CHAPTER 6--REQUIRED MINIMUM DISTRIBUTIONS-EXPLANATION OF OLD AND NEW REGULATIONS

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INTERNAL REVENUE SERVICE
TAX EXEMPT AND GOVERNMENT ENTITIES

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Section 1 Introduction

The required minimum distribution rules of Internal Revenue Code section 401(a)(9) apply to all pension, profit-sharing and stock bonus plans qualified under section 401(a), IRAs, section 403(b) and section 457 plans. Section 401(a)(9) provides qualification rules that govern when and how benefit payments must be paid before and after the participant's death. A minimum amount must distributed from the accounts of plan participants and contract owners.

The purpose of this lesson is to review the basic rules regarding minimum distributions and to highlight the changes to section 401(a)(9) effective January 1, 2002. Prior to the new proposed regulations published in the Federal Register on January 17, 2001, the rules for calculating minimum distributions were found in the 1987 proposed regulations. For more information on the minimum required distribution rules as amended by the Small Business Job Protection Act of 1996 effective for years beginning after December 31, 1996, see *CPE Technical Topics for 1999*.

If less than the required amount is distributed, an excise tax is applied pursuant to section 4974. The excise tax is equal to 50% of the difference between the amount distributed and the amount required to be distributed.

Failures to comply with section 401(a)(9), for qualified plans and 403(b) plans, may be corrected through the Employee Plans Compliance Resolution System (EPCRS). See Rev Proc 2001-17 (2000-7 I.R.B. 518).

Section 401(a)(9) was first effective in 1984. The amendments made by DEFRA (The Deficit Reduction Act of 1984) repealed the section 401(a)(9) legislation enacted by TEFRA (The Tax Equity and Fiscal Responsibility Act of 1984). The next significant legislation to section 401(a)(9), effective after 1988, was enacted by TRA 86 (The Tax Reform Act of 1986) and proposed regulations were published in the Federal Register on July 27, 1987 (referred to as "1987 proposed regulations"). At that time, the definition of required beginning date was limited to not later than the April 1 of the calendar year following the calendar year in which the employee attains age 70½. SBJPA (Small Business Job Protection Act of 1996) became effective after 1996 and the required beginning date was amended to the Pre-TRA' 86 definition allowing non 5%-owners to defer distribution until the later of the April 1 of

the calendar year following the calendar year in which the employee attains age 70½ or the calendar year of retirement.

The 1987 proposed regulations also created new objective requirements for the minimum distribution incidental benefit (MDIB) rules. The MDIB rules require that death and other incidental benefits must be incidental to the primary purpose of a retirement plan, which is to provide retirement benefits. Following these regulations, Notice 88-38 (1988-1 CB 524) provided guidance regarding IRAs. Amendments to the 1987 regulations were published in the Federal Register on December 30, 1997.

Notice 96-67 (1996-2 CB 235) and Notice 97-75 (1997-2 CB 337) provided guidance on SBJPA changes. Announcement 97-70 provided a transitional rule for employees reaching age 70½ and retiring in 1996. For further information on this guidance, see the 401(a)(9) chapter in CPE 2000.

2001 proposed regulations – 1.401(A)(9)

The new regulations were proposed in response to comments and concerns about the 1987 proposed regulations. The new rules have significantly simplified the minimum distribution requirements and have the effect of reducing the required amount for most employees. In addition to the Federal Register, the new 2001 regulations can be found in Internal Revenue Bulletin 2001-11 IRB 865 (March 12, 2001).

Prior to January 1, 2002, plan sponsors may continue to rely on the 1987 proposed regulations as amended by SBJPA. During 2001, however, plan sponsors are permitted to use the new proposed regulations by adopting one of two published model amendments. In order to make distributions using the 2001 regulations for calendar year 2001, plans must adopt the model amendments, found in Announcements 2001-18 (for plans using new rules for entire year) and 2001-82 (for plans using old rules part of the year and changing to the new rules), no later than the end of the GUST remedial amendment period. The new rules may then be used in a plan's operation without disqualification or violating the requirement that a plan be operated in accordance with its terms.

Determination, opinion or advisory letters will not cover these proposed regulations until final regulations are published. When this CPE chapter was written, the final regulations were to be published shortly. Until then, letters will be based on the 1987 proposed regulations and SBJPA. Adoption of the model amendments will not affect the letters to be issued.

EXAMPLE 1

The Mayer, Marks, Menackler and Petroff 401(k) Profit Sharing Plan begins to make required distributions during calendar year 2001 to some employees under the old 1987 regulations prior to the date on which the plan begins to operate in accordance with the new 2001 regulations.

The employer must adopt the model amendment in Announcement 2001-82 by the end of its GUST remedial amendment period.

EXAMPLE 2

Joe has a required distribution for calendar year 2001of $10,000 calculated under the 1987 regulations. Joe elects a single sum distribution of $100,000 on May 31, 2001 and elects a direct rollover of $90,000 to his IRA. The plan sponsor adopts the model amendment in Announcement 2001-82 within its GUST remedial amendment period. The plan begins to operate in accordance with the new 2001 proposed regulations effective July 1, 2001. Using the 2001 rules, Joe's 2001 required minimum distribution is $8,000. The plan administrator does not need to take any corrective action with respect to the $2,000 difference that Joe received. However, Joe can rollover the $2,000 into an IRA if he does so within 60 days.

EXAMPLE 3

Shelley has a required distribution of $12,000 for calendar year 2001 calculated under the old 1987 regulations. Pursuant to plan terms, Shelley's required distribution is being paid $1,000 per month during 2001. As of June 30, 2001, Shelley has received $6,000 in plan distributions. The plan sponsor adopts the model amendment in Announcement 2001-82 within its GUST remedial amendment period. The plan begins to operate in accordance with the new 2001 proposed regulations effective July 1, 2001. Under the 2001 rules, Shelley's 2001 required minimum distribution is $9,000. The plan must distribute $3,000 as a required minimum distribution for 2001, and not $6,000, to Shelley during the remainder of 2001.

