

The PRS Report

Qualified Plan Distributions: Your TPA - Invaluable During The Distribution Process

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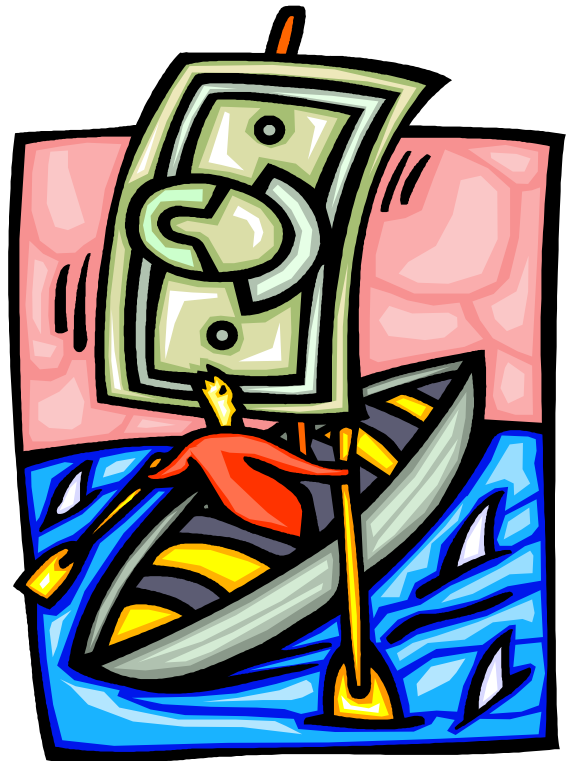
**QUALIFIED PLAN
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Why involve the TPA (Third Party Administrator)?

In the highly regulated world of pension plans, a plan sponsor should tread with caution when making distributions to participants from a qualified plan. (For purposes of this newsletter, the term “distributions” refers to monies withdrawn from a plan (other than loans) for the benefit of a participant, whether rolled over or not.) Unfortunately, some plan sponsors view their pension plan as one views car repairs – if something seems easy enough to do on your own then why ask for help? This approach is fraught with danger. When receiving a request from a participant to receive a distribution from the plan, **contact your TPA to guide you through the process to maintain the qualification of the Plan.** IRS regulations regarding distributions from pension plans are both numerous and complex. Plan distributions are a popular target for audits! Below are some of the areas the TPA will guide you through to “get it right.”

Determination of Eligibility

Although this step may seem simple enough, when a participant requests a distribution from plan assets, it must first be determined whether the participant is eligible to receive such a distribution. A Plan making a distribution to a participant who is not eligible for



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one is not being operated in accordance with its terms (a cause for disqualification). And the IRS has mandated several restrictions before assets can be paid depending upon the type of qualified plan. For example, a 401(k) plan cannot distribute elective deferrals prior to a termination of employment except under certain limited circumstances. Participants who have access to their accounts (e.g. allowed to direct the investment of the accounts) should not have the ability to withdraw money directly from the Plan.

The Amount to Distribute

The amount of the distribution to which the participant is entitled needs to be calculated, and for all but 401(k) accounts, which are 100% vested, the vested percentages must be part of that calculation. For defined contribution plans, it may also be necessary to consider if allocations for a prior year need to be taken into account. Paying either too much or too little to a participant can require complex correction, increasing the administrative costs of the Plan as well as potential penalties upon audit.

Distribution Forms

The IRS requires that specific paperwork be completed and signed by a participant before a distribution can occur. This paperwork includes an election form on which the participant elects the form of the distribution and how it is to be distributed (e.g. rolled over or not). The participant must be informed of his or her estimated benefits payable under the various forms of benefit available in the plan. Depending upon the plan's provisions and the type of plan, the spouse's signature may be required in the presence of a notary. Upon audit, more often than not, the IRS will request to see copies of the signed distribution paperwork. In the absence of such paperwork, or if the paperwork is deficient, penalties can be assessed to the plan sponsor. Some asset vendors can provide distri-



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tribution forms; however, these forms often do not satisfy all the IRS requirements for distributions. Therefore, even with an asset-vendor provided distribution form, it is essential to use the TPA to direct you through the process.

Income Tax Issues

Prior to the payment of the distribution, it must be determined if any and how much income tax MUST be withheld, or is desired to be withheld from the distribution. The TPA can inform the Plan Sponsor and the participant of such amounts and the payment options available. Examples of possible income tax/withholding tax issues include: (1) if the participant has left employment and is over age 70½, a portion of the distribution may not be eligible to be rolled over, (2) mandatory withholding of 20% must be remitted to the IRS for lump sum distributions that are not rolled over, and (3) 401(k) pre-tax and roth deferrals may be treated differently upon distribution. Incorrect distributions and withholding may trigger excise taxes for both the plan sponsor and the participant.

Regardless of how a distribution is taken, a Form 1099-R must be prepared and given to the participant (generally by January 31 following the year of distribution) to include with his tax return.

Impact On Future Contributions

Another reason to involve your TPA in the distribution process is that the TPA should be assessing the impact of terminating participants on the design of the Plan. For example if the Plan's demographics change, does the design of the Plan still allow for the skewing of the company's contributions in favor of the owner(s)?



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Conclusion: Involve Your TPA

As TPA, it is our job to make the distribution process as easy and painless as possible for our clients. Note: Plan termination does not eliminate these steps! Consulting with your TPA is a crucial and necessary step in the distribution process for plan sponsors. By following our instructions, clients can rest assured that distributions are made in compliance with IRS regulations, that distributions are made in the correct amounts and that there are no overlooked steps in the distribution process. We charge a modest fee for the preparation of a distribution package, which includes all these checks and balances. Trying to bypass your TPA in order to save this fee may be penny wise but is surely pound foolish. The distribution process is often examined during an audit, which, if not done properly, can lead to penalties for both Sponsors and plan participants.



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