Pension ANALYST

Important Information | Distributions and Withdrawals | March 2001*

IRS Issues New Minimum Required Distribution Regulations

WHO'S AFFECTED These regulations apply to qualified defined benefit and defined contribution plans (including 401(k) plans) and 403(b) programs.

BACKGROUND AND SUMMARY Recently, the IRS issued proposed Minimum Required Distribution (MRD) regulations. These regulations were issued in response to the numerous comments made to the IRS regarding the complexities of the existing regulations. In general, the new rules should make it easier for plan administrators and participants to comply with the MRD requirements. Generally, use of these rules will result in a longer retention of plan assets in participants' retirement accounts. Under the new rules, a plan administrator does not need to identify a participant's designated beneficiary until December 31 of the calendar year following the calendar year of the participant's death. If a participant dies before the date his MRD payments must begin, the default for beneficiary payments will be an annuity, regardless of whether the beneficiary is a spouse or nonspouse. If no beneficiary is designated by the due date noted above, or that beneficiary is not an individual or properly-designated trust, the default remains the five-year cash-out rule. The new rules also reduce the number of decisions that participants need to make when calculating payment amounts. The old recalculation and term certain options are no longer relevant. However, the new methods do still bear some similarities to the old. For example, the payment amount is still calculated by dividing the prior year's account balance by a life expectancy factor. That factor is determined by using the Uniform Table, or what was previously called the Minimum Distribution Incidental Benefit (MDIB) Table.

ACTION AND NEXT STEPS These regulations are *proposed* to be effective for payments made for *calendar years* beginning on or after January 1, 2002. For payments made for calendar year 2001 or for later calendar years beginning before the effective date of final regulations, plan sponsors may apply either the new rules or the old rules (except where the Small Business Job Protection Act made changes to them). To use the new rules, plan sponsors must adopt a model amendment from the proposed regulations.

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PRUDENTIAL RETIREMENT

The majority of the old Minimum Required Distribution (MRD) rules still apply to qualified plans and 403(b) programs. The new rules revise the timing of beneficiary designations and generally affect the way MRDs are calculated. The new rules cannot be used for 2000 MRDs that are deferred until the required beginning date of April 1, 2001 (either because the participant attained age 70-1/2 or retired in 2000.)

Beneficiary Designation

Under the new rules, the plan administrator does not need to identify the participant's designated beneficiary until December 31 of the calendar year following the year of the participant's death. This means that the participant's choice of beneficiary can now be based solely on traditional post-death estate planning. Also, a designated beneficiary may give up his or her rights to the benefit in favor of another beneficiary by making a disclaimer before the beneficiary designation deadline described above.

MRD Calculations for Defined Contribution Plans

Under the new rules, all required payments are calculated by dividing the participant's account balance as of the end of the preceding year by the life expectancy factor found in the IRS Uniform Table (i.e., the Minimum Distribution Incidental Benefit (MDIB) table). The distribution will be recalculated each year using the life expectancy factor based upon the participant's age during the relevant calendar year in the Uniform Table. Generally, the new calculation method will result in a smaller payment. Unlike the old MRD rules, no beneficiary information is needed for the calculation. However, if there is a designated beneficiary, special rules apply if the participant's spouse, who is more than 10 years younger than the participant, is named as the sole beneficiary. In that case, the annual life expectancy factor will be determined using the table reflecting joint life expectancies of the participant and spouse. If the spouse dies before the participant or they divorce, the calculations will revert back to using the Uniform Table.

Post-Death Distributions

As under the existing regulations, different death benefit payment rules apply, depending on whether the participant dies before or after his required beginning date (RBD). For a non-5% owner, the RBD is the April 1 of the calendar year following the later of the year the participant reaches age 70-1/2 or the year he retires. For a 5% owner, the RBD is the April 1 of the calendar year following the year he reaches age 70-1/2.

Death Before the Participant's RBD

If the designated beneficiary is the participant's spouse, the surviving spouse must take required payments either (a) under the five-year cash-out rule, or (b) over the spouse's life expectancy beginning by the later of (i) December 31 of the year following the year of the participant's death or (ii) the December 31 of the year in which the participant would have reached age 70-1/2.

While the surviving spouse is alive, payments must be taken over the beneficiary's own life expectancy, redetermined each year. When the surviving spouse dies, any remaining benefits must

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be paid over a fixed-term life expectancy based on the deceased spouse's age in the year of death and reduced by "1" for each later year. If the deceased spouse has no designated beneficiary, the five-year cash-out rule applies and the entire account must be paid out by the December 31 of the year containing the fifth anniversary of the spouse's death.

