Plan Grief Over 2009 Minimum Distribution Relief

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The year 2009 is a "skip" year for required minimum distributions (RMDs) from qualified defined contribution retirement plans like 401(k) plans as well as rollover vehicles like IRAs because legislation enacted in 2008 temporarily exempted plans from the rules that require these distributions. The skip only applies to RMDs for 2009 and does not include the initial RMD that is triggered by a participant's attainment of age 70 1/2 in 2008 even though that RMD does not have to be made until 2009. Similarly, RMDs for a participant who reaches age 70 1/2 in 2009 is suspended, despite the fact that the distribution would not have been due until 2010.

The IRS recently issued Notice 2009-82 to provide guidance on how plans must be amended to accommodate this 2009 exemption and to clarify certain questions such as rollover options if amounts are distributed despite the suspension.

One of the major tax advantages of qualified retirement plans is the ability for employers to receive current deductions from taxation for contributions to these plans, while earnings on the amounts contributed are not subject to income tax as long as the amounts are held in the plan or in a rollover vehicle like an IRA. This tax deferral aids in the investment growth of amounts available to workers when they retire. However, Uncle Sam eventually expects his due from these amounts; accordingly distributions to participants from these tax-deferred vehicles are subject to income tax when distributed. Furthermore, Uncle Sam is not willing to wait to receive his due until the participant is ready to take a distribution. Instead, the RMD rules were enacted to force participants to take distributions and thereby incur income tax once participants have reached an age at which it would be reasonable to expect them to retire.

Thus, participants are legally required to start taking RMDs, which are calculated as a fractional portion of their accounts based upon their life expectancies, in the plan year following the plan year when they reach age 70 1/2. This required distribution for non-owner participants of qualified retirement plans can be further delayed by remaining an active employee of the plan sponsor. For participants who own 5% or more of the plan sponsor, the RMD rules apply even if they are still actively working.

Retirement plans must include these mandatory distribution rules in their plan documents as a qualification requirement. The 2009 RMD must be implemented via a plan amendment; however, the amendment is not due until the 2011 plan year. Plan sponsors must decide whether all 2009 RMDs will be suspended or whether to offer an option to allow participants to receive the 2009 RMD amount despite the suspension. Plans which await 2011 to amend must operate in compliance with the terms of the eventually adopted amendment, at least in the month of December, 2009. IRS Notice 2009-82 provides sample amendments and guidance for plan sponsors who want to adopt plan amendments before 2011. The sample amendments include the option of permitting participants to receive their 2009 RMDs.

The sample amendments provided in Notice 2009-82 also offer rollover options for plans which permit optional distributions of otherwise suspended 2009 RMDs. Normally, RMDs are ineligible for rollover, but amounts distributed in 2009 that would have been RMDs but for the suspension rule are eligible for rollover, which means that they can be deposited within a certain period of time in an IRA or a qualified plan and defer taxation. Plans which offer this option do not have to comply with the direct rollover notice rules or the special income tax withholding rules; however they can opt to treat 2009 RMDs as direct rollovers if plans opt to do so via early plan amendments.

The IRS Notice also provides relief for any action taken by a plan prior to November 30, 2009 that ultimately is different that the treatment elected by the plan sponsor via a later plan amendment. The Notice also extends the 60-day rollover deadline for 2009 RMD rollovers so that the 60-day period ends no earlier than November 30, 2009. This means that distributions received earlier in 2009 can still be rolled over even though the 60-day deadline would normally have lapsed.

Action Plan: Plan sponsors who have any participants affected by the RMD rules in 2009 should determine now whether all RMDs in 2009 will be suspended or whether participants can have the option of receiving them. If participants can opt to receive the distributions, then plan sponsors should determine whether a direct rollover option will be offered for these distributions. Plans must be operated consistently with the RMD choices made, at least for the month of December, and plan sponsors may want to go ahead and adopt the required amendment now rather than waiting until 2011.

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