From the desk of
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"Still Working" Exception to Retirement Plan Age 70 1/2 rule

In most cases participants in qualified retirement plans must begin taking required minimum distributions (RMDs) from the plan no later than April 1 of the year after which they turn 70 1/2.

An exception applies to certain plan participants who are still working for the entire year in which they turn 70 1/2.

Under the qualified pension, profit-sharing, and stock bonus plan required minimum distribution rules, benefits must be distributed or commence being distributed by the required beginning date (RBD).

An employee's RBD for receiving distributions from a qualified plan is April 1 of the year following the later of the calendar year the employee

1. Reaches age 70 1/2 or
2. Under the "still working" exception retires from employment with the employer maintaining the plan. (Code Sec. 401(a)(9)(C)(i); Reg §1.401(a)(9)-2, Q&A 2)

The above rule does not apply to distributions from IRAs (including those established in conjunction with a SEP or SIMPLE IRA plan) and distributions from qualified plans to more-than-5% owners.

Such distributions must begin no later than April 1 of the year following the calendar year such individual turns age 70 1/2 (even if not retired). (Code Sec. 401(a)(9)(C)(ii); Reg. § 1.408-8, Q&A 2 and Reg. §1.408-8 Q&A 3).

Once begun required minimum distributions must generally continue each year.

Individuals are 5% owners if they directly or constructively own more than 5% of any of the employers maintaining the plan for the plan year ending within the calendar year the individual reaches age 70 1/2. (Code Sec. 401(a)(9)(C)(ii))

What is the calendar year the employee retires?

The still-working rule causes the required beginning date to be April 1 of the year following the year the employer retires from employment with the employer maintaining the plan.

When is an employee considered to be still working? When is he considered to have retired? There appears to be no official IRS position on this question.

For example there is no requirement that one work 40 hours a week in order for the exception to apply.

As long as a person is considered to be an employee under the Code (see, for example, Code Sec. 3121(d)(2)), that person is "still working" for the purpose of the still-working exception (even if the ongoing work is part time).

Also note that any taxpayer retires in a given calendar year unless he works at least one day in the following year.

A taxpayer who is older than 70 1/2 who has no intention of retiring but is laid off in a given year by employer A must begin RMDs from the employer A plan in the next calendar year because the still-working exception only applies if the taxpayer is still working for the employer maintaining the plan.

That employee could then get a job with employer B and then use the still-working exception with respect to employer B's plan.

The still-working exception applies only to the current employer's retirement plan accounts and not any other retirement accounts; thus, 401(k) plans with former employers are still subject to RMDs upon reaching age 70 ½.

An employer plan can require RMDs to begin before the Code-provided RBD and thus prevent the taxpayer from taking advantage of the still-working rule.

The 5% owner test

While the Internal Revenue Code uses the term "5% owner", the definition of that term applies a *more-than-5%* owner.

The 5% test is a one-time test.

The test only applies to the plan year that ends in the calendar year in which the employee attains age 70 1/2. (Code Sec. 401(a)(9)(C)(ii)(I))

One planning technique is to reduce one's ownership in the entity for that plan year, and continues to work.

A 5% owner is any person who owns more than 5% of the stock of a corporate employer. (Code Sec. 416(i)(1)(B)(i)(I))

If the employer is not a corporation a 5% owner is any person who owns more than 5% of the capital or profits interest in the employer. (Code Sec. 416(i)(1)(B)(i)(II))

An employee is treated as owning stock owned by certain members of his family or, in certain cases, by the partnerships, estates, trusts, or corporations in which he has a 5% interest under the constructive ownership rules of Code Sec. 318. (Reg § 1.416-1, Q&A T-16; Reg § 1.416-1, Q&A T-17).

In the case of a non-corporate entity "capital or profits interest" must be substituted for "stock". (Reg § 1.416-1, Q&A T-18).

For purposes of determining whether an individual is a 5% owner of the employer the aggregation rules for controlled groups of corporations, partnerships, proprietorships, or affiliated service groups do not apply. (Code Sec. 416(i)(1)(C))

The family member rules apply to stock owned by a spouse, children, grandchildren, and parents (though not siblings, cousins, aunts/uncles, and nieces/nephews).

Planning

Roll in amounts from his other retirement plans and/or IRAs to his current employer's plan

A taxpayer can delay the RBD on his retirement plans from previous employers, from self-employed plans and from IRAs by rolling the amounts in those plans into his current employer's plan.

To fully avoid having any RMDs until the employee separates from service in the future complete these roll-ins before the year that the employee turns 70 1/2.

Any RMDs for the old plans with respect to the age-70 1/2 year must be taken before doing the roll-in. However in future still-working years, RMDs will be delayed with respect to the now-larger full balance in the current employer's plan.

This roll-in strategy is only possible if the employer retirement plan actually allows employees to roll in outside accounts (as not all of them do).

In addition under Code Sec. 402(c)(2) only pre-tax dollars can be rolled into a 401(k) plan, and not after-tax dollars; as a result, any after-tax contributions that were previously made to an IRA must remain behind in the IRA.

Become a part-time employee rather than a retiree

As noted above as long as a taxpayer is a part-time employee he/she qualifies for the still-working exception.

Such a scenario could conceivably cause some suspicion by the IRS in that the taxpayer might not truly be working, but such suspicion would be minimized if the employer is not a related party (which is generally the case because of the 5%-owner rule) and the employer is actually paying the taxpayer a salary.

Reduce 5% ownership

If the taxpayer is a 5%-owner and is considering selling all or part of his ownership it maybe practical to continue at least part-time employment in the business after that sale, sell enough of the ownership so that he isn't a 5%-owner with respect to the plan year ending in the calendar year in which he attains age 70 1/2.

Conceivably the purchaser with respect to that sale could be the business itself if that sale results in an ownership interest of 5% or less.

Consider Possible Disadvantages

Taxpayers should also consider the possible disadvantages of delaying their RBD using the still-working exception.

One might face restrictions in the plan that would not apply to the IRA from which they rolled over.

Taking RMDs later means taking larger RMDs.

Larger RMDs can mean higher tax brackets.

Social Security income could be taxed, and the taxpayer could lose out on deductions, credits, exemptions and/or phase-outs.

There is a lot to consider for those who want to continue working, and avoiding the Required Minimum Distribution rules, but with the correct planning, it can be accomplished.

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