

IRS Issues Guidance on 2009 Required Minimum Distributions for Defined Contribution Retirement Plans

As a means of alleviating some of the financial burdens on older Americans in these unprecedented economic times by allowing participants to retain investments in their retirement accounts and perhaps recoup lost value prior to distribution, the Worker, Retiree, and Employer Recovery Act of 2008 (the "Act") suspended required minimum distributions ("RMDs") for calendar year 2009. This temporary relief applies to defined contribution retirement plans—including 401(k) plans, 403(b) plans, certain 457(b) plans and IRA accounts. The relief does not, however, apply to defined benefit retirement plans and, as noted below, RMDs for 2008 were not suspended even if not paid until 2009.

Due to the confusion that arose for plan sponsors and practitioners alike with respect to how the Act applies to specific plans, the Internal Revenue Service ("IRS") recently issued long awaited guidance addressing the Act, which includes transition relief for plan sponsors and rollover relief for participants and beneficiaries through November 30, 2009. The IRS guidance also includes sample plan amendments which may be helpful to plan sponsors in documenting plan operation with respect to the Act. The guidance, Notice 2009-82, is available at <http://www.irs.gov/pub/irs-drop/n-09-82.pdf>.

Background on RMDs

Under Section 401(a)(9) of the Internal Revenue Code of 1986, as amended (the "Code"), a participant in a tax-qualified defined contribution plan must normally take an annual RMD beginning on his or her "required beginning date." The "required beginning date" is generally the April 1 of the calendar year following the later of the calendar year in which an individual reaches age 70½ or retires, with special rules for 5% owners. RMDs are also required for beneficiaries of deceased participants.

Example: Without the relief provided under the Act, a participant who attains age 70½ in 2009 would be required to take an RMD for 2009 by April 1, 2010.

The RMD rules are intended to prevent individuals from using retirement accounts as a tax shelter. Failure to take an RMD in any calendar year triggers a 50 percent excise tax for a participant or beneficiary on the required amount that is not withdrawn.

2009 RMDs Under the Act

1. General Rules

The Act provides a waiver of RMDs for the 2009 calendar year. The following examples illustrate permitted application of the waiver:

- *Participants whose required beginning date is in 2009:* The Act waives the initial RMD that would normally be required by April 1, 2010. The first RMD for such individuals will be the 2010 RMD, due by December 31, 2010.
- *Participants whose required beginning date was in 2008:* An initial RMD was still required by April 1, 2009. This RMD was not waived under the Act. However, the RMD for 2009 (due by December 31, 2009) need not be made.
- *Participants whose required beginning date is before 2008 who are already receiving RMDs:* Distributions ordinarily required for the 2009 calendar year by December 31, 2009, need not be made.

For participants whose required beginning date is in 2010 or beyond, the Act does not apply—i.e., the first RMD will generally be required by the required beginning date, and an annual RMD will be required thereafter. There has, however, been discussion of the possibility of future legislation that could extend the RMD relief to apply in future years.

2. Payments After Death

The suspension of the 2009 RMD also applies to beneficiaries entitled to benefits following the death of the participant. The 2009 RMD normally payable by December 31, 2009 to a participant's spouse or beneficiary is waived. For beneficiaries under defined contribution plans who must withdraw all funds from the participant's account by the end of the fifth year after the year of the participant's death, the determination of the five-year period is made without regard to 2009, in effect extending the period to six years.

Example: If a participant died in 2007, the five-year period over which payments must be made to a beneficiary ends on December 31, 2013, rather than December 31, 2012.

For plans that permit direct rollovers by non-spouse beneficiaries (which will be mandatory in 2010), if a participant dies before the required beginning date, the amount that must be distributed to the non-spouse beneficiary rather than rolled over (which normally reflects that year's RMD) depends on whether the distributing plan meets the RMD rules using the life-expectancy rule or the five-year payout rule. When the five-year payout rule would otherwise apply, a special rule allows non-spouse beneficiaries to elect to instead determine the RMD using the life expectancy rule if the plan distribution is made before the end of the year following the year of death. The IRS has confirmed the modification of this special rule so that non-spouse beneficiaries of participants who died in 2008 have until the end of 2010 to make the direct rollover and use the life expectancy rule.

