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Defined Contribution Legislative and Regulatory Update

DECEMBER 2016

We are committed to providing you with the information and tools you need to help meet your fiduciary responsibilities as a plan sponsor and to offer your employees an exceptional retirement plan. This newsletter is designed to inform you about the latest legislative and regulatory developments that may affect your plan.

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From the Hill

Pension reform efforts

In September, pension reform became a major topic of conversation in the Senate Finance Committee. On September 8, Senator Ron Wyden (D-Ore.), the ranking Democrat on the Senate Finance Committee, released a discussion draft of legislation. The Retirement Improvements and Savings Enhancement (RISE) Act would address perceived abuses of Roth IRAs and encourage lower-income workers to save more for retirement. Later in the month, the committee marked up the Retirement Enhancement and Savings Act (RESA) legislation that included a number of reforms that have enjoyed broad bipartisan support. RESA was formally introduced on November 16.

It should be noted that pension reform is an issue where there is a level of broad bipartisan support, and there appears to be an appetite on both sides of the aisle to move forward.

Retirement Improvements and Savings Enhancement Act

- Roth IRAs would be limited to $5 million. If an individual had more than $5 million in a Roth IRA at the time the legislation became effective, that amount would be the limit. If at the end of the year the dollar limit was exceeded, no contribution could be made to the IRA and 50% of the amount in excess of the limit would have to be distributed.
- Conversion of pretax balances to Roth IRAs or Roth 401(k) accounts would no longer be allowed.
- Roth IRAs would be subject to the same required minimum distribution rules of traditional IRAs.
- Allow individuals over the age of 70½ to make contributions to traditional IRAs.
- In 2017, the Saver's Credit provides an up to 50% non-refundable tax credit on contributions to plans or IRAs, capped at $1,000. The credit is unavailable for joint filers making more than $62,000 in adjusted gross income, and single filers making more than $31,000. The RISE Act would make the credit refundable, but the refund would have to be deposited to a Roth 401(k) or a Roth IRA account. Plans would not be required to accept the contributions and if the recipient did not specify where the monies should be deposited, a MyRA would be established on their behalf.
- The age on required minimum distributions would be gradually raised. Currently set at 70½, it would increase to 71 for 2018 – 2022, 72 for 2023 – 2027 and 73 for 2028. The age would be adjusted in accordance with life expectancy changes after 2028.
- One of the more unique provisions of the RISE Act would be allowing plans to make matching contributions on student loan payments made by plan participants. Several rules apply:
  - — The amount of the student loan payment would not be considered a contribution for discrimination testing purposes, but the total amount matched for any participant could not exceed the 402(g) limit ($18,000 in 2017) taking into consideration both loan payments and any employee contributions to the plan.
  - — Matching contributions made on loan payments would be considered employer contributions for all purposes including discrimination testing.
  - — In order to receive the loan repayment match, the employee must be eligible to participate in the plan and the rate of the match must be the same as any matching on contributions.
  - — The employee must provide the employer with proof of student loan repayments.
  - — The loan repayment match must be available for all eligible employees.

It is important to note that this is currently a discussion draft. Senator Wyden may make revisions to it if it is officially introduced.

Retirement Enhancement and Savings Act

With RESA, members of the Senate Finance Committee were seeking to put together a package of non-controversial pension reform provisions. Many of the provisions were included in the committee's Bi-Partisan Tax Working Group Report from the summer of 2015. Actual legislative language was not included with the mark-up, so many of the details are not currently available. Key components include:

