

# KRAVITZ Retirement Plan News

## Required minimum distributions

The tax-deferral break on funds placed in retirement plans only lasts so long. Retirement funds are meant to be distributed — and taxed — during retirement, not left in the plan to be passed to the next generation.

All qualified plans, such as 401(k) plans, must satisfy the requirements of Internal Revenue Code Section 401(a), including Section 401(a)(9), which requires qualified plans to make required minimum distributions (RMDs) to participants, generally when they reach age 70½. It is estimated that RMDs will result in at least half of a participant's assets being returned to the tax stream before his or her death. If RMD payments are not made, it is a plan qualification failure.

### Timing

Each year in which an RMD is due is called a "distribution calendar year." The RMD for a participant's "first" distribution calendar year may be taken anytime from January 1 of the year the participant reaches age 70½ until his or her required beginning date (RBD), which is generally until April 1 *after* the year he or she reaches age 70½. After the first year, RMD payments are calculated

annually on a calendar-year basis. April 1 is the deadline for the first RMD only — every other RMD must be paid by December 31. If a participant waits until April 1 to take the first RMD, then his or her second RMD is due by December 31 of the same year.

The plan may provide a later RBD — April 1 after the year the employee severs employment — for non-5% owners who work beyond age 70½. See page three for an in-depth discussion of RBDs.

### Calculating RMDs

For defined contribution plans, a participant's RMD is calculated by dividing his or her account balance on December 31 of the prior year by the appropriate factor from the IRS Uniform Lifetime Table. If the participant's beneficiary is a spouse who is more than 10 years younger than the participant, the dividing factor comes from the IRS Joint Life Expectancy Table instead. For plans that do not run a valuation on December 31, the last valuation date in the prior year is used and adjusted for contributions and distributions through December 31.

### Participant-level RMD penalty

Participants who fail to withdraw any RMD or fail to withdraw the full amount of their RMD are subject to a



50% excise tax (penalty) based on the underpayment (i.e., the RMD amount that was not distributed). If there is a reasonable cause for the failure, however, the IRS may waive the penalty.

### Plan disqualification for failing to distribute RMDs

Failure to distribute RMDs can result in plan disqualification. The IRS's Employee Plans Compliance Resolution System (EPCRS) offers a Voluntary Compliance Program (VCP) that allows plan sponsors to correct RMD failures for a discount fee of \$500 for up to 50 missed RMDs. The VCP also allows plan sponsors to have the participant's 50% excise tax waived.

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# IRS Uniform Lifetime Table

The IRS's Uniform Lifetime Table is used to determine a participant's required minimum distribution (RMD) each year. To calculate an RMD, divide the participant's account balance on December 31 of the prior year by the factor from the Uniform Lifetime Table corresponding to the age the participant will be on his or her birthday in the current year.

The uniform table is based on the participant's age and the age of an individual who is 10 years younger. When a plan participant's spouse is more than 10 years younger, the Joint Life and Last Survivor Expectancy Table may be used since it provides a longer life expectancy. Beneficiaries will generally use the new Single Life Expectancy Table. These tables may be found in IRS Publication 590, *Individual Retirement Arrangements (IRAs)*.

To calculate an RMD, use the age the participant will be on his or her birthday this year. Participants reaching age 70½ in 2013 (born between July 1, 1942, and June 30, 1943) must take their first RMD by April 1, 2014. Those born between July 1, 1942, and December 31, 1942, will be age 70½ by June 30, 2013, and will also turn age 71 in 2013. Use age 71 from the table.

Those born between January 1, 1943, and June 30, 1943, will be age 70½ between July 1 and December 30, 2013, but will not reach age 71 in 2013. Use the age 70 factor to determine their RMD for 2013. For the following year's calculation, use the participant's age on his or her birthday in that year to determine the age factor.

