

Client Alert

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Required Minimum Distribution Rules Suspended for 2009 for IRAs and other Defined Contribution Plans

On December 23, 2008, President Bush signed the Worker, Retiree, and Employer Recovery Act of 2008 (H.R. 7327) (the “WRER Act”), which provides that owners and beneficiaries of IRAs and other defined contribution plans who are required to take required minimum distributions (“RMDs”) from their plans in tax year 2009, will generally be able to leave their money in their plans (hopefully to grow) without suffering any penalty for failure to withdraw. The normal rules still apply for 2008.

Background

Employer-provided qualified retirement plans and individual retirement accounts and annuities (IRAs) are subject to RMD rules. RMDs generally must begin by April 1 of the calendar year following the calendar year in which the individual reaches age 70 ½. RMDs are generally based on the joint life expectancy of the IRA owner and his beneficiary. For IRAs and defined contribution plans, the RMD for each year is determined by dividing the retirement account balance as of the end of the prior year by a distribution period, which is found in an IRS-supplied life expectancy table. For instance, an individual’s 2008 RMD is determined by reference to such individual’s account balance on December 31, 2007 divided by the joint life expectancy of the individual and his beneficiary found in the IRS table.

Failure to make a RMD triggers a 50% penalty tax calculated against the RMD that should have been distributed in that particular year.

Under the WRER Act, no RMD is required for 2009 from IRAs and retirement plans that are defined contribution plans (within the meaning of IRC Section 414(i)). Thus, any annual minimum distribution for 2009 from these plans required under current law, determined by dividing the account balance by a distribution period, is not required to be made. The next RMD would be for calendar year 2010. These provisions apply to life-time distributions to IRA owners and employees as well as to after-death distributions to beneficiaries.

Technical Requirements

The WRER Act applies to defined contribution plans described in IRC Section 403(a), 403(b) and 457 (eligible deferred compensation plan), and individual retirement plans. Thus, these provisions provide relief to participants in and beneficiaries of IRAs, SEP-IRAs, SIMPLE IRAs, 401(k) plans, money-purchase plans and profit-sharing plans. The WRER Act does NOT apply to defined benefit plans.

If an individual dies before his required beginning date (generally April 1 of the year after the year he turns age 70 ½), there are two methods for satisfying the after-death RMD rules – the life expectancy rule and the “5-year rule”. Under the life expectancy rule (which is generally more favorable because distributions are made over a long period), the RMD for each year is determined by reference to the beneficiary’s life expectancy. Under the 5-year rule, the deceased individual’s entire account must be distributed no later than December 31 of the calendar year containing the fifth anniversary of the individual’s death. For instance, if an individual dies on July 1, 2005, under the 5 year rule, his entire account must be distributed by December 31, 2010.

For IRA owners that die before reaching age 70 ½ and who have not designated qualified beneficiaries (usually this results because they name their estate as the beneficiary of their IRA), their estate or heirs generally are subject to the 5 year rule, meaning that they have 5 years to take distributions from their IRAs. Under the WRER Act, the 5-year period is determined without

regard to calendar year 2009 – the period is extended by one year, automatically.

Since the WRER Act is only effective for 2009, it does not apply to any RMD for 2008 that is permitted to be made in 2009 by reason of an individual's required beginning date being April 1, 2009. This would apply to individuals who turned age 70 ½ during 2008.

Examples

1. **Individual attains age 70 ½ in 2008.** John turned 70 ½ on July 1, 2008. Although John is required to take a RMD for 2008, since it is his first year of RMDs he is allowed to defer the 2008 distribution until April 1, 2009. Since this is still considered a 2008 distribution, John must take his distribution by April 1, 2009.

2. **Individual attains age 70 ½ in 2009.** John turned 70 ½ on July 1, 2009. Before the WRER Act, the first year for a RMD is 2009, and John's beginning date would be April 1, 2010. Under the WRER Act, no distribution is required for 2009 and thus, no distribution need be made before April 1, 2010. However, John's 2010 RMD must be made on or before December 31, 2010.

3. **5-year rule.** Jack died in 2007. The beneficiary of his 401(k) elected to take under the 5-year rule. Under the WRER Act, the 5-year period ends in 2013 instead of 2012.

Comment

IRA owners and beneficiaries may not want to withdraw assets from retirement accounts at this time because they may need to sell stocks and bonds at a depressed price in order to access their funds. The hope is that the market will rebound by 2010, at which time it would be more logical to sell the stocks and bonds to meet the RMDs.

However, the WRER Act does not provide any relief for 2008 RMDs. For most IRA owners and beneficiaries, the problem is that they had to take their 2008 RMD that was computed on a higher value (i.e., value of retirement account on December 31, 2007) out of a possibly depleted account (i.e., \$100,000 value on 12/31/07 may now only be worth \$60,000).

In addition, the WRER Act does not provide relief for those persons who actually need to use their IRAs and retirement accounts for their support – in these cases the individuals will still take distributions regardless of the suspension of the RMD rules.

Consequently, the primary beneficiaries of the RMD relief rules of the WRER Act are individuals who have sufficient

other income or assets that they do not need to take any withdrawals from their retirement accounts in the first place.

Finally, for people facing the distress of a significant decline in assets, any retirement relief is welcome. Tax planning opportunities emerge out of this law by simply providing people with the flexibility to choose whether to take distributions from retirement accounts in 2009, rather than being required to do so as a result of the RMD rules.

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