Section 2 Distributions During Participant's Life

REQUIRED BEGINNING DATE EFFECTIVE AFTER SJBPA

The "required beginning date" (RBD) is the date by which benefits must commence. The entire interest must either be distributed or begin to be distributed by the RBD.

Employee who is not a 5% owner:

April 1 of the calendar year following the later of:

- The calendar year the employee attains age 70 ½, or
- The calendar year in which the employee retires

Employee who is a 5% owner:

April 1 of the calendar year following the calendar year in which the employee retires attains age 70 ½ regardless of whether retirement has occurred.

The first minimum distribution made on April 1st is made on account of the previous calendar year. Another minimum distribution must be made for the next calendar year. Thus, in the year that the first minimum distribution is made, there will be two minimum distributions, one on April 1st and the other on December 31st.

A 5-percent owner, determined for the plan year ending in the calendar year in which the employee attains age 70½, is defined in IRC 416. If distributions have begun to the 5% owner, they must continue, even if the participant is no longer a 5% owner.

For purposes of determining when an employee reaches age 70 ½, an employee attains age 70½ as of the date six calendar months after the 70th anniversary of the employee's date of birth.

EXAMPLE 4

Arthur was born June 30, 1932. The 70th anniversary of his date of birth is June 30, 2002. Arthur attains age 70½ on December 30, 2002. If Arthur is a 5% owner or retired, his RBD is April 1, 2003. His first required distribution must be made no later than April 1, 2003 and his second required distribution must be made no later than December 31, 2003. All subsequent distributions will be required no later than December 31 of each following year.

If Arthur were born on July 1, 1932, the 70th anniversary of his date of birth would be July 1, 2002. In this case, Arthur would attain age 70½ on January 1, 2003 and his RBD would be April 1, 2004. In practice, section 401(a)(9) rules provide the latest time by which distributions must be made from a plan. For example, section 401(a)(14) would require Arthur to receive a distribution no later than 60 days following the close of the plan year in which the latest of the following occurs:

(1) earlier of age 65 or normal retirement age;
(2) tenth anniversary of commencement of plan participation; or
(3) separation from service.

Arthur would have to receive a distribution by the March 1 following his retirement year, unless he had made an election to defer his distributions. This election, however, cannot cause distributions to be delayed beyond his RBD.

Prior to 1997, the RBD was the April 1 following the calendar year the participant turned 70½ for all participants. Due to the changes in SBJPA, after 1996, the RBD for non-5% owners was extended to the April 1 following the later of the calendar year the participant turned 70½ or retired. For 5% owners, the RBD remained the April 1 following the calendar year the participant turned 70½.

As a result of SBJPA, a plan that was amended immediately as of the SBJPA effective date to provide for the extended RBD for non-5% owners violated Code section 411(d)(6). An optional form of benefit, the right to receive a minimum distribution on the April 1 following the calendar year in which the participant attained age 70½, would be eliminated by such an amendment. Thus, this pre-retirement distribution option is an optional form of benefit that begins on January 1 of the calendar year in which the employee reaches age 70 ½ and ends April 1 of the following year.

To correct this conflict between the SBJPA amendment to section 401(a)(9) and the application of section 411(d)(6), subsequent pronouncements provided for three possible required beginning dates for which plan language would vary.
The three options are as follows:

1. April 1 following the calendar year in which the participant turned 70½, Notice 97-75, 1997-51 I.R.B. 18. This would make no change to the RBD,
2. April 1 following the calendar year in which the participant turned 70½ or retires, except that benefits already accrued cannot be delayed until retirement, or
3. April 1 following the calendar year in which the participant turned 70½ or retires, except for 5% owners. In this case, participants must be able to elect to defer distributions (Announcement 97-24, 1997-11 I.R.B. 24, Announcement 97-70, 1997-29 I.R.B. 14.).

There are conditions that must be met to use this option:

- Participants who attain age 70½ after 1995 can elect to defer distributions by the April 1 following age 70½. If no election is made, distributions begin the April 1 following age 70½.
- Participants reaching age 70½ prior to 1997 could elect to stop and recommence distributions. The 70½ option is only eliminated for employees who reach age 70½ in or after the calendar year that begins after the later of December 31, 1998 or the adoption of the amendment (Notice 97-75 and the final regulations).

DISTRIBUTIONS FROM INDIVIDUAL ACCOUNTS

A minimum payment must be made to the participant by the RBD and for each subsequent calendar year. These rules will not apply if a single sum of the entire account balance is distributed by the RBD. If the benefit is to be distributed under an annuity contract from an insurance company, the plan simply has to state that distributions from an insurance company will comply with IRC 401(a)(9).

Distributions may be made over either the:

- life, or
- the period not extending beyond the life expectancy of the participant or the participant and the designated beneficiary.

The required minimum distribution for a calendar year for which a required minimum distribution is required (distribution calendar year) is determined by the following fraction:

$$\frac{\text{The participant's account balance}}{\text{The applicable distribution period}}$$

PARTICIPANT'S BENEFIT

The account balance as of the last valuation date in the calendar year immediately preceding the distribution calendar year (valuation calendar year) is adjusted by the following:

(1) Increased by contributions or forfeitures allocated after the valuation date, but within the valuation calendar year and

(2) Decreased by distributions after the valuation date, but within the valuation calendar year,

The benefit is determined without regard to vesting. If the participant is not fully vested, distributions are to be paid only from the vested benefits. If the employee's vested benefit is less than the required minimum, subsequent distributions are adjusted.

If the amount distributed in any year exceeds the minimum required, no credit is given in subsequent years for the excess amount. The account balance, as of the next valuation date, will take into account the entire distribution.

APPLICABLE DISTRIBUTION PERIOD

Under prior law, the distribution period is the applicable life expectancy determined under Table V and VI of Regulation section 1.72-9.

Starting in 2002, the period over which benefits must be distributed has been simplified. A table has been published in the 2001 proposed regulations that provides for distribution periods that will apply based upon the age of the participant. The table is contained in Regulation section 1.401(a)(9)-5 and is reprinted at the end of this chapter (See Table I). In contrast to prior law, participants are no longer required to

(1) Determine the beneficiary by the RBD,

(2) Decide whether or not to recalculate life expectancy each year, and

(3) Satisfy a separate incidental death benefit rule.