**The IRS Uniform Lifetime Table (April 17, 2002)**

Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
70	27.4	86	14.1	101	5.9
71	26.5	87	13.4	102	5.5
72	25.6	88	12.7	103	5.2
73	24.7	89	12	104	4.9
74	23.8	90	11.4	105	4.5
75	22.9	91	10.8	106	4.2
76	22	92	10.2	107	3.9
77	21.2	93	9.6	108	3.7
78	20.3	94	9.1	109	3.4
79	19.5	95	8.6	110	3.1
80	18.7	96	8.1	111	2.9
81	17.9	97	7.6	112	2.6
82	17.1	98	7.1	113	2.4
83	16.3	99	6.7	114	2.1
84	15.5	100	6.3	115+	1.9
85	14.8				

## Required minimum distributions (Continued from page 1)

### Aggregating RMDs

It's not unusual for individuals to have multiple 401(k) plan accounts and/or multiple individual retirement accounts (IRAs). The rules for these two types of retirement accounts are different when it comes to aggregating RMDs. Individuals with multiple IRAs must calculate an RMD for each account separately but may withdraw the total of those RMD amounts from one (or more) IRA. Qualified plans, such as 401(k)s, do not have this rule. The IRS requires an RMD to be distributed from each plan.

### Tax withholding

RMDs are not eligible rollover distributions. Therefore, they are not subject to the 20% mandatory federal tax withholding. Distributions that are not eligible for rollover are subject to voluntary tax withholding (generally 10%), which the participant may elect to waive. Note that the first distribution made by a participant in a distribution calendar year is considered the RMD and thus may not be rolled over.

### Roth 401(k)

For participants with Roth 401(k) contributions, RMD calculations must include Roth 401(k) amounts. However, the RMD may be taken entirely from the non-Roth portion of the participant's account until the Roth 401(k) portion becomes a qualified distribution amount (i.e., earnings are distributed tax free). Once the Roth 401(k) funds have satisfied the rules and are qualified, they may be taken first to satisfy an RMD. If there is enough tax-free Roth money to satisfy the entire year's RMD, then only Roth 401(k) funds may be distributed. **Note:** Roth IRA funds are not subject to RMDs.

### Interesting RMD facts

- The IRS allows participants to take more than their RMD amount in any year since taxes will be paid sooner that way. The amount of the distribution that is over the RMD amount is eligible for rollover and subject to the 20% withholding requirement.
- Extra amounts taken in one year may not be applied to a future year's RMD.
- If the plan is subject to the qualified joint and survivor annuity (QJSA) rules, the participant and the spouse must waive, in writing and witnessed by a notary public or plan representative, the option to receive the RMD in the form of an annuity. If the QJSA is not waived, the plan must buy an annuity to satisfy the RMD.
- Defined benefit plans have an entirely different set of regulations for RMDs and an actuary is needed to do the calculations.



# What is the required beginning date?

The term “required beginning date” (RBD) refers to the kickoff event, if you will, for required minimum distributions (RMDs). RBD is the deadline for a participant to receive his or her first RMD, followed by annual RMDs thereafter. For a qualified plan participant who stops working before reaching the age of 70½, RBD is April 1 after the year in which the participant reaches age 70½.

## RBD defined

For a qualified plan, such as a 401(k), profit sharing, or money purchase plan, the broad regulatory definition of RBD is:

- April 1 of the year following the year of attainment of age 70½ for
  - Owners of more than 5% of the business entity (known as 5% owners) and
  - Individuals who are not 5% owners but who retire before or during the year in which they attain age 70½, or
- April 1 of the year following the year the participant severs employment for those individuals who are not 5% owners and who continue working for the employer beyond the year in which they reach age 70½.

## Plan design options

The retirement plan defines RBD and is not required to adopt this broad regulatory definition. For example, a plan document may elect to establish April 1 of the year following the year a participant reaches age 70½ as the RBD for every participant.

