BCG Benefit Consultants Group

Qualified Plan Distribution Rules

As the year-end approached, it is a good time to review the rules governing required minimum distribution rules from qualified plan, including who is considered a designated beneficiary for purposes of these rules.

In general, the minimum required distribution rules specify the latest permissible date for plan distributions to begin and the maximum time period over which they may be made. Their purpose is to ensure that retirement plans are used to provide retirement benefits rather than as mechanisms for the indefinite deferral of tax. Failure to make minimum required distributions results in an excise tax on the payee (*i.e.*, plan participant)of 50% of the amount by which the required distribution exceeds the amount actually distributed during the year.

General Rule

Distributions to a participant in a retirement plan must begin by the required beginning date and must be paid over:

• the life of the employee;

• the lives of the employee and a designated beneficiary; or

• a period, which may be a term certain, that cannot exceed (a) the life expectancy of the employee or (b) the life expectancy of the employee and a designated beneficiary.

The “required beginning date” of a participant (other than a 5% owner) is April 1 of the calendar year following the calendar year in which the employee reaches age 70 1/2 or retires, **whichever is later**. However, the required beginning date for a 5% owner is April 1 of the calendar year following the year in which the 5% owner reaches age 70 1/2, even if not retired. Before the required beginning date, you need not be concerned with the operation of the minimum required distribution rules. As much or as little as desired can be distributed under the plan's terms.

Designated Beneficiaries

As noted above, the minimum required distribution amount will depend on the person designated as the beneficiary to receive the remaining portion of your interest in the plan after your death. Certain rules apply in determining those persons eligible to be designated beneficiaries for this purpose.

1. Determination

Only persons who are designated under the plan may be designated beneficiaries. A person may be designated as a beneficiary under the terms of the plan, or, if the plan provides, through an election by you or your surviving spouse.

The passing of your plan interest to a certain individual under applicable state law (under the state intestacy laws, for example) will not result in the recipient being treated as the designated beneficiary unless the individual also is designated as a beneficiary under the plan.

Except in certain cases involving trusts (described below), only individuals may be designated beneficiaries. If an entity other than an individual is designated, the rules apply to the interest of the employee as if no beneficiary was designated.

If a trust is named as beneficiary, all trust beneficiaries will be treated as designated beneficiaries if: (i) the trust is valid under state law or would be valid except that it lacks a corpus; (ii)the trust is irrevocable; and (iii) the trust beneficiaries who are beneficiaries of the employee's interest are identifiable.

With respect to the minimum required distributions, the designated beneficiary generally is determined as of September 30 of the calendar year following the calendar year of the employee's death.

2. Rules if No Beneficiary Properly Designated

If no beneficiary is properly designated, distributions to you during life commencing with your required beginning date must be made over your life or over a period not exceeding your life expectancy. This can result in a shorter period for making the minimum required distributions, resulting in earlier payment of taxes on the distributions than may be desired.

3. Rules when Multiple Beneficiaries Are Designated

In general, if multiple beneficiaries are designated, the one with the shortest life expectancy must be used in determining the minimum required distribution amount. Each beneficiary's life expectancy can be used in determining the beneficiary's minimum distribution, however, if separate accounts or segregated shares are maintained for each beneficiary.

If a beneficiary's entitlement to a benefit after your death is contingent, the contingent beneficiary still is considered a beneficiary in determining which designated beneficiary has the shortest life expectancy. However, a person will not be considered a beneficiary merely because he or she could become a successor beneficiary, unless a person has any right (including a contingent right) to your benefit beyond being a potential successor beneficiary. If a designated beneficiary dies after the date when beneficiaries are determined, the beneficiary's life expectancy is used without regard to the life expectancy of any subsequent beneficiary.

Calculating the Minimum Required Distribution Amount from an Individual Account

The rules for calculating the minimum required annual distribution depend on whether the distribution is made from an individual account or in annuity form. The calculation for individual accounts determines the minimum required distribution amount by dividing the account balance by the distribution period. For lifetime required distributions, there is a uniform distribution period for almost all employees of the same age under a table in IRS regulations based on the joint life and last survivor expectancy of an individual and a hypothetical beneficiary 10 years younger. However, if your spouse is your sole beneficiary and your spouse is more than 10 years younger than you, a longer distribution period based upon the joint life and last survivor life expectancy of you and your spouse can be used.

For years after the year of your death, the distribution period generally is the remaining life expectancy of your designated beneficiary. The beneficiary's remaining life expectancy is calculated using the age of the beneficiary in the year following the year of the employee's death, reduced by one for each subsequent year. If the employee's spouse is the employee's sole beneficiary, the distribution period during the spouse's life is the spouse's single life expectancy. For years after the year of the spouse's death, the distribution period is the spouse's life expectancy calculated in the year of death, reduced by one for each subsequent year. If there is no designated beneficiary, the distribution period is your life expectancy calculated in the year of death, reduced by one for each subsequent year.

For lifetime distributions, your marital status is determined on January 1 of each year. Divorce or death after that date is disregarded until the next year. Also, a change in beneficiary due to the spouse's death is not recognized until the following year.

The account balance is figured as of the last valuation date in the calendar year immediately preceding the distribution calendar year, increased by contributions or decreased by distributions made after that date. The first distribution calendar year generally is the first calendar year for which a minimum distribution is required. For lifetime distributions, however, the first distribution calendar year is the year in which you reach your required beginning date even though distributions need not begin until April 1 of the next year.

In general, if the amount distributed in any calendar year exceeds the minimum required, no credit is provided in later years for the excess. A credit is provided, however, for distributions made during the year in which you reach your required beginning date. The lack of credit for distributions in excess of the minimum amount can create a hardship. For example, if you take a large distribution to purchase a retirement home, you would receive no credit toward meeting the minimum required distributions in later years and would have to continue receiving minimum required distributions. You should consider whenever a large distribution is proposed in a single year to make a large purchase whether it is better to purchase the item using financing rather than cash, so that payments may be stretched over several years (to be paid using future years' minimum required distributions).

Generally, a minimum required distribution for a particular calendar year must be made by December 31 of that year, unless it is for your first distribution calendar year, in which case it can be made by April 1 of the next year. If you delay your first minimum required distribution to the following calendar year, however, you must receive two minimum required distributions in your second year: one on or before April 1 and a second on or before December 31.

BCG consultants are available to consult with plan participants regarding minimum distribution planning. The cost for such services can be paid by the participant.

Note that Congress is considering waiving required minimum distributions for 2008 and/or 2009. BCG intends to alert our clients via email should such a law be enacted.