- Open Multiple Employer Plans (MEPs) was one of the centerpieces of the mark-up. A MEP is a plan maintained by unrelated employers. Under current law, these may only be offered if there is some common interest between the participating employers. As a result, they are typically offered by trade associations such as the American Bar Association. In addition, under IRS rules if a single participating employer has a disqualifying event, the entire MEP is deemed disqualified. RESA would remove the commonality requirements and apply any disqualification only to the employer who had the disqualifying event. Several rules must be met for an open MEP:
  - — The MEP must have a pooled plan provider (PPP). A PPP is a party named as a fiduciary under the plan that assumes responsibility for plan administration and must register with the DOL.
  - — Each participating employer retains fiduciary responsibility for the selection and monitoring of the PPP.
  - — The open MEPs would not become effective until 2020 and are scored at a cost of $3.2 billion over ten years.
- In order to keep RESA revenue neutral, it was necessary to come up with offsetting revenue for the open MEP provision. The committee achieved this by placing limits on stretch IRAs. Under current law, the beneficiary to an IRA could take the after-death required minimum distribution-based distributions based on their life expectancy. If the beneficiary were significantly younger than the IRA holder, this would stretch the distribution stream. Under RESA, the IRA would be required to be paid out within five years of the original IRA holder's death. There are a few exceptions:

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— The aggregate value of all IRAs and plan assets must be greater than $450,000

— The five-year payout is not required if the beneficiary is an eligible beneficiary defined as:

- The surviving spouse
- A minor child
- A disabled individual
- Someone who is chronically ill
- The beneficiary is not more than 10 years younger than the original IRA holder

- RESA would require benefit statements to include a lifetime income illustration. The illustration would be based on the participant's account balance and would be expressed as both a single and joint life annuity.
- A new fiduciary safe harbor would be established for the selection of annuity providers. Plan fiduciaries could rely on representations from insurers regarding their approved status under state law, and would be deemed to have met their prudence requirements.
- A new lifetime income portability provision was added to make it easier for plans to offer lifetime income options as part of their plan's investment lineup. There had been concern that if a plan had to discontinue offering a lifetime income option under the plan, the participant would be forced to cash out and would lose any annuity buildup. Under RESA, if a lifetime income option is no longer authorized as an investment option, this would be deemed a distributable event solely for the amounts held in that option. The participant could take a direct rollover to an IRA or other plan, or could receive the distribution in the form of an annuity contract.
- The start-up credit for small businesses would be expanded under RESA. Currently, employers with 100 or fewer employees can receive a non-refundable tax credit of up to $500 per year for three years to offset the cost of starting a new plan. The three-year credit would be increased to the lesser of $5,000 or the number of non-highly compensated employees multiplied by $250. If the small employer included automatic enrollment options in the plan, they would receive an additional $500 tax credit. The credits would continue to be non-refundable.
- The current automatic enrollment/automatic escalation safe harbor caps automatic acceleration at 10%. RESA would eliminate any automatic acceleration cap.

As was mentioned earlier, the goal of RESA was to find a package of non-controversial pension reform proposals. There is some thought that these proposals could be included in end-of-the-year legislation that the lame-duck congress might consider.

Practical implications

It has been ten years since the Pension Protection Act, the last major pension reform package, was signed into law. There appears to be an appetite to tackle a new round of pension-related issues. In addition, both the House Ways and Means Committee and the Senate Finance Committee have expressed interest in tax reform. While tax reform is a more difficult issue to get consensus on, it has also been a vehicle for pension reform.

At Empower, we are committed to working with policymakers to increase access to retirement savings and lifetime income solutions. We look forward to working with the Trump administration and the new Congress in making sure that American workers may achieve their retirement goals. We will keep you apprised of any developments.

Information on Empower's fiduciary rule implementation initiatives

The DOL's fiduciary rule has been coined by some as the most impactful change for those serving retirement savers since ERISA was passed. At Empower, we began our efforts toward compliance back in 2015, when the proposed rule was published, by creating numerous teams to address the rule's impacts on our products, services, communications, clients and those we coordinate with to sell and service retiree accounts. An initial set of recommendations was completed in June and for the past several months has gone through a vetting process with both internal and external audiences. This process is intended to ensure that the changes we make will support our mission of creating successful retirement outcomes for plan participants and being a valuable partner to those with whom we coordinate toward that end. Following are some key developments in our implementation efforts.

Call center and other participant communications

Many of these communications, whether delivered in person at enrollment meetings, on the phone, via the web or other electronic means or by mail will continue to be non-fiduciary and fall within the definition of education that is not fiduciary advice. We are reviewing and editing these communications as necessary to ensure that they do not include any fiduciary recommendations. We are also revising the training and monitoring processes for our employees who interact with participants so they will be prepared to keep their communications within the education definition.

