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Unraveling the IRA Maze

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IRS Issues Guidance on Rollovers of 2009 RMDs and Extensions of Certain Periods

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Introduction

Required minimum distributions (RMD) are waived for participants and beneficiaries of IRAs , defined contribution plans, 403(b) plans, 403(a) annuity plans and governmental 457(b) plans for 2009[i]. However, some of these individuals withdrew amounts which they intended to treat as their RMD in 2009. The reason for *inadvertently* taking these RMDs includes the fact that they were unaware of the waiver; and in some cases, their distributions were set up on automatic scheduled payouts that took effect before the distributions could be suspended. In response to questions about whether these amounts were rollover eligible, the IRS issued Notice 2009-82.

Other Provisions Included in Notice 2009-82

Notice 2009-82 addresses the rollover rules that apply to 2009 RMD amounts and answers other questions relating to the 2009 RMD waiver. It also includes:

- Transition relief for employer plans[ii] that are not operated in accordance with the plan's terms with respect to waived RMDs and certain related payments;
- Relief for rollover of waived RMDs and certain related payments, including an extension of the 60-day rollover period for some of these distributions;
- Answers the question of whether the RMD waiver also applies to a series of substantially equal periodic payments (SO-SEPP or SEPP)/72(t) payments, under which the 10% early distribution penalty is waived; and
- Explains when certain distribution related deadlines are extended and the duration of the extension.

Notice 2009-82 also includes two sample plan amendments that employers can use to amend their employer plans for the 2009 RMD waiver and related provisions.

Background Rules

- ### RMD Rules

  Owners of traditional IRAs, SEP IRAs and SIMPLE IRAs are required to begin taking RMDs from their IRAs for the year they reach age 70 ½ , and must continue to take RMDs for every year after. Qualified plans, 403(b) plans, 403(a) annuity contracts and governmental 457(b) plans are subject to the same rules, except that these plans may allow participants who are not 5% owners [iii] to defer beginning their RMDs past age 70 ½, until they retire.

  Beneficiaries of these aforementioned retirement accounts and Roth IRAs are also subject to the RMD rules. Generally, a beneficiary is required to take distributions:

  - Under the single life expectancy rule [iv] or under the five-year rule, if the account owner dies before the required beginning date (RBD). The single life expectancy is the default provision under the tax code. The five-year rule applies if the beneficiary elects to take distributions under that period, if the plan provisions require that the five-year rule is the only option, or if the plan

provisions default to the five-year rule failing an election of the life expectancy option and the beneficiary failed to make the election.
- Over the longer of the life expectancy of the decedent or the beneficiary, if the owner dies on or after the RBD.

- **Rollover Rules for RMDs**

  Individuals who receive distributions from their IRAs or employer plans are allowed to rollover those amounts within 60-days of receipt, providing the amount is rollover eligible. Ineligible rollover distributions include RMD amounts[v]. As such, an individual who receives an RMD amount from his retirement account should not attempt to rollover the distribution, as it would result in an ineligible rollover to the receiving account. This ineligible rollover could create an excess contribution, which in turn could result in penalties being owed to the IRS if not corrected on a timely basis. It could also result in double taxation of the amount.

- **Waiver of RMDs for 2009**

  The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) was signed into law on December 23, 2008. WRERA provides a waiver of RMDs for 2009 for participants and beneficiaries of IRAs and employer plans. The waiver does not apply to defined benefit pension plans. For more on the WRERA provision, see the article *Waiver of Required Minimum Distribution for 2009* at www.retirementdictionary.com.

- **Deadline for Completing Rollovers**

  If an amount is rollover-eligible, and the distribution is paid to the account owner instead of directly rolled over to an eligible retirement plan, the owner has 60-days within which to rollover the amount. The IRS has the authority to extend the 60-day deadline in cases where failure to provide the waiver would be against equity or good conscience; such as in cases of casualty, disaster or other events beyond the reasonable control of the distributee.

