

Employee Benefits & Executive Compensation ADVISORY

December 12, 2008

MRD Relief – What It Means and Why Is It Important to Your Retirees Now

If you administer a defined contribution retirement plan (like a 401(k) plan) you may have many retirees who have a problem between now and December 31. We anticipate some “relief” from the IRS and Treasury Department in the next few weeks. If you act now, that relief may help your retirees. If not, they may miss an opportunity and sustain painful losses.

What Does “MRD” Mean and Why Is Relief Needed?

Section 401(a)(9) of the Internal Revenue Code requires retirees over the age of 70½ to take “minimum required distributions” (or “MRDs”) from their defined contribution retirement plans. If the retiree fails to take a required MRD, there is an excise tax of 50% on the amount that should have been withdrawn. A retiree who is over age 70½ must take the MRD out of the plan by December 31.

Why is this a problem? Suppose you are an 80 year old retiree. On December 31, 2007 your account balance was \$1,000,000 and you believed this would be sufficient to carry you through your retirement. Your “life expectancy” is 10 years¹ so you are required to withdraw one-tenth of your account balance by December 31, 2008.

The problem is that your “one-tenth” is based on your account balance on December 31, 2007. That means you have to withdraw \$100,000. Due to the current market meltdown, your account is now only \$400,000, so taking a withdrawal of \$100,000 means depleting your account by 25% (which you can’t afford to do because you plan to live more than 4 more years) and it means liquidating your securities at what, we all hope, is the bottom of the market.

In addition to the 50% excise tax on the retiree, the plan is required to make the MRD in order to preserve its qualified status.

What Do You Do?

The IRS and Treasury have indicated they intend to issue relief within the next few weeks. Obviously, this will be too late for anyone who initiates a withdrawal now, knowing that it takes some time to process a distribution. Also, at this time, we do not know what relief will be available for 2008. Our belief is that, most likely, the IRS will allow the retiree to take out 10% of \$400,000 rather than 10% of \$1,000,000. This would be a significant help.

As of now, probably the best advice is to hold off on MRDs until the last possible minute, or until MRD relief is published. As events unfold, we will do our best to keep you informed.

This advisory was written by David Godofsky (202.756.3392).

¹ Actually, according to the IRS, it’s 10.2 years, but we’re going to call it 10 to make the numbers easier to follow.

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