There are some areas where we will not be able to provide the type of help we offer participants today without becoming a fiduciary, so we will accept fiduciary status for those communications. We intend to operate under the Best Interest Contract Exemption (BIC exemption) when offering these fiduciary services. We have identified distribution or roll-in and certain investment-related conversations as areas where we will accept fiduciary status. In doing so, we will enhance the model we already have in place today for providing fiduciary participant services. We are building a flexible approach so that we can readily re-categorize communications as fiduciary or not in response to additional DOL guidance, client feedback or other factors.

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Working with advisors and other intermediaries

Many of our implementation project teams are focused on the changes we need to make to support the impact of the rule on advisors and others with whom we work in selling to and servicing retirement savers. We are preparing to meet the demand for changes in compensation and payment preferences. We are taking steps to help those with whom we work to identify whether they may become a fiduciary and whether the Independent Fiduciary exception is available to them. We are also working with the financial institutions responsible for monitoring and documenting the compliance of their advisors to support the data collection and reporting they will need to fulfill those responsibilities.

Changes to products and services

While the rule will require some tweaks to our service model, we do not anticipate any decrease in services and remain committed to providing best-in-class service to our clients and business partners. We are reviewing all of our products to determine whether any changes are needed in response to the rule and will communicate any changes in a timely manner.

Looking ahead

Empower is on track to meet the April 10, 2017, deadline for general compliance and the January 1, 2018, deadline for certain BIC exemption requirements. At this time, we do not anticipate any changes to the deadlines resulting from the recent presidential election. We expect to make refinements after these deadlines as the DOL provides additional guidance and as we assess the impact of the changes we make. We will continue communicating with all those affected (plan participants and sponsors, advisors and other intermediaries, financial institutions, etc.) in the weeks and months ahead. If you have any questions or comments regarding our implementation plan, please ask your Empower retirement representative who will forward your question(s) to our project team.

DOL publishes fiduciary rule FAQs

On October 27, 2016, the Department of Labor (DOL) published the first of what it states will be part of a three-part series of Frequently Asked Questions (FAQs) on the new fiduciary rule. This first FAQ focuses on the prohibited transaction exemptions published with the rule, and in particular the BIC exemption. It does not address questions related to the rule itself. Following are some key issues addressed in the FAQ. The full document can be accessed here.

Advisor compensation practices

Under the BIC exemption, advisor compensation must be reasonable and any variable compensation must be based on neutral factors that do not create an incentive for the advisor to provide advice that is not in the best interest of the advice recipient. The FAQ addresses the application of these standards in the context of both recruitment payments and use of escalating compensation grids.

In the context of recruitment, the FAQ makes it clear that signing bonuses not tied to the transfer of accounts or assets/sales targets are permitted but back-end awards that are contingent on these goals may not satisfy the conditions of the BIC exemption. There is some grandfathering permitted for back-end awards where there is a contractual commitment to pay the bonus that was entered into before the FAQ was published. To use the grandfather rule, the recipient advisor's activities must be the subject of "stringent oversight" to ensure that the best interest standard is adhered to. Question 12 of the FAQ also identifies practices the DOL views as prudent for financial institutions to use when recruiting advisors.

The FAQ also addresses the use of compensation grids whereby advisors can earn more based on volume. Use of these grids is permitted as long as they are designed to avoid incentivizing conflicts of interest, such as encouraging the use of products that are more profitable to the financial institution. The DOL cautioned that compensation grids should provide gradual (not dramatic) increases and should not be retroactive. It also discussed application of the neutral factor rule allowing for receipt of variable compensation. The FAQ clarifies that advisor compensation can vary for selling different categories of investments as long as the difference in compensation is based on time or complexity and not tied to how lucrative the product is for the financial institution. If variable compensation is paid based on neutral factors, the financial institution should document the reasons why it is appropriate and monitor the accuracy of its analyses over time.

