



Required Minimum Distributions

SITUATION: We have several former employees who have retired and left their 401(k) account balances in our plan.

QUESTION: When are we required to start distributing money to them from their plan accounts?

ANSWER: In general, retirement plans must make required minimum distributions (RMDs) to retired employees who have reached age 70½ and to any current employees who own more than 5% of the company and are age 70½ or older. RMDs also must be paid to beneficiaries of a deceased employee's qualified plan account.

DISCUSSION: More specifically, RMDs must begin by the "required beginning date" (RBD). The tax law provides that the RBD is April 1 of the year following the year a retired employee or a more-than-5% owner turns age 70½. If an employee (other than a 5% owner) continues to work for the sponsoring employer after age 70½, the plan can allow the employee to wait until April 1 of the year after retirement to start taking RMDs.

For beneficiaries of employees who die before their RBD, minimum distributions usually must start on or before December 31 of the year after the year of the employee's death. However, a surviving spouse who is the sole account beneficiary and leaves the

money in the plan has the option to wait until December 31 of the year the employee would have turned age 70½.

Your plan must make subsequent RMDs by December 31 of each year.

Basically, an employee's RMDs are calculated each year based on the employee's age using the IRS's Uniform Lifetime Table. A more favorable joint life expectancy table can be used if the employee's spouse is more than 10 years younger than the employee.

For an individual beneficiary designated by an employee who dies before his or her required beginning date, RMDs generally are calculated based on the beneficiary's life expectancy. When the employee has designated more than one beneficiary, the oldest beneficiary's life expectancy should be used. If the employee dies after his or her RBD, the remaining balance must be paid out over the longer of the beneficiary's or the employee's remaining table life expectancy.

COMMENT: Fall is a good time for plan sponsors to review their plans in preparation for making RMDs to retired employees and beneficiaries. If you have questions, please give us a call.

2 It Does Compute

2 Sell Your Employer Match

3 Handling Erroneous Hardship Distributions

4 Recent Developments In Benefit Plans



It Does Compute

What can employers do to encourage employees to take positive action toward providing for their retirement security? One step in the right direction may be to encourage employees to calculate a retirement savings goal. The Employee Benefit Research Institute's *2008 Retirement Confidence Survey*^{®*} found that 44% of respondents who had calculated a goal amount reported having made changes to their retirement planning as a result.

What changes did they make? Fifty-nine percent started saving or investing more, 20% changed their investment mix,

7% reduced debt or spending, 5% enrolled in a retirement savings plan at work, 3% decided to work longer, and 3% researched other ways to save for retirement.

A majority of the employees surveyed (56%) indicated that they prefer a retirement calculation tool that asks for seven to ten pieces of detailed information and gives an answer tailored to their individual situations. Seventy-two percent said they like a tool that gives a range of answers based on different scenarios.

* EBRI Issue Brief No. 316, April 2008, www.ebri.org

Sell Your Employer Match

Most 401(k) plan sponsors offer their employees some type of matching contributions. The most common match, according to the Profit Sharing/401(k) Council of America, is 50 cents for every dollar an employee contributes to the plan, up to 6% of compensation. The reason for offering this benefit is simple. The availability of matching contributions encourages employees to participate in their employer's plan and, in many cases, to contribute more to the plan — both of which can help at annual nondiscrimination testing time.

But many employees, particularly lower paid employees, fail to take full advantage of this important benefit. By some estimates, as many as two thirds of the lowest paid employees may not be contributing enough to receive the full company match. What can you do to get all of your employees on board?

Show Them the Money

To start, look at your enrollment and educational materials to see how matching contributions are explained. Many employers find that a “free” money approach, pointing out that the employer is *giving* employees extra money for retirement, is effective. Also helpful are illustrations showing the difference matching contributions can potentially make in their plan account balance at retirement.

Target Education

Also consider reviewing your plan data to determine which participants are not taking full advantage of your matching contributions. You might want to target these employees with payroll stuffers or e-mail communications pointing out the benefits of matching contributions. Or, if employees who are not taking advantage of your match seem to be concentrated in certain departments, you may want to post matching contribution posters in those areas. Another idea is to briefly talk about your 401(k) plan and your match program at the performance/pay reviews of select — or perhaps all — employees.