3. Eligible Rollover Distributions

a. Direct Rollovers and Withholding Requirements

Ordinarily, an eligible rollover distribution excludes any portion of a distribution made to satisfy the RMD rules. Pursuant to the Act and the IRS's guidance, however, the portion of a distribution that would normally be either (i) an RMD for 2009 (and thus normally ineligible for rollover) or (ii) a distribution for 2009 that is a payment in a series of substantially equal distributions (that include the 2009 RMD) made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancy) of the participant and the participant's beneficiary, or for a period of at least 10 years, will now generally be eligible to be rolled over. In recognition of the administrative burden that plan sponsors and administrators might face, the Act provides that a plan sponsor may, *but is not required to*, offer the direct rollover option for what otherwise would have been the 2009 RMD or such a payment including the 2009 RMD, but for provisions of the Act.

If the 2009 RMD is distributed to a participant, the mandatory 20 percent income tax withholding that normally applies to the distribution of an amount that is eligible for direct rollover will not, however, apply to such distribution (the voluntary withholding rules apply, which, for a lump sum payment (i.e., non-periodic payments), is generally a 10 percent income tax withholding rate).

Example: If a plan makes a distribution in 2009 to a retiree of his entire account balance under the plan and part of the distributions is a 2009 RMD, the portion of the distribution that is not a 2009 RMD is subject to the 20 percent mandatory withholding rules and the portion that is a 2009 RMD is subject, generally, to the 10 percent optional withholding rules.

The IRS has confirmed that in determining which distributions during 2009 are 2009 RMDs, ordering rules apply in which the first distributions made in 2009 are considered RMDs from prior years not yet distributed, followed by 2009 RMD amounts.

b. Indirect Rollovers

As another option, participants and spousal beneficiaries may elect a 60-day indirect rollover of 2009 RMDs (non-spouse beneficiaries are generally not eligible for 60-day indirect rollovers) or of a distribution for 2009 that is a payment in a series of substantially equal distributions (that include the 2009 RMD) made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancy) of the participant and the participant's beneficiary, or for a period of at least 10 years. The IRS has provided for rollover relief to assist plan participants and spousal beneficiaries who have already received distributions in 2009 but may have been unsure about which amounts could be rolled over. Such individuals now have until November 30, 2009, or 60-days from the date of the distribution, if later, to rollover such distribution to an IRA, another qualified retirement plan, or, as the IRS has confirmed in its recent guidance, back into the same plan from which the distribution was made (if the plan so provides).

4. Notice Requirements and Spousal Consent

The Act does not impose any specific notice obligations on plan sponsors. However, some plan sponsors are choosing to advise participants of the temporary change in the law and the approach the plan sponsor is taking with respect to 2009 RMDs. In addition, although there does not appear to be a requirement to provide direct rollover notices for 2009 RMDs, plan sponsors may want to communicate with participants and beneficiaries who may be impacted by the 2009 RMD waiver, as such information may be helpful for participants and beneficiaries.¹

The IRS's guidance confirms that spousal consent requirements will generally not apply when continuing or suspending 2009 RMDs (except if a plan provides that there is a new annuity starting date when distributions are suspended and then restarted).

Plan Amendments

For many plans, the plan sponsor's decisions regarding 2009 RMDs will require a plan amendment. Plan sponsors have until the last day of the plan year beginning in 2011 (2012 for governmental plans) to amend their written plan documents to reflect the operation of the plan with respect to 2009 RMDs. Such plan amendment would be retroactively effective to 2009.

