Don't Forget Your Required Minimum Distributions!

Tax-qualified retirement plans, such as 401(k) plans, profit-sharing plans and pension plans, as well as IRAs, are subject to required minimum distribution (RMD) rules under the Internal Revenue Code which prevent the plan participant or IRA owner from deferring distribution of his or her benefits indefinitely. Very generally, these rules require the plan participant or IRA owner to begin receiving benefit payouts by his or her "required beginning date."

Generally, the required beginning date for an employee participating in a tax-qualified plan is April 1 of the calendar year following the later of (a) the calendar year in which the employee reaches age 70½, or (b) the calendar year in which the employee retires. So, in general, an employee can defer receipt of benefits from his or her employer's plan until after age 70½ by continuing to work. However, RMDs for employees who are 5% owners, or for IRA owners, must begin no later than April 1 of the calendar year following the calendar year in which individual attains age 70½ whether or not the individual retires. An individual is a 5% owner if he or she owns more than 5% of the stock of a corporation (by vote or value) or is a sole proprietor or a more the 5% partner in a partnership. The 5% owner determination is made in the year in which the individual attains age 70½.

Compliance with the RMD requirements is a plan qualification issue. Accordingly, if a plan fails to make proper RMDs to a single plan participant, not only that participant, but also the plan itself, could be in for trouble with the Internal Revenue Service.

Recently, we have seen an uptick in RMD violations. Usually, the reason is simple ignorance of the RMD rules or bad advice.

Here are some pitfalls to look out for:

- As noted above, 5% owners and IRA owners cannot defer RMDs beyond April 1 following attainment of age 70½ under any circumstances.

- Certain ownership attribution rules under the Internal Revenue Code apply to determine whether an individual is a 5% owner.

  Example: A company employs the father of the 100% owner of the company. By attribution, the father is a 5% owner. The father's required beginning date is April 1 of the year following the year he attains age 70½, even if he continues working for the company.

- The 5% owner determination is made by treating a group of related companies as a single employer.

  Example: An employee of an employer who maintains a plan has no ownership in that employer. However, the employer is part of a controlled group, and that employee owns more than 5% of another company that is part of the controlled group. That employee is treated as a 5% owner of the employer.

- If an individual is a 5% owner for the year in which the individual attains age 70½, but later is no longer a 5% owner, the individual nevertheless continues to be treated as a 5% owner. Such individual may not discontinue RMDs because, at some point after the individual's required beginning date, the individual is no longer a 5% owner.

- A sole proprietor is always a 5% owner, so his or her required beginning date is always April 1 of the year following the year in which he or she attains age 70½.

- If an IRA includes a rollover from a qualified plan, that does not change how the required beginning date for that IRA is determined. Once funds are rolled over, they are subject to the RMD rules applicable to the recipient plan or account.

- As noted above, the first RMD must be made by April 1 of the year following the year in which the individual attains age 70½ or retires, as applicable. However, the second and all future RMDs must be made by December 31 of the applicable year. So, if the individual waits until April 1 of the following year to take his or her first RMD, the individual would have to take a second RMD by December 31 of that same following year.

Even if your plan fails to properly make RMDs, the failure can be corrected under the IRS' Employee Plans Compliance Resolution System.

If you have any questions concerning the RMD rules, or think you may have missed making your RMDs, please feel free to contact our ERISA attorneys, Jay Fenster or Mark Hamilton.

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