Determining if Distribution is a 2009 RMD

In order to determine the distribution amount to which these rules apply, one must first be able to identify whether or not the amount is a 2009 RMD from a defined contribution plan or IRA .If it is, it may be rollover eligible.

The provisions do not apply to the following amounts:

- *Distributions from defined benefit plans, even if the amount represents an RMD*
- *RMD amounts for previous years*. For instance, if a participants' first RMD year is 2008, that individual can to defer taking that 2008 RMD until April 1, 2009. The amount withdrawn in 2009 for the 2008 RMD would not be a 2009 RMD and therefore would not be eligible for the special provisions described in this document.
- Amounts in excess of the 2009 RMD. If the 2009 RMD amount is $10,000 and $11,000 was withdrawn, only the $10,000 is a 2009 RMD.

- *Amounts withdrawn after the 2009 RMD has been satisfied*. Under the RMD rules, the first distribution that occurs after RMD for prior years have been distributed is the 2009 RMD.

  Example:
  Jane's 2008 RMD is $5,000
  Her 2009 RMD is $4,000
  She did not take her 2008 RMD until 2009.
  She made the following distributions during 2009.
  $2,000 on January 2
  $3,000 on April 2
  $4,000 on June 16, and
  $7,000 on July 1

  The $2,000 plus the $3,000 (total $5,000) is her 2008 RMD. Her 2009 RMD is $4,000, because it was distributed after she withdrew her 2008 RMD, and it is the first distribution that occurred after she withdrew her 2008 RMD. The $7,000 is not her 2009 RMD, because it was not the first distribution that she made after she withdrew her 2008 RMD amount. If she had withdrawn more than $4,000 on June 16, only $4,000 of that amount would be her 2009 RMD, because amounts in excess of the RMD amount are not RMDs.

Amounts in excess of the 2009 calculated RMD amounts are not eligible for the exceptions under Notice 2009-82 and WRERA.

Rollover Relief for 2009 RMDs

Distributions paid to a participant in 2009 will be treated as an eligible rollover distribution, providing the following requirements are satisfied:

- The amount satisfies the requirements to be an eligible rollover distribution. The fact that the amount may have been withdrawn under the assumption that it would satisfy the 2009 RMD would not violate this requirement, since the RMD for 2009 is waived and the amount therefore, is *technically* not an RMD,
- The amount represents one or more payments in a SO-SEPP distribution from an employer plan that includes the 2009 RMDs. In this case, the SO-SEPP must continue for at least 10-years and should not be confused with the SO-SEPP distributions under which the 10% early distribution penalty is waived.

Extension of the 60-Day Rollover Deadline

Considering that participants may have been unsure or unaware that these amounts are rollover eligible, the IRS has extended the 60-day deadline for completing the rollover to November 30, 2009. If the 60-day period goes beyond November 30, 2009, then the later date applies. This extension does not apply to amounts in excess of what would have been the 2009 RMD amount.

Plans to Which the Rollovers can be made

The rollover eligible amount can be rolled over to:

- A traditional IRA (including a SEP IRA), if the distribution was made from an employer plan, traditional IRA, SEP IRA, or SIMPLE IRA that has met the SIMPLE IRA two year requirement.
- An employer plan, if the distribution was made from an employer plan, traditional IRA, SEP IRA, or SIMPLE IRA that has met the two year requirement, providing the employer plan allows for the rollover[vi]. The receiving employer plan can be the same plan from which the amount was distributed, if the plan permits such rollovers.
- A Roth IRA, if the distribution was made from an employer plan or a traditional IRA, SEP IRA, or SIMPLE IRA that has met the two year requirement. In such cases, the amount would be included in the individual's ordinary income for 2009. Additionally, since this would be a Roth conversion or a rollover from an employer plan, the transaction is permissible only if the individual's modified adjusted gross income (MAGI) is $100,000 or less and his tax filing status is not married-filing-separately.