As of this printing, the current draft of the final regulations modify the life expectancy tables to reflect current life expectancy. As a result, the uniform table has also been adjusted in accordance with these new mortality tables.

If the spouse is the sole beneficiary and more than 10 years younger than the employee, the distribution period is the longer of the participant's distribution period, as determined above, or the joint life expectancy of the participant and the spouse. Life expectancy is recalculated by using the attained ages of the participant and the spouse in the year of distribution and recalculated for each subsequent year.

EXAMPLE 5

Bob was born October 1, 1931 and turned 70½ in 2002. He is not a 5% Owner and retired in 1998. He participates in a calendar year profit sharing plan of his former employer. Bob's RBD is April 1, 2003. For purposes of calculating the amount to be distributed by April 1, 2003, the distribution year is 2002 and the valuation year is 2001. Bob's account balance as of December 31, 2001, $25,300, is used to make the first calculation. Bob does not have a designated beneficiary as of his RBD. His applicable distribution period is determined, using the table in the 2001 proposed regulations, as of his birthday in the distribution calendar year (Bob turned 71 on October 1, 2002). The minimum distribution, for the 2002 calendar year, is $25,300 /25.3, or $1,000 and must be paid no later than April 1, 2003

Bob's next required distribution, for calendar year 2003, must be made by December 31, 2003. The valuation year is 2002 and his account balance, as of the December 31, 2002 valuation date, is $26,400. The account balance is reduced by the amount of the required distribution for the prior calendar year (including the distribution made by April 1, 2003). Consequently, the benefit for purposes of determining the 2003 required distribution is $25,400 ($26,400 - $1,000).

If, instead, $20,000 is distributed to Bob on April 1, 2003, the account balance as of December 31, 2002 is still reduced by $1,000 for the 2003 calendar year distribution. The amount of the distribution that exceeded the required minimum, $19,000, may be applied toward the required minimum for 2003. The 2003 required minimum is $1,040.10 ($25,400/24.4). According to the regulations, however, the remaining $17,959.90 ($19,000-$1,040.10) may not be used to satisfy the minimum

distribution requirements for 2004, or later years. But by using the prior year's account balance for calculating the required minimum distributions, distributions of such lesser amounts has the affect of reducing future required minimum distributions.

EXAMPLE 6

Michael was born November 10, 1931 and he turned 70½ in 2002. He is not a 5% owner and retired in 1998. He participates in a calendar year profit-sharing plan of his former employer. Michael's RBD is April 1, 2003. The value of his account at December 31, 2002 is $90,000. Michael's sole designated beneficiary is his spouse, Laura, who is 67 in 2002.

The applicable distribution period is the longer of the period calculated using the table in the 2001 regulations for determining the applicable distribution period ($90,000/25.3 = $3,557.31) or the joint life expectancy from Table VI of Regulation section 1.72-9 using the attained ages of the participant and spouse in the distribution calendar year. The joint life expectancy using Table VI for an individual who is 71 and a spouse who is 57 is 21.7. The minimum required distribution using joint life expectancy is $90,000 / 28.2 or $3,191.49. The minimum required distribution calculated using the distribution table in the regulations is 90,000 / 25.3 or $3,557.31). The amount based on the joint life expectancy is less than the amount based on the table for determining the distribution period. The minimum amount, therefore, may be based upon the longer distribution period, 25.3, determined using the table in the proposed regulations in order to take advantage of the lower annual minimum required.

> *When the spouse is more than 10 years younger than the participant, the longer distribution period will be the joint life expectancy using Table VI*. The new proposed uniform distribution table in the regulations, is based upon the joint life expectancy of an individual and a beneficiary who is 10 years younger. As a result, the lifetime distribution period for most employees and beneficiaries will be lengthened under the regulations. The table simplifies some of the complexities in the prior law. The table also, generally, eliminates the need to fix the amount of an employee's lifetime distribution based on the beneficiary designated as of the RBD, as well as eliminating the need to elect whether to recalculate life expectancy at the RBD because you do not need to know the beneficiary in order to start making distributions.

MINIMUM DISTRIBUTION INCIDENTAL BENEFIT (MDIB) RULE

The minimum distribution incidental benefit rule is designed to ensure that the participant's benefit remains primarily a retirement benefit, not primarily a death benefit. The MDIB requirement limits the effect a designated beneficiary, who is much younger than the participant, will have on the calculation of the minimum distribution.

Prior to 1989, minimum distributions had to satisfy both the requirements of IRC 401(a)(9), and IRC 401(a)(14). This separate incidental rule required that, if the participant's spouse was not the designated beneficiary, at least 50% of the present value of the benefit had to be paid within the individual's life expectancy. The 1987 proposed regulations changed this rule by limiting the life expectancy that determined the distribution rate of the account balance.

The 2001 proposed regulations provide that, if distributions are made in accordance with section 1.401(a)(9)-5 of the regulations, the minimum distribution incidental benefit requirement of IRC 401(a)(9)(G) will be satisfied, eliminating the use of two separate life expectancy calculations as in prior law. In fact, the new uniform distribution period of proposed Regulation section 1.401(a)(9)-5 is the original MDIB divisor table found in the 1987 proposed regulations.

ANNUITY PAYMENT DISTRIBUTIONS

Annuity payments must begin on or before the RBD. The first payment must be the amount required for one payment interval (period over which payments are to be made, for example, monthly or annually). If the annuity is purchased after the RBD, the first payment must begin on or before the purchase date. If the annuity irrevocably commences before the RBD, the annuity starting date is treated as the RBD.

Annuity distributions must be paid in periodic payments at intervals not longer than one year for a life (or lives), or over a period certain not longer than a life expectancy (or joint life and last survivor expectancy). A "period certain" is a defined period over which an annuity is payable. The life expectancy (or joint life and last survivor expectancy) for purposes of determining the length of the period certain is discussed below. Once payments have commenced, the period certain may not be lengthened, even if the period certain is shorter than the maximum permitted under section 401(a)(9).