Rollovers and BIC Lite

The BIC exemption contains a special streamlined level fee exemption, often referred to as "BIC Lite," which provides exemptive relief under conditions that are much less burdensome than the "Full BIC." BIC Lite is expected to be used broadly in the context of providing rollover advice, and there are special conditions for using it in the context of plan to IRA rollovers. The FAQ clarifies what is considered a "level fee" for purposes of relying on BIC Lite, and also provides guidance on how to satisfy the special conditions for plan to IRA rollovers.

BIC Lite is available when advisors and their affiliates receive only a level fee in connection with the advice. A level fee is either a basis point fee or a set dollar amount and does not include commissions or other transaction-based fees. The FAQ clarified that even if the amount of revenue sharing or commissions is the same for every available investment option, such that the advisor's compensation won't vary based on what's selected, the mere fact that these third party payments exist will preclude the availability of BIC Lite. BIC Lite is also not available when the only investments offered are proprietary investments. The fact that a client is given a choice between a level fee arrangement and a commission or other non-level fee arrangements does not preclude the use of BIC Lite in the event the level fee arrangement is selected.

When using BIC Lite in the context of recommending a rollover from a plan to an IRA, the advisor must take into consideration fees and who pays them as well as services and investments available in each option. The FAQ describes how these conditions can be satisfied in practice. It identifies the 404(a)(5) or participant fee disclosure document as the primary source for obtaining this information

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but allows reliance on the plan's Form 5500 or other reliable benchmarks if the 404a-5 document is not available as long as there is documentation of why the assumptions used are reasonable. The FAQ also makes it clear that the process described in BIC Lite for collecting, analyzing and documenting rollover recommendations should be followed regardless of whether the full BIC exemption or BIC Lite is being used.

Other items of note

The FAQ contains clarifications on a number of other items including:

Grandfathering of accounts: Dividend reinvestment programs are considered a systematic purchase program eligible for grandfathering relief.

BIC website disclosure: The requirement to post individual BIC contracts on a website can be satisfied by posting a model contract, although the DOL prefers posting of individual, signed contracts.

Acting at direction of the client: The execution of a transaction at the direction of a client in the absence of any recommendation or in the absence of compensation (defined broadly) is not fiduciary advice.

Insurance and annuity products: The FAQ contains a number of questions about the sale of these products, including guidance on how independent insurance agents can use the BIC exemption.

Practical considerations

The FAQ is most helpful to financial institutions who will use the BIC exemption and to individual advisors who will use BIC Lite for plan to IRA rollover recommendations.

From the Courts

Federal court dismisses ERISA breach claim for use of money market fund over stable value fund

A U.S. District Court recently dismissed an ERISA breach of fiduciary duty claim against a large 401(k) plan sponsor for selecting a money market fund as the plan's capital conservation option. The plan participants had sued the plan sponsor, claiming that use of a money market fund instead of a stable value fund was imprudent and violated the plan's investment policy statement (IPS).

In this case, the plan's IPS provided that the plan's investment objectives were to offer a variety of funds across a broad risk/return spectrum and include at least one fund that provides for a high degree of safety and capital appreciation. Although both money market funds and stable value funds provide for capital preservation, the plan participants claimed that the returns for stable value funds generally exceed the returns for money market funds particularly over the prior six years during which money market funds did not even beat the rate of inflation. The participants also claimed that most large 401(k) plans offered stable value funds as an investment option.

In its review, the court noted that neither the plan's IPS nor ERISA require the use of a stable value fund and that offering a money market fund as one of an array of funds along a risk/reward spectrum satisfied the plan fiduciary's duty of prudence. The court also noted that the plan participants did not plead any facts in their complaint that suggested that the plan fiduciaries failed to evaluate the relative risks and benefits of money market funds versus stable value funds and other capital conservation options. Finally, the court stated the participants' comparisons of performance of money market funds versus stable value funds over the last six years is an "improper hindsight-based challenge" and that under ERISA "a fiduciary's actions are judged based upon information available to the fiduciary at the time of each investment decision and not from the vantage point of hindsight." Accordingly, the court dismissed the participants' claim against the plan fiduciary.

