

retirement

plan news

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Required Minimum Distribution Rules

The required minimum distribution (RMD) rules are intended to prevent retirement plan participants from leaving money in their plan accounts indefinitely to avoid paying federal income taxes. Participants may, however, spread out their benefit payments over a period of time (as specified by the IRS) so that spouses or other beneficiaries may have an opportunity to receive remaining benefits following a participant's death.

The IRS provides specific rules with respect to the timing and determination of RMDs. This article focuses on RMD rules for defined contribution plans.

Required minimum distributions begin on a participant's required beginning date (RBD). A participant's RBD is April 1 after the year he or she reaches age 70½ for:

- 5% owners (defined as anyone who owns more than 5% of the business; family attribution rules apply),
- Employees who are not 5% owners and who retire before or during the year they reach age 70½, and
- Owners of individual retirement accounts.

The RBD for employees, other than 5% owners, who continue working beyond the year they reach age 70½ is April 1 after the year they retire, provided plan documents contain such a provision.

Participant RMDs are calculated using life expectancy figures from the IRS's uniform lifetime table. The figures are based on the age of the participant and a beneficiary assumed to be 10 years younger,

regardless of the beneficiary's actual age.

Example: Sally, a retired participant, is age 72. She designates her husband Seymour, age 73, as her beneficiary. The distribution period for a 72-year-old from the uniform lifetime table is 25.6 years. If Sally names her niece Suzie, age 39, as beneficiary instead of Seymour, the same 25.6-year distribution period is used.

An exception applies if a spouse is more than 10 years younger than the participant. In this case, the IRS joint and last survivor table is used. Because the table is based on the actual ages of the spouses, the results are more favorable.

Example: Sally decides to divorce Seymour and marry Andrew, age 51. She designates Andrew as her beneficiary. Based on the joint table, the distribution period for a 72-year-old with a 51-year-old spouse is 34.1 years.



Generally, RMDs are calculated using the participant's account balance on the prior December 31 and dividing it by the life expectancy factor from the appropriate IRS table. The factor is based on the participant's age on his or her birthday during the current year.

(Continued on page 2)

CONTENTS

Required Minimum Distribution Rules

Circular 230: Changes to Written Advice

IRS Proposes Electronic Communication Standards

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Required Minimum Distribution Rules *(Continued from page 1)*

Example: Assume that Virginia's date of birth is August 19, 1934. Although she will reach age 70 in 2004, she won't be 70½ until February 19, 2005. Therefore, her first distribution will be in 2005. She will be 71 years old in 2005, so the factor listed in the uniform lifetime table for age 71 is used to determine her RMD.

Also assume that Virginia's account balance is \$100,000 as of December 31, 2004, and that her beneficiary is also age 71.

First Year Distribution Calculation:

| | |
|----------------------------------|-----------|
| Account value on 12/31/04 | \$100,000 |
| Life expectancy for age 71 | ÷ 26.5 |
| First distribution made 12/23/05 | \$ 3,774 |

Second Year Distribution Calculation:

| | |
|-----------------------------------|-----------|
| Account value on 12/31/04 | \$100,000 |
| Earnings on account in 2005 | + 6,000 |
| First distribution taken 12/23/05 | - 3,774 |
| Account value on 12/31/05 | \$102,226 |
| Life expectancy for age 72 | ÷ 25.6 |
| Second distribution | \$ 3,993 |

Uniform Lifetime Table

| Age | Distribution Period | Age | Distribution Period |
|-----|---------------------|------|---------------------|
| 70 | 27.4 | 93 | 9.6 |
| 71 | 26.5 | 94 | 9.1 |
| 72 | 25.6 | 95 | 8.6 |
| 73 | 24.7 | 96 | 8.1 |
| 74 | 23.8 | 97 | 7.6 |
| 75 | 22.9 | 98 | 7.1 |
| 76 | 22.0 | 99 | 6.7 |
| 77 | 21.2 | 100 | 6.3 |
| 78 | 20.3 | 101 | 5.9 |
| 79 | 19.5 | 102 | 5.5 |
| 80 | 18.7 | 103 | 5.2 |
| 81 | 17.9 | 104 | 4.9 |
| 82 | 17.1 | 105 | 4.5 |
| 83 | 16.3 | 106 | 4.2 |
| 84 | 15.5 | 107 | 3.9 |
| 85 | 14.8 | 108 | 3.7 |
| 86 | 14.1 | 109 | 3.4 |
| 87 | 13.4 | 110 | 3.1 |
| 88 | 12.7 | 111 | 2.9 |
| 89 | 12.0 | 112 | 2.6 |
| 90 | 11.4 | 113 | 2.4 |
| 91 | 10.8 | 114 | 2.1 |
| 92 | 10.2 | 115+ | 1.9 |

Source: McKay Hochman

There is a grace period for the first RMD. Participants have until April 1 of the year *following* the year they reach age 70½ or, in the case of non-5% owners, April 1 of the year after actual retirement, if that is later. In subsequent years, the deadline for taking RMDs is December 31 of each year. Thus, if the individual decides to take the first distribution during the grace period, the second distribution will be due by December 31 of the same year.

If an RMD is not taken in full, the IRS imposes a penalty of 50% of the amount of the RMD that was not distributed. Thus, using the example, if Virginia withdraws only \$2,000 the first year, \$1,774 (the remainder of the RMD) will be subject to the 50% penalty. ❖

Circular 230: Changes to Written Advice

Circular 230 governs the way approved tax practitioners are permitted to practice before the IRS. The U.S. Department of the Treasury and the IRS recently revised Circular 230 to reduce the occurrence of tax avoidance and tax evasion schemes. The revisions include new disclosure requirements for written advice, including electronic communications such as e-mails and faxes, provided by any of the four IRS-approved classifications of tax practitioners: enrolled actuaries, attorneys, accountants, or enrolled agents.