For employees that retire after 70½ and are not receiving benefits, an actuarial increase, using the plan's assumptions, must be made to take into account the period beginning April 1 of the year that follows the year

age 70½ is attained and ending when benefits commence. This increase does not apply if the plan provides for a required beginning date of April 1 of the calendar year following the calendar year in which the employee attained age 70 ½ (regardless of whether the employee is a 5% owner). If an employee is not fully vested, the unvested portion is treated as not having accrued.

EXAMPLE 7

A defined benefit plan provides monthly annuity payments of $500 for the life of unmarried participants. Nathan is not married and attains age 70½ in 2001. The first payment of $500 must be made no later than April 1, 2002. Payments continue monthly during his life. This satisfies the minimum distribution requirements.

If distributions from a defined benefit plan are not paid as an annuity, the benefit will be treated as an individual account.

ANNUITY PAYMENTS AND THE MINIMUM DISTRIBUTION INCIDENTAL BENEFIT (MDIB) RULE

If the employee's benefit is to be paid in the form of a life annuity for the life of the employee satisfying IRC section 401(a)(9), the minimum distribution incidental rules will be satisfied.

If the employee's benefit is to be paid in the form of a joint and survivor annuity and the employee's sole beneficiary, as of the annuity starting date, is the employee's spouse and the distributions satisfy IRC section 401(a)(9) without regard to the MDIB requirement, the distributions to the employee will be deemed to satisfy the MDIB requirement.

If the employee's benefit is to be paid in the form of a joint and survivor annuity and the beneficiary is someone other than the employee's spouse, the MDIB requirement is not automatically satisfied. To satisfy the MDIB requirement, the distribution option must provide that annuity payments to be made to the employee on and after the employee's RBD will satisfy certain conditions. The regulations require that the periodic annuity payment payable to the survivor must not at any time on and after the employee's RBD exceed the applicable percentage of the annuity payment payable to the employee using the table contained in the regulation. Since the survivor payment cannot exceed the applicable percentage of the employee's payment at any time, this provision must be satisfied with respect to any benefit increases after the RBD, including cost-of-living increases. The table for determining the applicable percentage is reprinted at the end of this chapter. See Table II. The applicable percentage is based on the excess of the age of the employee over the age of the beneficiary. If the employee has more than one

beneficiary, the applicable percentage is determined using the age of the youngest beneficiary.

EXAMPLE 8

Jack is a participant in the defined benefit plan of J.P. and Son Janitorial Services Company, Inc. Distributions begin on January 1, 2001 to Jack, born March 1, 1935, after retirement at age 65. Jack's son, Steven, born February 5, 1965, is his beneficiary. The distributions are in the form of a joint and 100% survivor annuity for the lives of Jack and Steven with payments of $500 a month to Jack and, upon his death, $500 a month to Steven.

Table II, at the end of the chapter from Proposed Regulations, section 1.401(a)(9)-6 (A-2) is used to determine the allowable applicable percentage, which is the death benefit that is payable to the beneficiary. As of January 1, 2001, the date annuity distributions commence, the plan does not satisfy the MDIB requirement because the distribution option provides that, as of Jack's RBD, the monthly payment to Steven upon his father's death (100%) will exceed 60 percent of Jack's monthly payment.

Section 3 DISTRIBUTIONS AFTER DEATH

PARTICIPANT DIES BEFORE THE RBD

The entire interest must be distributed using either the:

- Five year rule or
- The life expectancy rule

5-YEAR RULE

Under the 5-Year Rule, a participant's interest must be completely distributed by the end of the calendar year that contains the 5th anniversary of the participant's death.

No distributions are required prior to the end of this 5-year period.

EXAMPLE 9

Edward dies on January 23, 2002 without a designated beneficiary. He participated in his employer's 401(k) plan. His account balance must be completely distributed no later than December 31, 2007. His account can be distributed in a lump sum or in a series of distributions, as long as the final distribution occurs no later than the 5-year deadline.

LIFE EXPECTANCY RULE

The Life Expectancy Rule requires that distribution of a participant's account balance must commence on or before the end of the calendar year immediately following the calendar year in which the employee died. The account balance is paid over the life (or life expectancy) of the designated beneficiary.

Life expectancies are calculated using the expected return multiples in Tables V (single life expectancy) and VI (Joint and Survivor table) of Regulation Section 1.72-9. Effective January 1, 2003, final regulations set forth new life expectancy tables.

In order to satisfy the Life Expectancy Rule, the applicable distribution period is the remaining life expectancy of the employee's designated beneficiary.

If the designated beneficiary is the spouse, distributions must commence before the later of:

- December 31 of the calendar year immediately following the participant's death, or
- December 31 of the calendar year the participant would have attained age 70½.

The surviving spouse's life expectancy is determined for each year that a distribution is required using the surviving spouse's birthday in the year of determination.

If the designated beneficiary is not the surviving spouse, distributions must commence no later than the end of the calendar year immediately following the calendar year in which the participant died.

The beneficiary's life expectancy is determined by using his/her age in the calendar year immediately following the employee's death. This distribution period is reduced by "one" for each year that has elapsed since the date life expectancy was first calculated. This rule also applies if, in addition to the employee's surviving spouse, another individual is designated as a beneficiary. See Prop. Reg. Section 1.401(a)(9)-5, A-7 and Prop. Reg. Section 1.401(a)(9)-8, A-2 for special rules that apply when an employee's interest is divided into separate accounts.

If no beneficiary has been designated, distributions are made using the 5-Year Rule. The employee's remaining life expectancy is determined as of his/her birthday in the year of death. This distribution period is reduced by "one" for each year that has elapsed since the date life expectancy was first calculated.

EXAMPLE 10

Harry is a participant in the money purchase plan of I See the Light Lighting Company, Inc. His wife, Helen, is his sole designated beneficiary. In 2002, Harry dies before his retirement at age 59. Harry would have attained age 70½ in 2013.

