in some manner, since the change gives distribution recipients options that carry very different tax consequences. The type of notice to the participant depends on how the plan handles distributions subject to the RMD waiver. The next question discusses some alternatives.

10. How should a plan, during 2009, treat distributions that are affected by the RMD waiver?

It does not appear there is a clear answer to this question and IRS guidance would be helpful. In addition, specific plan language should be reviewed. Three potential approaches to consider are:

- i. ***Make distributions in accordance with previous elections, notwithstanding the RMD waiver.*** Under this approach, the plan would take the position that even though RMDs are not required for 2009, the plan will follow current distribution elections. If a participant has elected to receive installment payments, and the installments satisfy the RMD requirements and are not a series of substantially equal installments, the plan could continue to follow the election form, but advise

- the participant that the distribution is not an RMD for 2009, and the participant may be able to roll it over in order to avoid taxable income. If a participant has elected to receive “only my annual required minimum distributions, as determined under the Treasury regulations,” the plan similarly should be able to continue the distributions in accordance with the regulations, even though the distribution is not an RMD for 2009. In this case, the distribution will likely not be an ERD. This approach eliminates the need to revise the plan’s RMD procedures, while leaving participants the option of rolling over ERDs.
- ii. ***Suspend all RMDs for 2009.*** Under this approach, the plan simply would not make RMDs for 2009 unless the participant elected to receive the distribution. This approach would necessitate notice to the participant of the 2009 RMD waiver provisions, and additional distribution processing for participants who elect to receive a distribution. One benefit of this approach is that it avoids the issues of potential distributions that are not eligible for rollover under the long-term installment payment exception. However, this approach would involve additional correspondence, and potentially would require additional recordkeeping procedures for tracking the potential distributions. In addition, suspending distribution could create unexpected problems for those participants who count on the distribution and want them to continue.
 - iii. ***Let the participant choose whether to take a distribution of the 2009 RMD amount.*** This approach may be the least likely to generate complaints from participants, but, as in (ii), would require a notice to the affected participants and delivery of an election form. In addition, the plan would need to establish a default provision, either requiring distribution or requiring suspension, in the absence of a participant election to take distribution or to suspend. Any issues relating to plan language permitting a one-year suspension of payments for a participant who has elected installments will be able to be resolved by an applicable amendment implementing the RMD waiver.

11. Must a financial institution that is an IRA trustee send to IRA owners subject to the RMD requirements the annual notice due by January 31 regarding RMDs?

No. Under Notice 2002-27, an IRA trustee, by January 31 of each year, must provide an annual statement regarding RMD payments to owners of IRAs subject to RMDs. Also see the instructions to Form 5498. However, the IRS has stated that for 2009, a financial institution does not need to send the information required under Notice 2002-27. See Notice 2009-9. If a financial institution sends an RMD statement to an IRA owner, either initially or in response to a request to calculate the RMD for 2009, the financial institution must show the RMD for 2009 as zero. Alternatively, the financial institution may send the IRA owner a statement showing the RMD that would have been required but for the 2009 waiver, with an explanation of the 2009 waiver. The IRS, in Notice 2009-9, encourages all financial institutions to inform IRA owners who delayed taking their 2008 RMDs until April 1, 2009, that they still are required to take that distribution.

12. Does the 2009 waiver apply to a death beneficiary who is receiving distributions from the account of a deceased participant?

Yes. The 2009 waiver applies equally to participants and to death beneficiaries. The effect of the 2009 waiver is that a death beneficiary does not have an RMD for 2009. Furthermore, if a death beneficiary is taking distributions under 5-year rule that may apply when a participant dies prior to his/her required beginning date, the plan determines the 5-year period without regard to 2009. For example, for an account of a participant who died in 2007, the 5-year period ends December 31, 2013, not December 31, 2012. In essence, the beneficiary has 6 years, rather than 5, to complete the distributions if 2009 is one of the 5 years under the 5-year rule.

13. If an individual (whether an IRA owner or a participant who has separated from employment with the employer maintaining the plan) attained age 70½ in 2008, and did not take his/her first RMD in 2008, does the RMD waiver permit the individual not to take the first RMD in 2009?

No. The RMD rules permit a participant who attains age 70½ in a particular calendar to postpone his/her first RMD to the April 1 of the following calendar year. For example, an individual who attained age 70½ during 2008 may take the first RMD as late as April 1, 2009. However, that distribution satisfies the 2008 RMD obligation and still must be made. The WRERA waiver provision only applies to 2009 RMDs. Therefore, the individual who attained age 70½ during 2008 still must take his first RMD by April 1, 2009. However, the individual's 2009 RMD, normally payable by December 31, 2009, is waived under WRERA.

14. With respect to an individual who attains age 70½ during 2009, and has his or her initial RMD obligation for that year, must the individual still take his or her first RMD by April 1, 2010, since that date is after 2009, the year of the waiver?

No. Since the April 1, 2010, distribution would be the 2009 RMD, and WRERA waives the 2009 RMD, the individual who attains age 70½ during 2009 will not have to take a 2009 RMD by April 1, 2010. However, the individual, having reached his or her required beginning date, must take a 2010 RMD by December 31, 2010.

15. When must an employer amend its plan to add language reflecting the 2009 RMD waiver?

Under WRERA, an employer has until the last day of the 2011 plan year (2012 plan year in case of a governmental plan) to amend the plan for the 2009 RMD waiver provisions.

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For questions regarding this change or any other aspect of your retirement plan, please contact Rick Wedge at Northgate Benefits. (415) 499-1764.

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