Tax law changes could affect retirement

finances and you

Sid Mittra

The proposed tax law has created tremendous interest in retirement plan distribution under the new law. In a three-part article we will explore this issue.

Basic Distribution Rules

Withdrawals prior to age 59½. You can make withdrawals from a company retirement plan before you become 59½ without paying a penalty tax. However, retirement plan participants who own 5 percent or more of the company must pay a 10-percent penalty tax on any withdrawals prior to 59½.

You can withdraw part or all of your vested interest in the plan without paying a penalty, even if you own more than 5 percent of the company.

One important warning: A retirement plan is not required to permit withdrawal during employment. Even those plans that do permit withdrawals may impose a penalty to discourage employees from withdrawing money before retiring.

Withdrawals at age 70½. As a general rule, your entire interest in the plan must be distributed by April 1 of the year after the year in which you reach 70½ or retire, whichever is later.

There are two ways in which your plan money can be distributed.

First, a plan can distribute benefits in the form of an annuity over your life (or the joint lives of you and your designated beneficiary, including someone who is not your wife).

Second, the plan can make installment payments over a period of time no longer than your life expectancy, or joint life expectancies. Your life expectancy (or joint expectancy of the employee and spouse) can be redetermined once a year.

There can be no redetermination in the case of a life annuity. Annual redeterminations assure a lifetime stream of retirement benefits.

However, the present value of payments projected to be paid to you during your life must be more than 50 percent of the present value of all payments.

Distribution Upon Employee's Death

How soon after the death of an employee the plan must distribute benefits depends on whether distributions began before death. If the distributions did not begin before death, the distribution of benefits must be completed within five years after death.

One exception is that any portion of your interest that is payable to a designated beneficiary can be paid over the life expectancy of the beneficiary. The distribution must, however, generally begin one year after the death of the employee.

If the designated beneficiary is the spouse, the payment does not have to begin until the April 1 after the year the employee would have reached 70½. The payment can then be over the life expectancy of the spouse.

If the spouse dies before the payments begin, the benefits must be paid out within the one-year and five-year rules mentioned above. If the distribution did begin before the employee's death, the payout of remaining benefits can be longer than five years.

The payouts need only continue as per the payout schedule in effect prior to death.

Educational seminar: "Impact of Proposed Legislation on Your 1986 Investment, Tax and Retirement Planning." The seminar, sponsored by Observer & Eccentric Newspapers and Coordinated Financial Planning Inc., will be held at will be held 7-9:30 p.m. Thursday, Sept. 11. To register, call 643-8888.

Sid Mittra is director of certificate program in personal finance at Oakland University and president of Coordinated Financial Planning Inc.