Because Harry has died with his spouse as designated beneficiary of his benefits, the Life Expectancy Rule is applied. Helen's life expectancy is used to determine the applicable distribution period. Every year thereafter, Helen's distribution period is recalculated using her birthday for the year. Helen must receive her first minimum distribution before December 31, 2013 (Harry would have turned 70½ after the December 31 of the year following his death at age 59).

If Harry's designated beneficiary was his daughter, Jean, the distribution period is calculated differently. In this situation, Jean's life expectancy, determined as of her age in the year following Harry's death, is used for the distribution period. For every year that follows, the distribution period will be reduced by "one". Jean must receive her first minimum distribution by December 31, 2003.

DETERMINING WHETHER THE 5-YEAR RULE OR THE LIFE EXPECTANCY RULE APPLIES

If the plan does not contain a provision that specifies the distribution method after an employee dies, distribution must be made as follows:

- Life Expectancy Rule will apply if the employee has a designated beneficiary.
- 5-Year Rule will apply if employee there is no designated beneficiary.

The plan may provide for a specific distribution method after an employee dies. The same method does not have to be used for the benefits of all employees. (I.e. The plan may specify that the 5-Year Rule applies in every case or just to certain distributions after an employee's death even if the employee has a designated beneficiary.) The plan may also apply different rules for different types of beneficiaries. (I.e. surviving spouses may have one set of rules and all other beneficiaries may have another set of rules.)

A plan may provide that employees or beneficiaries can elect whether the five year or life expectancy rule applies to distributions after the death of an employee who has a designated beneficiary. Such election must be made before the earlier of

(1) December 31 of the calendar year in which distributions would be required to commence under the Life Expectancy Rule, or

(2) December 31 of the calendar year which contains the 5th anniversary of the employee's date of death.

As of the date determined under the Life Expectancy Rule, the election must be irrevocable with respect to the beneficiary (and all subsequent beneficiaries) and must apply to all subsequent calendar years. The plan may also specify which method applies if neither the employee nor the beneficiary makes the election. If an election is not made and the plan does not specify which rule applies, distributions must be made using the 5-Year Rule if there is no designated beneficiary and the Life Expectancy Rule if there is a designated beneficiary.

If the spouse dies after the employee and before distributions begin, the five year and life expectancy rules are applied as if the spouse were the employee. In this situation, the surviving spouse's date of death is substituted for the employee's date of death. This does not extend to the surviving spouse of the deceased employee's surviving spouse.

To summarize, the Life Expectancy Rule applies in all cases in which the employee has a designated beneficiary, unless there is a plan provision or election for the 5-Year Rule. The 5-Year Rule applies automatically only if the employee did not have a designated beneficiary as of the end of the year that follows the year of the employee's death.

Under SBJPA and the 1987 proposed regulations, distributions to be made after a participant's death and prior to the RBD also depend on whether there is a beneficiary and whether that beneficiary is the participant's surviving spouse. The major differences found in the prior rules are that a non-spouse designated beneficiary must use the 5-Year Rule, and the designated beneficiary is determined on the date of death. Since, prior to 2001, non-spouse beneficiaries were required to use the 5-Year Rule, final regulations provide a transitional rule for beneficiaries that did not commence distributions. As of this writing, final regulations permit a beneficiary to elect the Life Expectancy rule until December 31, 2003, provided that all amounts that would have been required to be distributed by that date, under the Life Expectancy Rule, are distributed.

PARTICIPANT DIES ON OR AFTER THE RBD

If the participant dies after minimum distributions have begun (generally after the RBD), then, like distributions when a participant dies before the RBD, the applicable distribution period is again determined based upon whether or not the participant has a designated beneficiary.

For an employee with a designated beneficiary, the same rules apply for distributions after the employee's death, regardless of whether death occurs before or after the employee's RBD. See above discussion regarding death prior to the RBD.

For an employee without a designated beneficiary, the distribution period is equal to the employee's remaining life expectancy recalculated immediately prior to the employee's death and reduced by "one" for each subsequent year.

EXAMPLE 11

Martin is retired and has been receiving distributions from his employer's Profit Sharing Plan. The annual payments have been determined over a period measured by the joint life expectancy for him and his spouse, Carol. Carol's remaining life expectancy is 17 years. Martin dies in 2001 when his remaining expectancy period is 19 years. The death benefit may be distributed over a period of 17 years.

A participant's interest is considered to be distributed on the RBD, even if payments are made prior to that date. However, if a distribution irrevocably begins prior to the annuity starting date, then a distribution is considered to begin on the date the distribution actually begins, and not the RBD.

DESIGNATED BENEFICIARY

The designated beneficiary becomes entitled to a portion of an employee's benefit contingent on the employee's death or another specified event.

An employee's choice of beneficiary determines how and when distributions will be made.

The minimum distribution requirements are more restrictive if an employee is treated as having no designated beneficiary. In this situation, the distribution period after the employee's death is limited to the employee's life expectancy as of his/her age in the calendar year after death. Furthermore, if the employee dies before the RBD, distribution must be made in accordance with the 5-Year Rule.

The designated beneficiary is the individual designated as beneficiary under the plan. An individual may be designated as a beneficiary under the plan either by the terms of the plan or, if the plan provides, an election to be made by the employee or surviving spouse. The choice of beneficiary is subject to the requirements of IRC 401(a)(11), 414(p) and 417. Only individuals may be designated beneficiaries.

The employee will be treated as having no designated beneficiary if a person other than an individual is designated as a beneficiary, such as an employee's estate. This applies even if there are also individuals who have been designated as beneficiaries. See below for an exception to this rule for trusts.

The employee is treated as not having designated a beneficiary if the plan provides, or allows the employee to specify that, after the end of the calendar year following the calendar year of the employee's death, any person may have the discretion to change the designated beneficiaries.