One Year Extension for Beneficiary Distribution Election

- **Extension to Choose between Life Expectancy and Five-year Rule**
  While the default election for a beneficiary who inherits a retirement account from a participant who dies before the RBD is the life expectancy option, some plan documents permit the employee or beneficiary to elect whether the 5-year rule or the life expectancy rule applies. Such an election must generally be made by December 31 of the year following the year in which the participant dies, or December 31 of the 5th year that follows the year in which the participant dies, whichever is earlier[vii]. For beneficiaries who inherited retirement accounts in 2008 and are required to make such an election by December 31, 2009, the deadline has been extended to December 21, 2010.

  Example:
  John died in 2008 at the age of 50. His sister, Jean, was the beneficiary of his retirement account.
  Under the terms of the plan document, Jean would have been required to make an election to take distributions under either the life expectancy rule or the five-year rule, by December 31, 2009, had the 2009 RMD waiver not applied. However the 2009 RMD waiver extended the deadline by one year, which means Jean has until December 31 2010 to make the election.
- **Extension to Complete Rollover to Avoid Five-year Rule**
  Effective for plan years beginning January 1, 2010, an employer plan is required to allow a nonspouse beneficiary to rollover inherited amounts to an Inherited IRA. For plan years that begin before January 1, 2010, offering this feature is optional[viii]. If a plan offers this option and the beneficiary is subject to the five-year rule, the beneficiary can switch to the life-expectancy rule, providing the rollover is made to the Inherited IRA by December 31, of the year that follows the year in which the participant dies[ix]. In cases where the participant died in 2008, the deadline for completing the rollover to enable

eligibility to use the life expectancy option has been extended for a year, to December 31, 2010.

Withholding Rules for 2009 RMD Amounts

If a rollover eligible distribution from an employer is paid to the participant, instead of being directly rolled over to an eligible retirement plan, the payer is generally required to withhold 20% for federal income tax from the taxable amount. However, any distribution amount, up to what would have been the 2009 RMD amount, is not subject to the 20% federal tax withholding. This is so because these amounts are not treated as rollover eligible distributions *for purposes of the tax withholding rules.*

The amount would be subject to the 10% optional withholding[x]. Additionally, if the participant was receiving distributions under a SO-SEPP taken for at least 10-years, and the distribution amount for 2009 exceeded his RMD, the entire distribution amount would be subject to the periodic-payment optional withholding rules.

When the Extension and Rollover Exception Does Not Apply

The extensions described under the "One Year Extension for Beneficiary Distribution Election", and the rollover waivers do **not** apply to the following:

- *The September 30 deadline for determining the designated beneficiary*. Where there are multiple beneficiaries for a retirement account, the age of the oldest beneficiary is used to calculate post-death RMD amounts, if separate accounting does not occur by December 31 of the year following the year of death. Beneficiaries who have either distributed or disclaimed their share by September 30 of the year following the year the participant dies are excluded when determining the oldest beneficiary.
- *The October 31 deadline for providing the IRA Custodian or plan administrator with certain information.* If the beneficiary is a qualified trust, trust documentation, showing the designated beneficiary as of September 30 of the year follow the year of death, must be provided to the plan administrator or IRA custodian/trustee by October 31 of the year following the year of death. For an alternative to providing a copy of the trust, see http://www.retirementdictionary.com/definitions/qualifiedtrust
- *The deadline by which separate accounting must occur.* Where there are multiple beneficiaries for a retirement account, the age of the oldest beneficiary is used to calculate post-death RMD amounts, if separate accounting does not occur by December 31 of the year following the year of death.
- *The once-per-year rollover rule.* Only one distribution from an IRA can be rolled over during a one-year period[xi]. As such, if the RMD amount was taken in more than one payment from an IRA, only one of those payments that were made from that IRA can be rolled over. This imitation does not apply to distributions that are rolled over from a non-Roth IRA to a Roth IRA as a conversion, or distributions from non-Roth IRAs that are rolled over to employer plans.
- *Restrictions on rollovers by nonspouse beneficiaries.* If a non-spouse beneficiary takes a distribution from an inherited retirement account, the amount cannot be rolled over. This

restriction does not apply to direct rollovers of inherited amounts from employer plans to Inherited IRAs.