To comply with Circular 230 requirements, practitioners must now provide a disclosure in each written communication stating that it was not written to be used and cannot be used for the purpose of avoiding IRS penalties.

Disclaimers must be displayed distinctly. This requirement highlights the IRS's intent to clearly convey to taxpayers that they may not rely on written opinions to avoid taxation

and/or penalties for avoiding taxation. So, expect to see disclosure language included in almost everything that is written by the four professional groups, including opinions and newsletters.

Disclosures will be everywhere.

Considering the number of written correspondences from attorneys and accountants, as well as enrolled actuaries and enrolled agents, disclosures will become commonplace. Even our newsletter has a Circular 230 disclosure (see page 4). ❖

IRS Proposes Electronic Communication Standards

The IRS has issued proposed regulations that set standards for using electronic media to provide participants of employee benefit plans with required notices. The regs also allow participant elections and consents to be sent electronically, and coordinate IRS notice and consent rules with the Electronic Signatures Global and National Commerce Act (E-SIGN).

Before covering the highlights of the proposed regulations, it's important to note that they *do not apply* to IRS tax reporting, tax records, substantiation of expenses, or COBRA. Also, the IRS regulations *will not extend* to areas within the authority of the Department of Labor (DOL) or the Pension Benefit Guaranty Corporation (PBGC). For example, the electronic delivery rules for disclosures required by ERISA, such as summary plan descriptions, are part of DOL regulations.

Plans Affected. The proposed rules apply to notices, elections, or similar communications provided to or made by participants or beneficiaries under qualified plans (401(k), profit sharing, defined benefit, etc.).

The regulations also apply to employee benefit plans, such as tax-sheltered annuity contracts, SEPs, SIMPLE IRAs, governmental 457 plans, accident or health plans, cafeteria plans, educational assistance programs, qualified transportation fringe benefit programs, Archer Medical Savings Accounts, and health savings accounts.

Rules for Notices. Retirement plan notices mentioned in the IRS proposal include safe harbor 401(k) notices, rollover distribution notices, notices to interested parties, qualified joint and survivor annuity notices, and notices of prospective cutbacks in benefits (better known as 204(h) notices).

Requirements for using electronic media to deliver notices:

- The timing and content of the notice must satisfy the applicable IRS rules. (For example, the safe harbor 401(k) notice must be provided 30 to 90 days prior to the beginning of the plan year.)
- The content of the notice and the delivery medium must be designed so the communication is no *less* understandable than if it had been delivered on paper.
- The transmittal must clearly identify the subject matter of



the notice and its importance.

- The transmittal must provide readily understandable instructions to ensure accessibility.

The IRS Consent Process. Participants must consent before benefit plan notices may be sent electronically. First, the participant must receive a disclosure of the consent rules. He or she may then consent electronically or in writing. If the consent is in writing, the participant must demonstrate the ability to obtain the notice electronically. (Participant consent may not be given verbally, even if recorded.)

When a notice is provided electronically, participants must be informed that a written paper copy may be obtained at no charge.

Rules for Participant Elections. The term “participant elections” refers to consents, elections, requests, or agreements. There are four basic requirements an electronic delivery system must meet:

- Participants must be able to effectively access the electronic system to transmit the election,
- A safeguard must be in place (e.g., a personal identification number or PIN) to replace the participant’s signature as authorization that the participant is the one making the election,
- The participant must have a reasonable opportunity to review, confirm, modify, or rescind the terms of the election before it becomes effective, and
- Provided the preceding electronic notice requirements are met, a confirmation must be sent to the participant within a reasonable period of time, either by paper or electronically.

The IRS will hold a public hearing on the proposed regulations on November 2, 2005, after which final regulations will be issued. ❖

recent developments

■ **Form 5500 Issued.** Three significant modifications have been made to Form 5500 (Annual Return/Report of Employee Benefit Plan) for the 2005 plan year: Schedule T (Qualified Pension Plan Coverage Information) is no longer required; the instructions for Schedule A (Insurance Information) reflect EBSA guidance issued earlier this year on the reporting of insurance fees and commissions; and Schedule B (Actuarial Information) and its instructions improve the reporting of investment returns, actuarial assumptions, and the summary of eligibility and benefit provisions used in plan valuations.

■ **Final Anti-cutback Rules.** Internal Revenue Code Section 411(d)(6)(B) protects the benefits a participant has

accrued from being cut back by a plan amendment. EGTRRA clarified that the anti-cutback provisions do not apply to plan amendments that reduce or eliminate benefits or subsidies that create significant burdens or complexities. As required by EGTRRA, the IRS has issued final regulations to provide rules under which a plan may be amended to eliminate benefits that are burdensome and are of *de minimis* value to plan participants.

■ **BAPCPA.** The Bankruptcy Abuse Prevention and Consumer Protection Act became effective October 17, 2005. Under BAPCPA, assets held in qualified retirement plans, 403(b) plans, and 457(b) governmental plans are exempt from the bankruptcy estate. BAPCPA estab-

lishes guidelines for determining the qualified status of a retirement plan for bankruptcy purposes. BAPCPA also exempts traditional IRAs and Roth IRAs from the bankruptcy estate up to a \$1,000,000 limit. There is no \$1,000,000 limit on rollover IRAs, SEPs, and SIMPLE IRAs. Because they each have an employer contribution component, they are totally exempt from the bankruptcy estate. In addition, the law settles a long-standing conflict between ERISA and the bankruptcy courts by requiring plan participants to continue making payments on qualified plan loans rather than allowing payments to be suspended. ❖

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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