Practical considerations

This case reflects the value and importance of performing a thorough and prudent review when making plan investment decisions. Although stable value funds outperformed money market funds during the period of this claim, the court noted that the participants did not allege any facts that suggested that the plan fiduciaries failed to engage in a prudent process when selecting the money market fund over other capital preservation options. As the court noted, a fiduciary's investment decision will be judged based on the information available to the fiduciary at the time and will not be judged in hindsight.

Plan sponsor wins case brought by minor beneficiary for distribution to mother as guardian

A breach of fiduciary duty claim brought by a minor beneficiary against a plan sponsor of a 401(k) plan was recently dismissed by a federal district court.

In this case, a participant in the 401(k) plan named her minor nephew as a beneficiary to a portion of her plan benefit. After the participant died, the mother of the minor beneficiary requested that the plan sponsor distribute the minor's benefit as a direct rollover to an inherited IRA in the minor's name. In order to process the request, the plan sponsor required the mother to produce proof of guardianship which she did by providing a birth certificate as well as a Social Security Benefit Statement reflecting her as the minor's mother and the minor as her dependent. The plan sponsor subsequently distributed the minor's benefit to the IRA.

After the distribution was rolled over to the IRA, the beneficiary's mother took withdrawals from the IRA for her own personal use. The minor beneficiary subsequently sued the plan sponsor claiming that the plan sponsor breached its fiduciary duty to the beneficiary by improperly distributing the benefit at the direction of the beneficiary's mother.

After review, the federal district court disagreed with the beneficiary and dismissed the claim against the plan sponsor. In its review, the court noted that the plan document provided the plan sponsor with discretion to make distributions to a beneficiary's guardian when the beneficiary is a minor. The court further noted that a plan sponsor's discretionary decision will not be overturned if reasonable. The court looked to several factors in assessing if the plan sponsor acted reasonably including: the adequacy of the materials considered to make the decision and the degree to which they support it; whether the fiduciary's interpretation was consistent with other provisions in the plan and with earlier interpretations of the plan; whether the decision-making process was reasoned and principled; and the fiduciary's motives and any conflicts of interest it may have. Based on these factors, the court concluded that the plan sponsor's decision-making process was reasoned and principled and that there was nothing that suggested that the plan sponsor had a conflict of interest in making the decision.

Practical considerations

In general, plan documents typically provide plan sponsors with discretion over many aspects of plan operation and, as a result, plan sponsors are required to regularly make discretionary administrative decisions in the normal operation of a retirement plan. As reflected in this case, plan sponsors should ensure that they gather appropriate materials and employ a consistent process when making plan decisions. If a decision is later challenged, the courts will not overturn a decision if the decision was consistent with other plan decisions, reasoned and principled.

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From the Regulatory Services Team

IRS updates its retirement plan correction program (EPCRS)

The Employee Plans Compliance Resolution System, or EPCRS, may be familiar to many plan sponsors. For those who may not be familiar, it is the IRS's correction program for nearly every tax issue that can go wrong with a retirement plan. With roots that stem back to the early 1990s, it has evolved and grown over time, and most recently it was updated via Revenue Procedure 2016-51 (RP 2016-51). In a perfect world, no errors would occur in retirement plan documentation or implementation, but the truth is sometimes things do go wrong. With EPCRS, plan sponsors have options on how to correct, short of the severest penalties that could apply if errors were left unresolved. This article focuses on the most recent changes to EPCRS.

Released on September 29, 2016, IRS Revenue Procedure 2016-51 (RP 2016-51) not only supplements existing EPCRS relief, but also seeks to simplify the corrective procedures by which plan sponsors may obtain that relief. RP 2016-51 supersedes the guidelines previously set forth in Revenue Procedure 2013-12 (RP 2013-12), takes into consideration the recent changes to the IRS's Determination Letter Program, and incorporates the changes made by other recent updates (specifically, Revenue Procedure 2015-27 (RP 2015-27) and Revenue Procedure 2015-28 (RP 2015-28)).

Please note that RP 2016-51 becomes effective January 1, 2017. Until then, plan sponsors should continue to apply the provisions found under those older revenue procedures (RP 2013-12, as modified by RP 2015-27 and RP 2015-28), when making any corrections to their qualified retirement plans.