- *Restrictions on rollovers of after-tax amounts.* Distributions of after-tax amounts from IRAs cannot be rolled over to employer plans.

Extension and Rollover Also does not Apply to SO-SEPP 72(t) Payments

Distributions that occur before the participant reaches age 59 ½ are subject to a 10% early distribution penalty (additional tax) unless an exception applies. One exception is available under IRC § 72(t)(2)(A)(iv), and is referred to as a SO-SEPP. Under this exception, distributions are generally required to be taken under one of three IRS approved methods for five years or until the individual reaches age 59 ½, whichever is longer[xii]. One of these methods is referred to as the RMD method, because the amount is calculated in a manner similar to the way in which RMDs are calculated.

Some individuals were unsure of whether the WRERA RMD waiver provisions apply to these distributions. The IRS confirmed in Notice 2009-82 that neither the WRERA provisions, nor any of those under Notice 2009-82 apply to these payments. As such, if the amount required to be distributed in 2009 was not withdrawn, it would result in a modification, unless the distribution was not taken because the participant was disabled or deceased. When a modification occurs, the program is discontinued and the individual would owe the IRS all of the penalties that were waived for all distributions taken under the program, plus interest[xiii].

Guidance for Plan Sponsors on Amending Plan Documents for 2009 RMDs

According to Notice 2009-82, some plan sponsors were unsure of the effect of the RMD waiver on the operational provisions for their plan for reasons which included the following:

- Whether the absence of the RMD waiver language could adversely affect the operational compliance of their plan if they wanted to suspend RMDs for 2009
- If they wanted to give participants and beneficiaries the choice of whether to continue or stop 2009 RMDs, would their current plan language permit such a provision,
- If they were permitted to allow direct rollovers in the case of certain types of distributions that include 2009 RMDs ,particularly where a payment consists of a 2009 RMD amount and an additional amount that is an eligible rollover distribution, and
- Whether distributions that include 2009 RMDs can be rolled over even if such distributions would be SO-SEPPs without regard to the 2009 RMDs.

Sample Plan Amendments Provided

In response to these concerns, the IRS provided two sample amendments in Notice 2009-82. These sample amendments can be used by individual plan sponsors, sponsors of pre-approved plans, and also can be used when drafting individually designed plans. The amendments included the following features:

Common provisions

- Provide participants and beneficiaries the choice between receiving and not receiving distributions related to 2009 RMDs, but only if the distributions would otherwise be equal to the 2009 RMDs or be one or more payments in a SO-SEPP (that include the 2009 RMDs) made for a period of at least 10 years. All other distributions, including distributions that consist partly of 2009 RMDs, will be made. **For example**, a 75-year-old retiree's request to have his remaining plan account balance distributed in 2009 in a lump-sum, or in five approximately equal annual installments over a period that includes 2009, would not be affected by the sample amendments.
- Provide direct rollover choices (in addition to ones already provided for in the plan), with the default in each amendment being that the plan will offer a direct rollover option only for pre-WRERA eligible rollover distributions (i.e., a direct rollover option will not be offered for 2009 RMDs nor for amounts that can be rolled over solely due to the transition relief provided). One of these options provide for the direct rollover of 2009 RMDs and of other amounts that may be rolled over under the transition relief for plans provided in Section IV of this notice (the latter amounts referred to as "Extended 2009 RMDs" in the sample amendments). Another option provides for the direct rollover of the entire amount of a distribution but only where the distribution consists of part or all of a 2009 RMD amount and an additional amount that is an eligible rollover distribution without regard to 2009 RMD amounts

Different Provisions for Default Elections

- The first sample amendment provides that the plan default that applies in the absence of a participant's or beneficiary's election will be to pay out distributions that include 2009 RMDs. The second sample amendment provides that the plan default that applies in the absence of a participant's or beneficiary's election will be to **not** pay out distributions that include 2009 RMDs.

