Plan Sponsor

Digest

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Your Challenge, Our Solutions™

A checklist for plan sponsors

Plan sponsors should periodically review their plans' provisions and features to ensure the plan continues to operate at maximum effectiveness.

Once a retirement savings plan has been approved and is in place, it's tempting to sit back and adopt an "I'm done," hands-off attitude. However, to ensure that a plan will continue to operate effectively, employers should periodically review plan provisions and features. Here are some points to check.

- **How the plan is presented.** The more convinced employees are of the wisdom of saving for retirement, the greater the level of employee participation. The greater the participation, the more the plan can benefit all employees -- including highly compensated ones. Regular meetings, newsletters, and handouts are effective means of communicating plan advantages. Check to make sure printed materials are up to date and easy to understand, and distribute them frequently.
- **Plan investments.** Employers that sponsor participant-directed plans can limit potential legal liability for losses caused by employees' investment decisions if plan investment choices meet certain requirements under Section 404(c). Very generally, where 404(c) protection is sought, a plan should offer at least three "core" investment choices, allow employees to switch investments at least once each quarter, and provide participants with adequate disclosure of specified investment information.
- **Administration.** Participants and beneficiaries must be given a copy of the Summary Plan Description (SPD) within 120 days after a plan is adopted or within 90 days after becoming eligible to participate in the plan or receive benefits. Review the SPD to make sure it accurately describes the provisions of your plan. If changes have been made to the plan document -- which is likely, given the recent tax law changes -- then all participants must receive a notification of these changes within 210 days after the end of the plan year in which the changes were adopted. Generally, all participants must receive a copy of the SPD every five years.
- **Summary annual reports (SARs).** Summary annual reports must be distributed to participants within nine months after the close of the plan year. If a plan receives an extension to file its annual report (Form 5500) with the IRS, then the SAR must be distributed within two months after the end of the extension.
- **Plan rollovers.** Qualified plans must allow a participant to elect direct rollover of any eligible distribution to an IRA or another employer-sponsored retirement plan. Your plan should have procedures in place to handle direct rollovers.
- **Bonding.** Generally, plan fiduciaries and others who handle the assets of a plan must be bonded. The bond must be equal to at least 10% of the funds handled by the bonded individual, but cannot be for less than $1,000 and need not be for more than $500,000.
- **Loans to participants.** Loans that are not properly administered may be treated as constructive distributions resulting in taxable income to the recipients. Review loans to make sure that loan balances do not exceed the maximum limitations. Unless used to finance the purchase of a principal residence, all loans must be repaid within five years. A plan may impose more stringent conditions on loans than the law requires.
- **Plan forms.** All forms should meet current requirements. Forms that may need updating include beneficiary designation forms, benefit election forms, and the notice of distribution options.

Correcting missed required minimum distributions

Internal Revenue Code (IRC) Section 401(a)(9) requires every qualified plan to provide required minimum distributions (RMDs) as soon as a participant reaches his or her required beginning date (RBD) and annually by every December 31 thereafter. Generally, the RBD is April 1 of the calendar year after the participant reaches age 70½, though it may be later if a non-5% owner continues to work after age 70½. If an individual worked at seven jobs during his or her career and left money in seven different 401(k) plans, each plan is required to distribute RMDs to the individual. In the event of a participant's death, the plan is required to follow the minimum distribution requirements for beneficiaries.

Failure to distribute an RMD may result in plan disqualification and/or the imposition of a 50% excise tax on the participant or beneficiary. This article will explain the correction process that is available when a qualified plan fails to timely distribute an RMD.

Missed RMDs from qualified plans

Mistakes can happen. For example, an employee's date of birth may be incorrectly recorded in the recordkeeping system, inadvertently causing the employer and plan administrator to be unaware of the year that the employee attained age 70½. Or an employee's data may have been lost in an implementation, merger, or acquisition.

Upon discovery of a missed RMD, all appropriate steps should be taken to remedy the situation as soon as possible. Specifically, RMDs should be calculated for all years since the participant attained age 70½ and, to the extent the RMDs were not distributed, immediately distributed along with calculated earnings. If the employer files under the IRS's Voluntary Correction Program (VCP), the employer may request that the IRS waive the excise tax imposed on the missed RMDs.

Excise tax

As noted, a participant or beneficiary who does not receive a full RMD for a distribution calendar year is subject to an excise tax of 50% on the underpayment pursuant to IRC Sec. 4974. For example, assume an RMD is calculated to be $3,200 for 2017, but the participant received only $2,000. The underpayment of $1,200 is subject to the 50% penalty, so a penalty of $600 must be added to the participant's taxes due for 2017. The $1,200 still has to be withdrawn, subject to income taxes (assuming the entire distribution consists of pretax funds). The participant files IRS Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, with his or her federal income tax return for the year in which the error occurred.

Asking for waiver of the 50% penalty due to reasonable cause

If there was a reasonable cause for the failure to take the RMD, the individual may ask for the penalty to be waived on Form 5329. The IRS will review the information provided and decide whether to grant the request for the waiver.

Automatic waiver for certain beneficiaries

An automatic waiver may be available in situations where an individual is the sole beneficiary of a participant's benefit or of a separate share. If the amounts are payable under the life expectancy method and a payment is missed during the first five years, the excise taxes are waived if the total death benefit is paid under the five-year rule.

Correcting RMD failures using the Employee Plans Compliance Resolution System (EPCRS)

The EPCRS provides a streamlined procedure for correcting missed RMDs using Form 14568-H: Schedule 8 (Failure to Pay Required Minimum Distributions Timely). As part of the VCP submission, the plan sponsor is able to request the waiver of the participant level excise tax imposed under IRC Sec. 4974.

Correction includes distribution of missed RMDs plus earnings

In a defined contribution plan, the permitted correction method is to distribute the missed RMDs with earnings from the date of the failure to the date of the distribution. If more than one year's RMD has been missed, the amount required to be distributed is the RMD for each year, starting with the year in which the initial failure occurred. Amounts are determined by dividing the adjusted account balance on the applicable valuation date by the applicable distribution period and then calculating the earnings for each missed RMD.

Example: A defined contribution plan missed an individual's RMDs for 2015, 2016, and 2017.[1]

For 2015:

- Suppose the fair market value (FMV) on December 31, 2014 was $100,000.
- The missed RMD for 2015 would be $100,000 ÷ 25.6 (age 72) = $3,906.25

For 2016:

- Suppose the FMV on December 31, 2015 was $108,000
- The missed RMD for 2016 would be 108,000 - $3,906.25 ÷ 24.7 (age 73) = $4,214.32

For 2017

- Suppose the FMV on December 31, 2016 was $115,000
- The missed RMD for 2017 would be $115,000 - $3,906.25 - $4,214.32 ÷ 23.8 (age 74) = $4,490.73

Source/disclaimer:

1Example is hypothetical. Your results will vary. Gains/losses are calculated on each RMD from the date the funds should have been distributed until the actual distribution date.

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