

New Required Distribution Rules for Qualified Retirement Plans

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Practice Area: Compensation and Benefits/ERISA

The Small Business Job Protection Act of 1996 (SBJPA) modified the law regarding required distributions from qualified plans. Prior to this change in the law, the Internal Revenue Code (Code) required a plan to begin distributions to an employee by the April 1 following the year in which the employee turned 70-1/2. The distributions were required to be made without regard to whether the employee was retired.

SBJPA changed the beginning date of the required distributions to the April 1 following the later of:

- the calendar year in which the employee attains age 70-1/2

OR

- the calendar year in which the employee retires.

The change in the required beginning date applies to plan years beginning after December 31, 1996. However, a plan is still required to begin distributions to a five percent employee-owner by the April 1 after the year the employee turns 70-1/2, even if he or she is still employed.

While SBJPA amended the Code to no longer require distributions to employees who are currently employed, a plan may not simply eliminate these in-service distributions immediately. Such an action would violate the "anti-cutback rule" of the Code. This rule prohibits the removal of a distribution option from a qualified plan.

The Internal Revenue Service may provide some relief from this rule for employers who want to amend their plans right away to take advantage of the new law. Unless and until such relief is provided, a plan may not eliminate the option current employees have to begin distributions after they attain age 70-1/2.

A plan is permitted, however, to allow current employees who attained age 70-1/2 and have not yet begun to receive their required distributions to elect to defer their distributions until after they retire. Similarly a plan may permit current employees who have begun their required distributions to elect to stop receiving them and recommence the distributions after retirement. An employee's election to stop and later recommence distributions is subject to the spousal consent requirements of the Code if those requirements otherwise apply to the plan. The IRS has recently provided guidance on how to comply with these requirements.

Also, if a plan provides employees with this option to defer the required distributions until after retirement, the plan must be amended retroactively to conform the plan to its operations. This amendment must be adopted by the last day of the plan year beginning in 1999.

In the case of an employer which is starting a new qualified plan that has no participant accrued benefits, the anti-cutback problem may be avoided. Such a plan may be drafted to provide that required distributions begin pursuant to the new law, by the April 1 following the later of the year an employee turns 70-1/2 or the year the employee retires.

Defined benefit plans that take advantage of the change in the beginning date for required distributions must actuarially increase the benefit of any employee who continues to work after turning age 70-1/2. This increase is to compensate the employee for the period after age 70-1/2 in which he or she is not receiving any plan benefits.

The actuarial increase is generally determined for the period starting on the April 1 following the calendar year in which the employee attains age 70-1/2 and ending on the date benefits commence after retirement. For an employee who turned age 70-1/2 prior to 1996, the starting date for the period of the actuarial increase is January 1, 1997.

It is important to note that a plan will remain qualified if it continues to require that distributions commence by the April 1 following the year in which a participant turns 70-1/2. If a plan maintains its pre-SBJPA required beginning date, then there are other issues to consider with respect to the employees who begin to receive required distributions under the plan. These issues include when to determine who is an employee's designated beneficiary and whether recalculation of life expectancy applies, the method of payment that should be used when an employee dies while receiving the required distributions, and the eligibility of distributions for rollover.

In light of this change in the law and the decision employers have relating to whether to delay required distributions, we suggest that you first decide whether your company would like to take advantage of the new law and then review or contact us to review the language in your plan document to determine if any change in the plan is necessary. We can also help you determine what steps must be taken to implement your decision.

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