In either amendment, the first blank should contain the section of the plan dealing with RMDs, and, if applicable, the section of the plan dealing with other distributions. The second blank should contain the section of the plan dealing with direct rollovers.

Plans Sponsor Options for Amendments

The plan sponsor may choose either of the amendments, and is allowed to modify the language so that it conforms to the plan's terms and administrative procedures. The following applies:

- The amendment must be adopted no later than the last day of the first plan year beginning on or after January 1, 2011 (January 1, 2012 for governmental plans),
- The amendment must reflect the operation of the plan to either cease or continue distributions that include 2009 RMDs in the absence of a participant's or beneficiary's choice,
- The timely adoption of the amendment must be evidenced by a written document that is signed and dated by the employer (including an adopting employer of a pre-approved plan).

- The amendment (as modified, if necessary, to conform to the plan's terms and administrative procedures) will not result in the loss of reliance on a favorable opinion, advisory, or determination letter
- The IRS will not treat the adoption of one of the sample plan amendments (as modified, if necessary, to conform to the plan's terms and administrative procedures) as affecting the pre-approved status of a master and prototype (M&P) or volume submitter plan, and therefore will not cause the plan to fail to be an M&P plan. Similarly, such an amendment to a volume submitter plan that is adopted by an employer will not cause the plan to fail to be a volume submitter plan.

When amending the plan to include the language from the sample amendment, the plan sponsor may incorporate the language within the plan document, and adoption agreement if any. Plan sponsors of plans that do not use an adoption agreement may modify the format of the amendment to incorporate the appropriate adoption agreement options in the terms of the amendment. In such cases, the notes in the adoption agreement portion of the sample amendment should not be included in the amendment that will be signed and dated by the employer.

Transition Relief for Plan Operations

Understanding that WRERA was enacted late in 2008, and also because plan sponsors were unsure of the options that were available to them, the IRS will not treat a plan as failing to satisfy the requirement that it be operated in accordance with its terms merely because, during the period beginning on January 1, 2009, and ending on November 30, 2009:

1) Distributions that equal the 2009 RMDs or that are one or more payments in a series of substantially equal distributions (that include the 2009 RMDs) made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancy) of the participant and the participant's designated beneficiary, or for a period of at least 10 years were or were not paid,
2) participants and beneficiaries were not given the option of receiving or not receiving distributions that include 2009 RMDs, or
3) a direct rollover option was or was not offered for 2009 RMDs or for other amounts that can be rolled over pursuant to the rollover relief provided in the following paragraph.

IRA Amendment Not Required

Traditional IRAs, SEP IRAs, SIMPLE IRAs and Roth IRAs are not required to be amended for the 2009 RMD waiver, unless guidance requiring such amendment is issued in the future.

Additional information can be found in Notice 2009-82

Appendix : Section 401(a)(9)(H) Sample Amendments

Default to continue 2009 RMDs

For use by plan sponsors that want to give participants and beneficiaries an election between receiving and not receiving distributions that include 2009 RMDs and where the default that applies in the absence of a participant's or beneficiary's election will be to continue making distributions that include 2009 RMDs.

Notwithstanding section __________ of the plan, a participant or beneficiary who would have been required to receive RMDs for 2009 but for the enactment of section 401(a)(9)(H) of the Code ("2009 RMDs"), and who would have satisfied that requirement by receiving distributions that are (1) equal to the 2009 RMDs or (2) one or more payments in a series of substantially equal distributions (that include the 2009 RMDs) made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancy) of the participant and the participant's designated beneficiary, or for a period of at least 10 years ("Extended 2009 RMDs"), will receive those distributions for 2009 unless the participant or beneficiary chooses not to receive such distributions. Participants and beneficiaries described in the preceding sentence will be given the opportunity to elect to stop receiving the distributions described in the preceding sentence. In addition, notwithstanding section __________ of the plan, and solely for purposes of applying the direct rollover provisions of the plan, certain additional distributions in 2009, as chosen by the employer in the adoption agreement, will be treated as eligible rollover distributions.