Under the 2001 proposed regulations, the employee's designated beneficiary is determined on the last day of the calendar year that follows the calendar year of the employee's death, rather than as of the employee's RBD or date of death, as under the 1987 proposed regulations. The result of the new rules is that, in determining who is an employee's designated beneficiary, any beneficiary who has either received distribution or disclaimed a right to benefits during the period between the employee's death and the end of the year following the year of death will not be considered. In this way, the determination of the designated beneficiary and the calculation of the beneficiary's life expectancy are usually contemporaneous with commencement of required distributions to the beneficiary. Furthermore, for an employee with a designated beneficiary, the new regulations provide the same rules for distributions after the employee's death whether death occurs before or after the employee's RBD.

Effective January 1, 2003, the final regulations modify the date for determining the designated beneficiary by changing it to the September 30 of the year following the year containing the employee's date of death.

Example 12

Carla dies during calendar year 2000 at age 62. Carla designated her children, Debra and David, as the beneficiaries of her benefits in her employer's profit-sharing plan. Debra and David remain the beneficiaries as of December 31, 2001 and, therefore, are considered designated beneficiaries on December 31, 2001.

If the spouse is determined to be the designated beneficiary, and dies after the employee and before distributions have begun, the distribution period is determined by the surviving spouse's designated beneficiary. The designated beneficiary is determined as of the last day of the calendar year that follows the calendar year of the surviving spouse. If, as of that date, there is no designated beneficiary, distribution must be made in accordance with the 5-Year Rule.

A participant's surviving spouse has rights that are unavailable to other designated beneficiaries. In addition to the protections offered by the QJSA and QPSA provisions of section 417, section 401(a)(9) also provides some entitlements to the surviving spouse. The spouse may

rollover a plan distribution into his/her own IRA or the decedent's IRA. If the spouse rolls the benefits into his/her own IRA, not only may income tax be deferred, but also the spouse may designate his/her own beneficiary who may also defer payment of income tax. In addition, the spouse can defer distributions until the later of April 1 following the year the spouse turns 70½ or the participant would have turned 70½.

Only an individual may be a designated beneficiary. Consequently, a trust is not a designated beneficiary, even though the trust is named as a beneficiary. The underlying beneficiaries of the trust, however, may be treated as designated beneficiaries if the following requirements are satisfied:

1. the trust must be valid under state law (or would be, except for the fact that there may be no corpus)
2. the trust is irrevocable no later than the participant's death
3. the beneficiaries of the trust must be identifiable, and
4. certain documentation must be provided to the plan administrator (including a copy of the trust instrument or a list of all trust beneficiaries with the employee's certification that the list is correct and notice will be given if the list is amended in the future).

This rule does not preclude a trust that fails these conditions from being named as a beneficiary. However, the participant is treated as having no designated beneficiary for section 401(a)(9) purposes if one of these conditions is not met.

A payment made by a plan to an estate or trust (subject to exception above) after an employee's death, may still satisfy section 401(a)(9). The impact is on how distribution will be made to the estate or trust.

MORE THAN ONE DESIGNATED BENEFICIARY

If more than one individual is designated as a beneficiary, the distribution period is calculated using the designated beneficiary with the shortest life expectancy. (See Section 4 for special rules that apply when an employee's interest is divided into separate accounts).

If a beneficiary (contingent beneficiary) is entitled to a benefit contingent on an event other than the death of the employee or another beneficiary, the contingent beneficiary is considered when determining who has the shortest life expectancy.

If a beneficiary (subsequent beneficiary) is entitled to a benefit only if another beneficiary dies prior to receiving the entire benefit to which

he/she is entitled, the subsequent beneficiary is not considered when determining who has the shortest life expectancy or whether a beneficiary who is not an individual is a beneficiary. This rule does not apply if the other beneficiary dies before the date for determining the designated beneficiary because the subsequent beneficiary becomes the designated beneficiary.

The distribution period remains based on the life expectancy of the individual with the shortest life expectancy, even if such individual dies after the date the shortest life expectancy has been determined.

EXAMPLE 13

The Enchanted Florist, Inc. maintains a defined contribution plan. Georgia is an unmarried employee who dies in calendar year 2001 at age 30. Georgia's brother, Thomas, is the beneficiary of her account balance as of December 31, 2002. Prior to her death, Georgia designated that, if Thomas should die before the entire account balance is distributed to him, their mother, Isabelle, will become the new beneficiary. Because the mother is only entitled to any portion of her daughter's account if Thomas dies before the entire account has been distributed, the mother is disregarded in determining Georgia's designated beneficiary. Accordingly, even after Thomas' death, his life expectancy continues to be used to determine the distribution period.

EXAMPLE 14

Jupiter Accounting Systems, Inc. maintains, a defined contribution plan. Ralph, a senior accountant in the company, died in 2001 at the age of 55. He was survived by his spouse, Estelle, who was 50 years old when he died. Prior to Ralph's death, he had named the trustee of a testamentary trust, established under his will, as the beneficiary of his entire account. A copy of the trust instrument and a list of the trust's beneficiaries were provided to the plan administrator before the end of the calendar year following the year of his death. As of the date of her death, the trust was irrevocable and was a valid trust under the laws of the state in which Ralph resided. See DESIGNATED BENEFICIARIES, below, for a discussion of trusts named as beneficiaries. Ralph's account balance was includible in his gross estate.

Under the terms of the trust, principal may not be distributed to anyone other than Estelle and she may require that all trust income is payable annually to her. Ralph's children, Susan and Daniel, are the sole remainder beneficiaries of the trust. Under the terms of the plan, the trustee elects to use the life expectancy rule over a distribution period equal to Estelle's life expectancy. If Estelle exercises her right to withdraw

the income earned, the trustee must withdraw from Ralph's account the greater of the income earned or the required minimum distribution. Under the terms of the plan and state law, only the portion of the distribution equal to the income earned is required to be distributed to Estelle.

Because some amounts distributed from Ralph's account to the trust may be accumulated in the trust during Estelle's lifetime for the benefit of the children, even though the children receive distributions only upon their mother's death, the children are considered to be beneficiaries of the account. To determine the distribution period, Estelle's life expectancy, the shortest life expectancy of the designated beneficiaries is used. In addition, because the surviving spouse is not the sole beneficiary, minimum distributions must begin no later than the end of the calendar year following the year of Ralph's death.