A plan designed to permit the delay of RBD for non-5% owners (until retirement after age 70½) must address whether in-service distributions for employed participants at and after age 70½ are permitted. Participants who work beyond age 70½ often do so with the expectation that they can count on RMDs to supplement their income. However, RMDs are not permitted before a participant’s RBD,

which doesn’t happen until he or she severs employment after age 70½ in this case. Therefore, a plan designed to delay RBD should include an in-service distribution provision to allow the plan to calculate what a participant’s RMD would have been and distribute it. The plan document usually will also provide for an in-service withdrawal provision to allow distributions to active participants. **Note:** An in-service distribution is not an RMD and therefore is subject to the mandatory 20% federal tax withholding.\*

The rule allowing plans to provide a later RBD does not apply to IRAs. IRA RMDs must be made by April 1 after the individual attains age 70½, even if payments from the plan are delayed.

## Retirement

For RBD purposes, if an employee severs employment, he or she is considered retired from the employer. The individual’s status with other employers is not considered. Thus, a person may be retired from one job and be subject to RMDs from that employer’s plan while actively working for another employer and not be required to take RMDs from the current employer’s plan.

Employees may change their status. For example, an individual over age 70½ who transitions from full-time employment to 800 hours of service a year has not severed service. Thus, as a non-5% owner who is still employed, the individual has not reached his or her RBD.



## 5% owner

Also for RBD purposes, a 5% owner is an employee who is a 5% owner with respect to the plan year ending in the calendar year in which the employee attains age 70½. If an individual was a 5% owner in the year he or she reached age 70½, then the individual will always be considered a 5% owner, even if his or her interest is sold at a later date (e.g., after RBD). Conversely, if a participant becomes a 5% owner after RBD, he or she is not considered a 5% owner for RBD purposes.

**Example:** A 74-year-old 5% owner began taking RMDs from his company’s 401(k) plan when he reached 70½. He is still working for the same company, and although he recently sold his ownership interest in the company, he must continue taking RMDs.

\* Unless the participant arranges for a direct rollover to a qualified plan or an IRA or establishes a schedule of payments over his or her lifetime or for at least 10 years.

## 5% owner and the family attribution rules

A 5% owner is an individual who owns more than 5% of the employer. Family attribution rules apply, i.e., the ownership of a company can be attributed to and from other family members. According to Internal Revenue Code Section 318(a)(1), an individual is considered to own stock that is owned, directly or indirectly, by or for his or her spouse,\* parents, children (including legally adopted children and regardless of age), and grandchildren.

\* Other than a spouse who is legally separated from the individual under a court-approved separation agreement. Note that for qualified plan purposes, the federal definition of spouse under the Defense of Marriage Act applies. Thus, same-sex spouses are not spouses for attribution purposes.

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## RECENT developments

### ▶ DOL proposes amendments to abandoned plan program

The Department of Labor (DOL) introduced a proposed rule and related class exemption that would assist bankruptcy trustees in distributing assets from bankrupt companies' retirement plans. The DOL Abandoned Plan Program provides streamlined termination and distribution procedures for 401(k) plans. Currently, the program applies only to financial institutions that hold the assets of an abandoned plan. Under federal bankruptcy law, bankruptcy trustees often must assume plan administrator duties for plans of companies in Chapter 7 bankruptcy. The proposed changes would allow bankruptcy trustees

to use the program. The DOL also introduced an amendment to Prohibited Transaction Exemption 2006-06 that would allow bankruptcy trustees to pay themselves a fee from the plan's assets for terminating the plan.

### ▶ Great expectations for 2013

Following are items that will hopefully be issued in 2013 by the IRS:

- Streamlined interim amendment procedures
- A revenue procedure for the 403(b) preapproved plan program
- Preapproved plan language for 403(b) plans
- Guidance on a delinquent filer program for Form 5500-EZ

- Final regulations on stopping/suspending a safe harbor 401(k) nonelective contribution (NEC) plan midyear

And by the DOL:

- New proposed definition of "fiduciary"
- New proposed regulation on electronic communication of disclosures
- Additional FAQ guidance on 408(b)(2) disclosure rules
- Final regulations on target date funds
- Final qualified default investment alternative (QDIA) regulations
- Final regulations on the abandoned plan program

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