If no election is made by the employer in the adoption agreement, a direct rollover will be offered only for distributions that would be eligible rollover distributions without regard to section 401(a)(9)(H).

(Adoption agreement provision)

Direct Rollovers:

For purposes of the direct rollover provisions of the plan, the following will also be treated as eligible rollover distributions in 2009:

(Check one or none.)

_____2009 RMDs and Extended 2009 RMDs (both as defined in the plan).

_____2009 RMDs (as defined in the plan) but only if paid with an additional amount that is an eligible rollover distribution without regard to section 401(a)(9)(H).

___________________________________ Name of Employer

By: Signature Date

Name and title

Default to discontinue 2009 RMDs

For use by plan sponsors that want to give participants and beneficiaries an election between receiving and not receiving distributions that include 2009 RMDs and where the default that applies in the absence of a participant's or beneficiary's election will be to discontinue making distributions that include 2009 RMDs.

Notwithstanding section __________ of the plan, a participant or beneficiary who would have been required to receive RMDs for 2009 but for the enactment of section 401(a)(9)(H) of the Code ("2009 RMDs"), and who would have satisfied that requirement by receiving distributions that are (1) equal to the 2009 RMDs or (2) one or more payments in a series of substantially equal distributions (that include the 2009 RMDs) made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancy) of the participant and the participant's designated beneficiary, or for a period of at least 10 years ("Extended 2009 RMDs"), will not receive those distributions for 2009 unless the participant or beneficiary chooses to receive such distributions. Participants and beneficiaries described in the preceding sentence will be given the opportunity to elect to receive the distributions described in the preceding sentence. In addition, notwithstanding section __________ of the plan, and solely for purposes of applying the direct rollover provisions of the plan, certain additional distributions in 2009, as chosen by the employer in the adoption agreement, will be treated as eligible rollover distributions.

If no election is made by the employer in the adoption agreement, a direct rollover will be offered only for distributions that would be eligible rollover distributions without regard to section 401(a)(9)(H).

(Adoption agreement provision)

Direct Rollovers:

For purposes of the direct rollover provisions of the plan, the following will also be treated as eligible rollover distributions in 2009:

(Check one or none.)

_____2009 RMDs and Extended 2009 RMDs (both as defined in the plan).

_____2009 RMDs (as defined in the plan) but only if paid with an additional amount that is an eligible rollover distribution without regard to section 401(a)(9)(H).

___________________________________ Name of Employer

By: Signature Date

Name and title

[Note to Sponsor: In either amendment, the first blank should contain the section of the plan dealing with RMDs (and the section of the plan dealing with other distributions, if applicable) and the second blank should contain the section of the plan dealing with direct rollovers.]

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[i] Worker, Retiree, and Employer Recovery Act of 2008

[ii] For the purpose of this text, 'employer' plan means defined contribution plans, 403(b) plans, governmental 457(b) plans and 403(a) annuity plans

[iii] The 5% owner rule does not apply to 403(b) plans

[iv] Under the life expectancy option, distributions are taken over the life expectancy of the beneficiary

[v] IRC§ 408(d)(3)(E)

[vi] Rollovers from IRAs to employer plans cannot include after-tax amounts.

[vii] Treas Reg §1.401(a)(9)-3, A-4(c),

[viii] IRC §402(c)(11)

[ix] IRS Notice 2007-7, A-17(c)(2)

[x] Under the 10% optional withholding rule, the participant can elect to have no taxes withheld, or chose to have 10% or more withheld for federal income tax.

[xi] IRC§ 408(d)(3)

[xii] Notice 89-25 and Rev. Rul. 2002-62

[xiii] IRC § 72(t)(4)