Assume that the trust provides that benefits from Ralph's account distributed to the trustee while Estelle is alive will go directly to Estelle upon receipt by the trustee. In this case, Estelle is the sole beneficiary and no amounts are accumulated in the trust during her lifetime for the benefit of her children. Because Estelle is sole beneficiary, annual required minimum distributions to the trust may be delayed until the end of the calendar year in which Ralph would have attained age 70½.

Section 4 ROLLOVERS AND TRANSFERS

ROLLOVERS

An amount that is distributed by one plan and rolled over to another plan has no affect on the required minimum distribution under the distributing plan. The amount rolled over is still treated as a distribution under the distributing plan for purposes of section 401(a)(9). Note, however, that there is another rule that an amount is not an eligible rollover distribution to the extent that it is a minimum required distribution. See A-7 of section 1.402(e)(2) of the regulations.

The amount distributed does, however, affect the receiving plan. The employee's benefit in the receiving plan is increased by the rollover. Because accounts are valued in the year prior to the year distribution must be made, there is no impact on the required minimum distribution to be made by the receiving plan for the year the rollover was made. The impact on the receiving plan is during the following year.

Since a rollover may be made to the receiving plan up to 60 days after having been distributed, it is possible for the amount to be received in the next calendar year. In this case, the rollover is deemed to have been received by the receiving plan in the year it was distributed from the distributing plan.

TRANSFERS

An amount that is transferred from one plan into another plan is not treated as a distribution. Instead, the employee's benefit in the transferor plan is decreased by the amount of the transfer. However, if the employee has a minimum distribution required, the transferor plan must determine the required minimum using the employee's benefit prior the transfer. In addition, if an amount is transferred in the second distribution calendar year, but on or before the employee's RBD (e.g. transfer occurs on or after January 1 and on or before April 1), the required distribution for the first distribution calendar year is based upon the employee's benefit in the transferor plan prior to the transfer.

Similar to rollovers, the employee's benefit in the transferee plan is increased by the transfer. Because accounts are valued in the year prior to the year for which a minimum distribution is to be made, the amount of the transfer impacts the transferee plan in years following the year of the transfer.

A spin-off, merger or consolidation is treated as a transfer of benefits for the employee involved.

Section 5 SPECIAL RULES

MORE THAN ONE PLAN

If the employee is a participant in more than one plan, each plan must separately meet the requirements of section 401(a)(9). Plans may not be aggregated to calculate or make required distributions, even if the same employer maintains the plans.

SEPARATE ACCOUNTS

If an employee's benefit is divided into separate accounts in a defined contribution account (or segregated shares in a defined benefit plan), all separate accounts (or segregated shares) are aggregated for satisfying the requirements of section 401(a)(9). If, however, such accounts (or shares) do not have the same beneficiaries, only the accounts (or shares) with the same beneficiaries are aggregated. Benefits payable pursuant to a qualified domestic relations order are, generally, to be treated as a separate account.

SPOUSAL CONSENT

If an employee reaches his RBD, but has not attained the normal retirement age under the plan, the minimum distribution is to be made even if the participant has not given consent. This means that benefits that may have been paid pursuant to section 401(a)(9), may still be immediately distributable, under sections 411(a)(11) and 417(e), and require employee and spousal consent prior to the annuity starting date. Nonetheless, the regulations provide that section 401(a)(9) must be satisfied and consent requirements deemed to be satisfied, if the plan has made reasonable efforts to obtain consent.

ANNUITY CONTRACTS

A distribution of an annuity contract is not a distribution for purposes of section 401(a)(9).

403(B) PLANS, IRAS AND 457 PLANS

The minimum distribution requirements also apply to:

1. Section 403(b) contracts (including annuity contracts, custodial accounts and retirement income accounts)
2. (IRAs) described in section 408 (including contributions to a simplified employee pension or SIMPLE plan, but excluding ROTH IRAs), and
3. Section 457 plans (deferred compensation plans of state and local governments and tax-exempt organizations).

For section 403(b) contracts, the rules apply to benefits that have accrued after December 31, 1986, plus earnings after December 31, 1986, on all benefits (before and after 12/31/86). Since there are no 5% owners in these arrangements, the RBD is the April 1 following the later of the year the employee attains 70½ or retires. The RBD for IRAs is the April 1 of the year following attaining age 70½. As with qualified plans, any part of the distribution that is required under section 401(a)(9) is not eligible for rollover. Also, if certain requirements are met, a surviving spouse may be considered the IRA owner.

The required minimum distribution is separately determined for each section 403(b) contract or IRA of an individual. However, the total distribution may be taken from any one or more of the contracts or IRAs. The distribution required for a 403(b) contract may not be taken from an IRA, nor may a distribution required for an IRA be taken from a 403(b) contract.

A surviving spouse in entitled to treat the entire IRA of a decedent as his/her own after the required minimum distribution for the year of the decedent's death is made. In order to do this, the surviving spouse must be the sole beneficiary with unlimited rights to withdraw assets from the IRA. This rule does not apply if a trust that is named as beneficiary, even if the spouse is the sole beneficiary of the trust.

TEFRA ELECTION

The transitional election rule in section 242(b) has not been changed under the proposed regulations. This section provides transition rules with respect to certain participants who made an election to apply the section 401(a)(9) requirements prior to DEFRA (1984). Guidance on this rule is provided in Notice 83-23 (1983-2 C.B 418) and the 1987 proposed regulations. See also Proposed Regulation section 1.401(a)(9)-8, A-13.

Determination Tips

REQUIRED PROVISIONS

Plans must provide for the general rules of section 401(a)(9), including the incidental death benefit requirement in section 401(a)(9)(G).

Plans must provide that section 401(a)(9) will override any other options the plan may have that do not satisfy the Code.

Section 401(a)(9) does not permit a plan to eliminate benefit options that violate section 411(d)(6). A plan must, by its terms, prevent participants from electing distribution options that do not satisfy section 401(a)(9).