Two sample plan amendments that individual plan sponsors can use in drafting plan amendments are provided in the IRS's guidance. However, it is likely that the sample amendments would need to be modified to conform to a plan's terms and administrative procedures. Both sample amendments provide for giving certain individuals a choice between receiving or not receiving 2009 RMDs, but only permit such choice for distributions that would otherwise be equal to the 2009 RMD or be a payment in a series of substantially equal distributions (that include the 2009 RMD) made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancy) of the participant and the participant's beneficiary, or for a period of at least 10 years, and contemplate that all other distributions, including distributions that consist partly of 2009 RMDs will be made. Accordingly, if a plan sponsor's approach to 2009 RMDs does not include giving participants such choice, the sample amendments may not prove overly useful.

Transition Relief

The IRS's guidance provides that a plan will not be treated as failing to be operated in accordance with its terms with respect to 2009 RMDs for the period January 1, 2009 through November 30, 2009. This transition relief was provided to address the fact that many plan sponsors were unable to make changes in their procedures to reflect the Act by the start of 2009, and there were many unanswered operational questions that existed prior to the IRS's latest guidance. Accordingly, the IRS's guidance provides transition relief to plan sponsors through November 30, 2009 specifically for: (i) paying or not paying 2009 RMDs, (ii) not giving participants and beneficiaries the choice to receive or not receive 2009 RMDs; and (iii) offering or not offering a direct rollover option for 2009 RMDs or for not operating in accordance with the indirect rollover relief discussed above. Even though plan sponsors have until 2011 to adopt formal amendments, as a result

¹ The IRS recently published new rollover notices to assist plan sponsors in meeting their disclosure obligations under Code Section 402(f). But, those new model rollover notices do not reflect the waiver of 2009 RMDs.

of the transition period, plan sponsors will want to have made final decisions regarding how they will handle 2009 RMDs by November 30, 2009, and, beginning December 1, 2009, plans should be in operational compliance with such decisions.

Action Steps for Plan Sponsors

Although the Act provides an extended period of time to formally adopt plan amendments, practically speaking plan sponsors need to make immediate decisions and take action now. Specifically, plan sponsors should:

- No later than November 30, 2009, decide what approach will be taken with respect to the temporary suspension for 2009 RMDs and review existing RMD procedures. Until further IRS guidance is published, it appears that plan sponsors may have the following options:
 - *Suspend all RMDs for 2009.* A plan sponsor could institute an automatic procedure that would suspend all RMDs for 2009, unless a participant otherwise requests a distribution (plan terms would need to be reviewed to see if such permissive distributions are provided for under the plan).
 - *Continue distributions in accordance with plan provisions and participants' elections.* A plan sponsor could decide to forego the suspension on 2009 RMDs and continue to make distributions of amounts that would otherwise be RMDs in accordance with a participant's prior election and applicable plan provisions (although, again, specific plan provisions would have to be reviewed to make sure this was permissible under the terms of the plan and that any such plan provisions continue to apply as intended after enactment of the Act). Under this approach, a plan sponsor would also need to consider whether to offer a direct rollover option for the distributions, and may want to notify participants that for 2009 the distribution that would otherwise be deemed an RMD and not eligible for rollover may nonetheless be rolled over to an eligible retirement plan (including an IRA).
 - *Give participants a choice whether or not to receive a distribution of the 2009 RMD.* A plan sponsor could permit participants to elect whether or not they want to receive an RMD for 2009 (although, again, this may require a plan amendment).
- No later than November 30, 2009, decide whether and to what extent direct rollovers of distributions containing 2009 RMDs will be offered.
- If desired, inform any participants and beneficiaries who have already received a 2009 RMD distribution of the indirect rollover relief until the later of November 30, 2009 or 60 days from the date of the distribution (although there does not appear to be a formal notice obligation).
- By December 1, 2009, operate in accordance with the IRS's guidance and decisions made with respect to 2009 RMDs.
- Consider whether plan language may need to be amended to document 2009 RMD procedures by the last day of the plan year beginning in 2011 (2012 for governmental plans). ♦

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