If the designated beneficiary is not the participant's spouse, payments must be made either (a) under the five-year cash-out rule, or (b) over the beneficiary's own life expectancy, beginning no later than December 31 of the year following the year in which the participant died. Payments must be paid over a fixed-term life expectancy based on the beneficiary's age in the year after the participant's death and reduced by "1" for each later year.

If the designated beneficiary is a not a person (e.g., the participant's estate, a charity), payments must be made under the five-year rule.

If there are multiple beneficiaries who are all individuals and where separate accounts are established for them by the December 31 of the year after the year the participant dies, each beneficiary is treated separately using the rules described above. However, if separate accounts are not established, the beneficiaries must take payments either (a) under the five-year cash-out rule, or (b) over the oldest beneficiary's life expectancy beginning no later than December 31 of the year following the year in which the participant died. Payments must be made over a fixed-term life expectancy based on the oldest beneficiary's age in the year after the participant's death and reduced by "1" for each later year.

If a participant dies before the date his MRD payments must begin, the default for beneficiary payments will be an annuity, regardless of whether the beneficiary is a spouse or nonspouse. Therefore, absent a plan provision or election of the five-year rule, the annuity rule would apply in all cases in which the employee has a person as designated beneficiary.

Death On or After the Participant's RBD

If the deceased participant has not taken the MRD for the year in which he dies, the beneficiary must take the payment by December 31 of that year. The MRD is determined as if the participant were still alive, (i.e., based on the participant's age in the year of death.)

If the designated beneficiary is the spouse or a nonspouse, the same payment rules as those where the participant died before the RBD apply to required payments beginning the year after the year the participant dies; however, the five-year cash-out rule does not apply. The five-year rule would apply automatically only if the participant did not have a designated beneficiary as of the end of the year following the year of the participant's death. Generally, the same rules also apply where there are multiple beneficiaries.

If the designated beneficiary is not a person, a fixed-term life expectancy will be based on the participant's age in the year of death and reduced by "1" for each later year.

Changes to Defined Benefit Plan Payments

The new regulations also make changes to annuity payments under defined benefit plans. Generally, these changes do not affect participants to whom Prudential Retirement makes

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payments since these participants are treated as if they have retired and are receiving annuity payments. Additional accruals after the required beginning date are reflected in the January 1st annuity payment immediately following the calendar year in which the accrual applies. However, the IRS is still evaluating whether any changes should be made in determining whether annuity payments satisfy the MRD rules. Single sum payments from defined benefit plans will follow the same rules that apply to payments from defined contribution plans.

Tax Deferred Annuities

The new rules clarify that if an individual has more than one Tax Deferred Annuity (TDA), MRDs must be calculated separately for each TDA, but may be paid from one or more TDA. Also, the IRS is considering the addition of a requirement that each TDA trustee report to them each participant's MRD amount for the distribution calendar year. However, the IRS will not require such reporting for qualified plans.

Amendment of Qualified Plans

The IRS is clear that the new rules cannot be included in "GUST" plan restatements except where the Small Business Job Protection Act made changes to them (e.g., the new definition of RBD). However, plan sponsors may apply the new rules for any calendar year on or after 2001 and prior to the effective date of the final regulations. To do so, they must adopt the model amendment contained in the proposed regulations. Even plan sponsors with documents that simply cross-reference Internal Revenue Code section 401(a)(9) "and regulations thereunder" must adopt the model amendment to operate under the new rules.

Effective Date and Next Steps

The new regulations are proposed to be effective for payments made for *calendar years* beginning on or after January 1, 2002. Plan sponsors may use the new rules for calendar year 2001. However, if you want to apply the proposed rules for 2001, it is important to note that there may be some distributions in 2001 that use the old rules (for calendar year 2000 MRDs paid in 2001, or 2001 MRDs paid before the adoption of the model amendment) and some that use the new rules (for calendar year 2001 MRDs paid in 2001 after the adoption of the model amendment). This may cause some confusion among participants, especially since communication to some participants due an MRD in 2001 has already occurred indicating the existing plan options (i.e., the old MRD rules).

You may continue to use the old rules until the IRS publishes final regulations. If you would like to use the new rules, you must adopt a model amendment. If you have questions about these rules, or their application to your plan, please contact your Prudential Retirement Representative.

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Editor: Mitzi Romano (860) 534-2768

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