OPTIONAL PROVISIONS

A plan may provide that the RBD for all employees is the April 1 of the calendar year following the calendar year in which the employee attains age 70½, regardless of whether or not the employee is a 5% owner. In this situation, an employee who dies after that date is treated as dying after the RBD, even though the employee has died before the April 1 after retirement.

A plan may provide that all or specific distributions will be made using the 5-Year Rule. The distribution method does not have to be the same for all employees. Additionally, a plan may provide for elections to be made by employees or their beneficiaries as to whether the 5-year rule or the life expectancy applies.

Examination Tips

If the plan does not state the distribution method or provide for elections, distributions *after* an employee's death must be made using the 5-Year Rule (if there is no designated beneficiary; if there is a designated beneficiary, distributions are made over the life expectancy of the fiduciary in the year after death, reduced by one for each year thereafter).

Distributions *prior* to an employee's death must be made using the employee's life expectancy for the year of death, reduced by one for each year thereafter, if there is no designated beneficiary; or the beneficiary's life expectancy, if there is a designated beneficiary.

Pay attention to employees that have separated from service in prior years and have subsequently attained their RBD or normal retirement age. Distributions may be required under sections 401(a)(9) or 401(a)(14).

A plan that is poorly administered is especially vulnerable to violations of the minimum distribution rules.

If a plan requires a participant to apply for benefits in order for payments to begin, distributions may violate section 401(a)(9).

TABLE I
DISTRIBUTION PERIOD-
Prop. Reg. 1.401(a)(9)-5 (A-4)

EMPLOYEE'S DISTRIBUTION AGE	PERIOD
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8
76	20.9
77	20.1
78	19.2
79	18.4
80	17.6
81	16.8
82	16.0
83	15.3
84	14.5
85	13.8
86	13.1
87	12.4
88	11.8
89	11.1
90	10.5
91	9.9
92	9.4
93	8.8
94	8.3
95	7.8
96	7.3
97	6.9
98	6.5
99	6.1
100	5.7
101	5.3
102	5.0
103	4.7
104	4.4
105	4.1
106	3.8
107	3.6
108	3.3
109	3.1
110	2.8
111	2.6
112	2.4
113	2.2
114	2.0
115 and older	1.8

TABLE II
APPLICABLE PERCENTAGE
Prop. Reg. 1.401(a)(9)–6 (A-2)

EXCESS OF AGE OF EMPLOYEE OVER AGE OF BENEFICIARY	APPLICABLE PERCENTAGE
10 years or less	1.00%
11	96%
12	93%
13	90%
14	87%
15	84%
16	82%
17	79%
18	77%
19	75%
20	73%
21	72%
22	70%
23	68%
24	67%
25	66%
26	64%
27	63%
28	62%
29	61%
30	60%
31	59%
32	59%
33	58%
34	57%
35	56%
36	56%
37	55%
38	55%
39	54%
40	54%
41	53%
42	53%
43	53%
44 and greater	52%

2001 Proposed Regulations
FLOW CHART

DISTRIBUTIONS BEFORE DEATH

TIMING: BY REQUIRED BEGINNING DATE, DISTRIBUTE EITHER ENTIRE INTEREST OR COMMENCE DISTRIBUTIONS OVER A PERIOD (AS DEFINED)

AMOUNT: ACCOUNT BALANCE / DISTRIBUTION PERIOD

DEATH ON OR AFTER REQUIRED BEGINNING DATE

TIMING: AT LEAST AS RAPIDLY

AMOUNT: ACCOUNT BALANCE / DISTRIBUTION PERIOD

Designated beneficiary		*No designated beneficiary*
Non Spouse Beneficiary	Spouse Beneficiary	
Use Life expectancy of Designated Beneficiary	Use life expectancy of spouse	Use employee's life expectancy at death
Life expectancy determined as of age in calendar year following death	Life expectancy determined as of age for each distribution date for calendar year after death	Reduce by 1 for each subsequent year thereafter
Reduce by 1 each year thereafter	When spouse dies, use spouse life expectancy as of year of death and reduce by 1 each year thereafter	
Designated beneficiary determined last day of calendar year following calendar year of employee's death		

DEATH BEFORE REQUIRED BEGINNING DATE

TIMING: **ENTIRE INTEREST MUST BE DISTRIBUTED USING EITHER:**

5 – YEAR RULE	***LIFE EXPECTANCY RULE***	
	NONSPOUSE BENEFICIARY	**SPOUSE BENEFICIARY**
	DISTRIBUTION MUST COMMENCE NO LATER THAN THE LATER OF:	
Entire interest must be distributed by end of the calendar year which contains the fifth anniversary of the particpant's death	end of calendar year that follows calendar year of employee's death	end of calendar year that follows later of calendar year of employee's death and end of the calendar year employee would have reached age 70 1/2
If: ❑ plan does not specify ❑ or employee cannot (per plan) or does not elect a distribution method to be used before required beginning date, and ❑ there is no designated beneficiary, 5 year rule is used		If spouse dies after employee and before distribution begins, apply rule as if spouse was employee
.		

DEATH BEFORE REQUIRED BEGINNING DATE

AMOUNT: LIFE EXPECTANCY RULE

DISTRIBUTION PERIOD = REMAINING LIFE EXPECTANCY OF DESIGNATED BENEFICIARY

DESIGNATED BENEFICIARY	
NON SPOUSE	**SPOUSE**
DESIGNATED BENEFICIARY'S LIFE EXPECTANCY	SPOUSE'S LIFE EXPECTANCY
AS OF AGE IN CALENDAR YEAR FOLLOWING CALENDAR YEAR OF DEATH	AS OF AGE IN EACH DISTRICT CALENDAR YEAR FOLLOWING YEAR OF EMPLOYEE DEATH
REDUCED BY 1 YEAR THEREAFTER	AT SPOUSES DEATH: o USE SPOUSE'S LIFE EXPECTANCY IN YEAR OF DEATH o REDUCE BY 1 EACH YEAR THERAFTER

LIFE EXPECTANCY TABLES—REG. SECTION 1.72-9, TABLE V