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Handling Erroneous Hardship Distributions

With the housing crisis and uncertain economy, some plan sponsors have seen an uptick in requests for hardship distributions from their 401(k) plans. If you receive a hardship request, take care that any distribution you make meets IRS requirements and your plan's provisions. Below, we answer questions about hardship distributions and how to correct erroneous distributions.

When can a 401(k) plan make a hardship distribution? It depends on the method used to define hardship. When a plan uses the *facts-and-circumstances method*, the plan administrator reviews all relevant facts and circumstances in each individual situation. While the plan generally can allow a hardship distribution for any reason, it must have established rules to ensure that the distribution will be used for an immediate and heavy financial need.

For example, the need to pay funeral expenses of a family member would constitute an immediate and heavy financial need. A distribution made for the purchase of a boat or television would generally not be considered a distribution made on account of an immediate and heavy financial need. A financial need may be immediate and heavy even if it was reasonably foreseeable or voluntarily incurred by the employee.

Under the *safe-harbor method*, a plan can allow hardship distributions to be taken for the following reasons: (1) to pay certain medical expenses incurred by the participant or the participant's spouse or dependents; (2) to purchase a principal residence; (3) to cover post-secondary educational expenses for the participant or the participant's spouse, children, or dependents; (4) to prevent eviction from or foreclosure on a principal residence; (5) to pay the funeral expenses of a spouse, parents, children, or dependents; and (6) to repair damage to the employee's principal residence that would qualify for the income-tax casualty loss deduction (without regard to whether the loss exceeds 10% of adjusted gross income).

Plans using a safe harbor method must restrict the employee from contributing to the plan (and all

other qualified and nonqualified plans maintained by the employer) for a minimum of six months following the hardship distribution.

What should a plan sponsor do if it discovers that a hardship distribution has been made in error? A plan generally can use either the IRS's Self-Correction Program (SCP) or Voluntary Correction Program (VCP), as set forth in Revenue Procedure 2006-27, to correct a hardship distribution error, unless the plan is under IRS examination. In that case, the plan generally will have to correct the mistake in accordance with a closing agreement under the Audit Closing Agreement Program (Audit CAP).

Take reasonable steps to ensure that the employee who received the distribution returns the erroneously distributed amounts to the plan. The employee also should be informed that any amounts not returned are not eligible for favorable income-tax treatment. For example, these amounts cannot be rolled over to an IRA or another retirement plan. To ensure the error doesn't occur again, review plan procedures for approving hardship distributions and make sure that everyone with authority to authorize distributions is aware of those procedures.

What can be done to avoid mistakes? The IRS recommends (1) reviewing the plan document to see when and under what circumstances distributions can be made, (2) establishing hardship distribution procedures, and (3) looking for signs that the hardship distribution feature is being abused or badly managed. For example, too many hardship requests from employees in one department or division or from only highly compensated employees may be a sign of abuse or that all employees haven't been properly notified of the availability of hardship distributions.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.



RECENT DEVELOPMENTS In Benefit Plans

Deferral Rates and Demographics. A recent study by the Spectrem Group found that age seems to be a significant factor in deciding how much money to defer to retirement savings plan accounts. Among those surveyed, employees age 55 and older had a mean deferral rate of 8.2%, while employees ages 40 to 59 deferred 6.9%, and those under age 40 deferred 5.9%. Income and gender also seemed to have an effect. Employees with incomes greater than \$75,000 deferred 8.1%, and those with

incomes between \$50,000 and \$75,000 deferred 7.2%. The mean deferral rate for employees with incomes below \$50,000 was 5.4%. Overall, men had a mean deferral rate of 7.6% and women 6.3%.

Plan Eligibility. Significant changes in 401(k) plan eligibility have occurred over the ten years during which the Profit Sharing/401(k) Council of America (PSCA) has collected eligibility data from companies sponsoring these plans. According to the recently released *Profit Sharing Plan Eligibility Survey 2007*, in

1998, only 24% of plans permitted employees to make 401(k) contributions immediately upon employment. By 2007, 51% of all plans and nearly 64% of plans with 1,000 or more employees that allowed 401(k) plan participation had adopted immediate participation. Waiting periods for companies that do have them typically are shorter as well. Seventy percent of all companies and 82.5% of large companies allow participation within the first three months of employment. A mere 17% require a one-year waiting period.

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