



Important Information

Distributions and Withdrawals

October 1996*

Defined Contribution Plans Must Make Minimum Payments

WHO'S AFFECTED This information applies to sponsors of defined contribution plans with participants age 70½ or older. *(The term participant includes both current and former employees who have vested account balances in the plan.)*

BACKGROUND AND SUMMARY The purpose of this *Pension Analyst*® is to clarify the status under current law and the changes made by the Small Business Job Protection Act of 1996 (SBJPA) to minimum required distributions (MRDs).

Most qualified plans must begin making MRDs to participants by the April 1st following the calendar year in which a participant reaches age 70½, whether or not the participant retires. Once benefit payments begin, the plan must continue to pay the participant each year. The first payment paid to participants during the calendar year in which they reach age 70½ will be considered to satisfy all or a portion of the MRDs for that calendar year.

Effective January 1, 1997, the SBJPA changed the rules that determine when participants who work beyond age 70½ must start taking payments from their employer's plan. There is a question whether participants who turned 70½ in 1996 are subject to the old law that requires them to take their first payment by April 1, 1997, or the new law that lets them defer the payment until they retire.

ACTION AND NEXT STEPS Review your records to identify any participants who must receive MRDs. Plan sponsors must make a reasonable effort to obtain spousal consent for married participants who elect a form of payment other than a joint and survivor annuity, if applicable.

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*Republished November 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

Old/Current Law

In general, when vested participants reach age 70½, they have to begin receiving payments. These payments have to begin by the April 1st following the calendar year in which a participant reached age 70½, whether or not the participant retired. This is called the participant's "required beginning date." Once these payments begin, the plan must continue to make payments annually by December 31 to the participant. These payments are called minimum required distributions (MRDs).

There are exceptions to the standard MRD rules:

- Participants in governmental plans and certain church plans can delay payments beyond age 70½, until they actually retire, if later than the year in which they reach age 70½.
- Participants who reached age 70½ before January 1, 1988, and who are not 5-percent owners, may postpone taking a MRD until the April 1st following the calendar year in which they retire.
- Participants who signed an election form before January 1, 1984, to remain under the pre-TEFRA distribution rules, must receive payments according to that election. A change in beneficiary does not revoke the election, unless it changes the period over which payments will be made. If the election is revoked, the plan must make payments by the end of the calendar year following the calendar year in which the revocation takes place. The payments must consist of the total amount that would have been paid had the payments started on the participant's required beginning date. This is called a "catch-up" payment. Payments must continue thereafter.
- Special rules apply to MRDs to participants in §403(b) plans. The MRD calculation is complex and requires two comparison calculations. Generally, the account is looked at in two parts - the portion attributable to the account balance before January 1, 1987, and the portion attributable to the portion after December 31, 1986.

Payments Due by December 31, 1996

Participants who have received previous MRDs must receive their 1996 MRDs by December 31, 1996.

Payments Due by April 1, 1997

As of this writing, the status of MRDs for active participants who reached age 70½ in 1996 is unclear.

Under old/current law, participants who reached age 70½ during 1996 are required to receive MRDs by April 1, 1997. This includes former employees who still have vested benefits in the plans. These former employees must take their first MRD by April 1, 1997.

However, as noted earlier, the Small Business Job Protection Act that was signed into law on August 20, 1996, made changes to the MRD rules. This Act reinstates the rules in place prior to TRA '86. The rules, however, have not changed for five-percent owners, terminated participants with vested account balances, and IRA owners. They still must start taking their payments no later than the April 1st of the calendar year following the calendar year in which they reach age 70½.

Description of New Payment Rules

Effective January 1, 1997, in general, an active employee with vested plan benefits must begin receiving payments from the plan by the April 1 of the calendar year following the later of the calendar year in which the employee reaches age 70½ or the calendar year in which the employee retires. This is called their required beginning date (RBD).

The law is not clear as to whether active participants who reached age 70½ in 1996 are subject to the old law, i.e., have to take their first payment by April 1, 1997, or are subject to the new law, i.e., can defer payment until they retire. As we receive more information from the Internal Revenue Service concerning the timing for making the first MRD to these active employees, we will update you.

More About The New Law

Effective January 1, 1997, if participants are currently receiving MRDs, who do not have to under the new law, the plan can choose, but is not required, to allow these participants to stop receiving MRDs until required under the new law.

Minimum Required Distributions Are Not Eligible for Rollover

Participants cannot roll over MRDs to an IRA or to another employer's qualified plan that accepts rollovers. These payments must be made to the participant.

Payments to Beneficiaries Of Participants Who Died Before Their Required Beginning Date

A single sum payment is due by the December 31st of the year containing the fifth anniversary of the participant's death. Annuity distributions must start by the December 31st of the year following the year in which the participant died. However, if the beneficiary is the participant's spouse, annuity payments do not have to begin until the December 31st of the year in which the participant would have turned age 70½.

The new law has made no changes to these rules.

Penalties for Not Making Timely Payments and the Ability To Correct Past Shortfalls

If a plan fails to make MRDs when due, the participant is subject to a penalty tax of 50% of the amount the plan should have paid. The IRS also may disqualify the plan.

These are stiff penalties that punish the affected participants and potentially all plan participants. To mitigate this, the IRS' Standardized VCR Program (SVP) allows plans, that failed to make timely MRDs, to correct that oversight. Under SVP, a plan must pay the total missed MRD amount for all prior years. The employer will enter into a closing agreement with the IRS to pay the penalty tax normally assessed against the participant. Plan sponsors that apply under SVP and

make the required corrections ensure that the IRS will not disqualify their plans on account of those errors.

Plan Sponsors Must Make a Decision

As noted above, after January 1, 1997, if participants are currently receiving MRDs, but do not have to under the new law, the plan can choose, but is not required, to allow participants with their consent to stop receiving MRDs until required under the new law.

Minimum Required Distribution Checklist

- Review your records to identify any participants or former employees who are vested in the plan and subject to these requirements.
- Review your plan document to verify that benefits are paid according to the provisions of the plan. Your plan may not allow participants to maintain an account balance in the plan beyond either the normal retirement date or the required beginning date.
- Obtain spousal consent, if applicable. Keep the consent form in your files. If, after making a reasonable effort, you are unable to obtain consent, you must still make the payment under the plan's applicable normal form of payment.
- If a MRD is required for a calendar year, all amounts paid during that calendar year are treated as required distributions if the total MRD has not been made for that year or any prior year.

Note: The participant is subject to a 50% penalty if the MRD is not made by the IRS's due date.

If you have any questions or need additional information, please contact your Prudential Retirement representative.

Pension Analyst by Prudential Retirement

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