

IRS Provides Additional Guidance for Making Minimum Payments Under New Rules

WHO'S AFFECTED This information applies to sponsors of defined benefit and defined contribution plans. It does not apply to governmental plans or church plans.

BACKGROUND AND SUMMARY The Small Business Job Protection Act of 1996 (SBJPA) significantly changed the rules regarding qualified plan minimum required distributions (MRDs). In [January 1997](#) and [March 1997](#), we published Compliance Bulletins, reporting on limited guidance the IRS provided regarding these new rules.

Unfortunately, this earlier guidance raised more questions than it answered. While the IRS let employers give actively employed participants who reached age 70½ in 1996 the option to defer their previously required minimum distributions, they did not explain how to make this option available. It did not address how employers could make the deferred distribution option available to participants. In addition, most plan sponsors could not simply remove the provision that allowed non-5% owners to receive distributions while still employed past age 70½, to reflect the new MRD rules, without violating the benefit anticutback rules. The most recent guidance from the IRS tries to address these open issues.

IRS Announcement 97-70 gives plan sponsors rules for providing non-5% owners who were actively employed on December 31, 1996, the option to defer their previously required distributions. *These elections will have to be made by December 31, 1997.*

A proposed regulation provides an exception to the anticutback rules. It would let plan sponsors remove the post-70½ in-service distribution provision for participants who reach age 70½ after December 31, 1998.

ACTION AND NEXT STEPS You will need to review your options under the special deferred payment provisions and decide what, if any, action to take. You should make sure to document your decisions so they can later be included in SBJPA plan amendments. Since the exception to the anticutback rule is only a proposal and cannot yet be acted upon, you should make yourself familiar with the proposal to be in a position to take action when it is finalized.

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Overall, the changes made to the minimum required distribution (MRD) rules by the Small Business Job Protection Act of 1996 (SBJPA) were welcomed by both plan sponsors and participants. However, this piece of pension simplification has raised many difficult technical issues, for which the IRS has had no ready answers. Since the beginning of 1997, the IRS has tried to address these issues through various forms of guidance.

On the one hand, the IRS clarified that an individual who:

- was not a 5% owner;
- reached age 70½ in 1996;
- was still employed at year-end; and
- would have had to receive his or her first MRD by April 1, 1997 under the pre-SBJPA rules,

did *not* have to receive a payment by that date. However, while cautioning employers not to rush into making SBJPA-related plan amendments, the IRS recognized that most plan documents contained language requiring such payments to be made (to comply with pre-SBJPA rules). To ignore these document provisions and not make payments to this group of plan participants could cause a plan to lose its qualified status. To address this dilemma, the IRS told plan sponsors that they could give affected participants the *option* to defer these payments to their new required beginning dates (the April 1 following the calendar year in which they retire). In doing this, the IRS did not provide guidance on how to make the deferred payment option available.

Now, through Announcement 97-70, the IRS has provided guidance for offering the deferred payment option. The IRS is also proposing a revision to the anticutback rules to allow plan sponsors to eliminate entirely the payment of in-service distributions to actively employed non-5% owners who reach age 70½.

Deferral of Previously-Required Payments

A qualified plan will not be disqualified for not making payments to a non-5% owner who reached age 70½ in 1996 and was still employed on December 31, 1996, even though the plan document requires such payments to be made if:

- The missed payments were required to be made between August 20, 1996, and December 31, 1997; and
- The affected participant is offered the option to defer the payment to the April 1 following the calendar year in which he or she retires, and he or she elects to defer the payment; or
- The plan sponsor pays a makeup distribution to the participant; and
- The deferred payment option or the makeup distribution meets all other plan qualification requirements, such as the spousal consent rules that apply to distributions and the requirements for actuarial increases to delayed defined benefit plan payments.

If affected participants are given the one-time option to defer their previously-required payments, all such *elections must be made by December 31, 1997*. If a participant chooses not to defer this payment of benefits, or if the plan sponsor does not make the deferred payment option available, the plan *must pay a makeup distribution to the participant by December 31, 1997*, equal to the amount the participant would have received had the terms of the plan been followed (plus required actuarial increases under defined benefit plans).

- **Amendments Eventually Required**

At this time, plan sponsors do not actually have to amend their plan documents to reflect the actions they decide to take with respect to this group of employees. However, they need to put into operation whatever decisions they make (e.g., offering the election to defer payments to affected participants) on a consistent basis. Future IRS guidance will let plan sponsors amend their plans retroactively to the date the chosen options are first used.

Both the deferred payment and makeup distribution options are available to employers who have adopted prototype plans, as well as to sponsors of individually designed plans. If the sponsor of a prototype plan does not eventually amend its documents to offer the option an adopting employer has chosen to use, that adopting employer may simply end up with an individually designed plan, rather than a prototype plan, post-SBJPA.

Elimination of In-Service Distributions to Age 70½ Participants

The IRS has also issued proposed rules to let plan sponsors amend their plans to eliminate in-service distributions to employees who are not 5% owners and have reached age 70½.

Most plans currently contain such in-service distribution provisions simply to comply with the MRD rules that had been in existence since 1984. However, starting in 1997, such payments are no longer required. While plan documents will have to be amended to reflect the new MRD rules, an amendment that completely eliminates the option to receive an in-service distribution beginning at age 70½ would normally be considered a prohibited cutback in benefits. Anticutback rules generally prohibit a plan sponsor from removing payment options that apply to benefits a participant has already earned.

- **Original Options Were Unattractive**

Earlier this year, the IRS provided limited guidance for dealing with this situation. They suggested that a plan sponsor could either:

- On an ongoing basis give employees the option of beginning distributions at age 70½ or deferring those payments until after retirement; or
- Amend the plan to eliminate such post-70½ preretirement distributions for future benefit accruals only.

Neither of these options is likely to be particularly attractive to plan sponsors, since both may be burdensome to administer.

- **New Option Offers Complete Elimination**

In the spirit of simplification, the IRS is now proposing another alternative which will let plan sponsors amend their plans to completely eliminate post-70½ in-service distributions without violating the anticutback rules, as long as certain conditions are met.

To take advantage of this IRS "special offer," the plan amendment may only eliminate in-service distributions to employees who reach age 70½ after the later of December 31, 1998, or the date the amendment is adopted. The amendment would have to be adopted by the deadline for adopting amendments to comply with SBJPA, which will be no earlier than December 31, 1998. However, the amendment may not be adopted or made effective before the IRS publishes the final rules for making these amendments. *Therefore, plan sponsors should not make any plan amendments at this time.*

- **Some Plans Are Not Affected**

Many plan sponsors may not have to take advantage of these special rules at all. For example, if a profit-sharing plan permits in-service distributions at any time after a participant reaches age 59½, in any amount, it could be amended to reflect the new MRD rules without violating the anticutback rules, since participants age 70½ would still be permitted to take in-service distributions after the change to the MRD rules.

The IRS realizes that plan sponsors are eager to settle these issues and has requested comments on this proposal by September 30, 1997. A public hearing has been scheduled for October 28, 1997, and the IRS intends to finalize the rules on an expedited schedule. We will keep you informed of future developments.

Pension Analyst by Prudential Retirement

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