EPCRS - Background

The tax advantages of qualified retirement plans are only available to plan sponsors that comply with the often complex requirements of the Internal Revenue Code and its corresponding regulations. Qualified retirement plans must comply in both form and operation and any failure to meet these obligations can subject a plan to fees, sanctions or even plan disqualification.

With this in mind, the IRS maintains EPCRS to provide plan sponsors with the opportunity and ability to self-correct most instances of noncompliance in a prescribed way. In most cases, the objective of the prescribed correction is to place the participants affected by the error in the position they would have been in had the error not occurred. EPCRS offers three programs for correcting plan errors:

- *Self-Correction Program (SCP):* Relief under SCP is limited to operational errors (e.g., not following plan document provisions or applicable law in the operation of the plan), but requires no application with the IRS and no fees to be paid. Under SCP, insignificant operational errors generally may be corrected at any time, while significant operational errors generally can be corrected before the end of the second plan year after the plan year in which the error first occurred. The goal of SCP is to encourage sponsors to find and fix their own errors. Some key elements of such a self-correction are documenting the error, the action being taken to correct the error and steps taken to ensure the error will not recur.
- *Voluntary Correction Program (VCP):* VCP is available for plan errors that are not eligible for self-correction under SCP or for any error in which the plan sponsor wants IRS approval regarding the method used to correct the error. The IRS requires an extensive application including the completion of special forms. Plan sponsors must also pay a fee to the IRS based on various factors such as the number of plan participants, type of error being corrected, type of plan being corrected, etc. At the end of the process, however, the IRS provides a formal agreement that the action being taken by the sponsor to correct the error is sufficient and that the plan will not be subject to an additional penalty with regard to the error that has been corrected. Like SCP, the goal of VCP is to encourage plan sponsors to find and fix errors rather than ignore them. For that reason, while the costs of a VCP correction can be significant, they are generally considerably less than the costs of the same error being uncovered by the IRS on audit or otherwise.
- *Audit Closing Agreement Program (Audit CAP):* The Audit CAP is used in conjunction with an IRS examination. The corrective action prescribed by the IRS will depend on the error discovered during the examination. However, the fees associated with the Audit CAP will generally be greater than the fee required under VCP but less than the tax, interest and penalties due if the plan lost its tax-favored status.

EPCRS - Important updates from RP 2016-51

- *Determination letter applications.* Much of the relief afforded by EPCRS is contingent upon the plan holding a favorable determination letter. However, under RP 2016-51, determination letter applications are no longer required to be submitted as part of corrections that include a plan amendment. RP 2016-51 also clarifies that any compliance statement for a correction through plan amendment will not constitute a determination that the plan amendment satisfies the qualification requirements.
- *Favorable letter requirements.* RP 2016-51 clarifies that a qualified individually designed plan submitted under SCP will still satisfy the favorable determination letter requirement when correcting significant failures even if its determination letter is out of date.
- *Incorporation of Rev. Procs. 2015-27 and 2015-28.* In 2015, the IRS modified EPCRS guidelines to provide alternative correction options for certain overpayments (Proc. 2015-27) and to relax correction requirements for certain elective deferral errors (Rev. Proc. 2015-28). The new EPCRS guidelines incorporate these modifications directly into a single EPCRS rather than as separate revenue procedures.
- *Fees.* The Voluntary Correction Program (VCP) fees are now user fees as the IRS uses that term. This means that, effective January 1, 2017, a plan sponsor must refer to the annual employee plans user fees revenue procedure to determine the applicable VCP user fees (e.g. Revenue Procedure 2016-8). Previously, fees were specifically listed in EPCRS but this change allows the IRS to update fees applicable to EPCRS without

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having to amend or restate EPCRS. Also related to fees, the IRS will no longer refund half of the user fee if there is a disagreement over a proposed correction in an anonymous submission.

- *Model forms.* The model forms for a VCP submission (e.g., Forms 14568-A through 14568-I, as well as Forms 8950, 8951, 2848, and 8821) can now be found on the IRS website (IRS VCP Forms).
- *Audit CAP changes.* The method used to determine the application sanction under the Audit CAP has also been revised. Sanctions will no longer be determined using a negotiated percentage of the maximum payment amount (MPA), which is based on the potential tax liability that would be incurred in open tax years if the plan were actually disqualified. Instead it will be determined on a facts and circumstances basis and will not be less than VCP fees.

Plan sponsor considerations:

Despite the changes made by RP 2016-51, the IRS still continues to solicit comments on the correction procedures for recouping overpayments. Thus, it is likely that the IRS and Treasury Department will continue to update EPCRS on a periodic basis. With this in mind, Empower will continue to keep you apprised of any significant developments as they become available.

EPCRS in its current form and going forward is likely to be a valuable tool to plan sponsors who find that something has not gone as expected or intended in the form or administration of their plans. Empower recommends that plan sponsors keep up to date with EPCRS as it evolves and work with Empower and their plan counsel to assess and resolve any issues that may arise.

A reminder regarding required minimum distributions

It is that time of year again when retirement plans must meet the qualification requirements in the Internal Revenue Code (IRC) that pertain to required minimum distributions (RMDs). These rules are in place to ensure that retirement plans (e.g., 401(k), 403(b), 457(b), DB, profit sharing, ESOPs, target benefit plans, money purchase plans) are used for retirement purposes and not to transfer wealth to a participant's heirs upon death. Another purpose for RMDs is to facilitate the government's collection of tax revenue as most of the contributions and benefits in these plans were made on a pretax basis.

What is a required minimum distribution (RMD)?

An RMD is the amount that a participant in a retirement plan is required to receive from the plan after reaching their required beginning date (RBD).

For a participant in a defined contribution plan, the amount is determined by dividing their account balance as of the last valuation date in the calendar year immediately preceding the calendar year the RMD must be distributed by the distribution period. The distribution period is found in the Uniform Lifetime Table under IRC §401(a)(9) and is based on the participant's age as of their birthday in the relevant calendar year.

When is the required beginning date (RBD)?

The RBD is the date by which a retirement plan participant must be paid or commence receiving RMDs from their qualified retirement plan.

Generally, the RBD is April 1 of the calendar year following the later of:

- The calendar year in which the participant attains age 70½.
- The calendar year in which the participant retires from employment with the employer maintaining the plan. (Please note that a plan is not required to allow a delay due to the participant still being employed; however, most plans are drafted to allow for this additional delay on taking RMDs.)

However, the RBD for participants who are defined as 5% owners is April 1 of the calendar year following the calendar year in which the participant attains age 70½. If the employer is a corporation, a 5% owner is any employee who owns (or is considered as owning within the meaning of IRC §318) more than 5% of the value of the outstanding stock of the corporation or stock possessing more than 5% of the total combined voting power of all stock of the corporation. If the employer is not a corporation, a 5% owner is any employee who owns more than 5% of the capital or profits interest in the employer. Please note that a person who owned exactly 5% is not considered to be a 5% owner under the IRC.

Generally, RMD payments are required to be paid by December 31 of each calendar year following the RBD. However, a participant may defer their initial RMD to their required beginning date as stated above.

Failure to pay RMDs timely

If a plan fails to pay an RMD timely, the participant may be subject to a 50% excise tax for the amount of the missed RMD payment. However, the plan sponsor can have this 50% excise tax removed if corrected according to the Employee Plans Compliance Resolution System (EPCRS). EPCRS will require the plan to:

- Make a submission to the IRS under the Voluntary Compliance Program (VCP) of EPCRS to correct the failure.
- Distribute the missed RMD with earnings calculated from the date of the failure to the date of the actual distribution.

The cost of the VCP submission is $500 if the failure is for 150 or fewer plan participants, $1,500 if the failure is for 151 to 300 participants, or if larger than 300 participants, the general VCP filing fee will apply. The reduced fee of $500 or $1,500 will only apply if the minimum distribution failure is the only failure in the VCP submission.

Practical considerations

As the year draws to a close, plan sponsors will want to ensure that RMDs are being processed. If for some reason an RMD is missed and is beyond the required timing, then there is an ability to correct this error with the IRS under VCP. As mentioned above, VCP filing is rather inexpensive and is a great alternative to a participant suffering a 50% excise tax penalty.

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