

DB digest

Best Practices for Pension Administration

KEY DATES

2/28/18

Deadline for plan sponsors to submit request to IRS to use substitute mortality tables for 2018.

3/31/18

Deadline to provide a Summary Plan Description to an individual who became a plan participant on 1/1/2018.

4/1/18

Benefit restrictions commence if the 3/31/18 certified AFTAP or deemed AFTAP is less than 80%. Benefit restrictions continue until a subsequent certification determines that the plan's funded ratio is sufficient to remove them.

4/1/18

Deadline to make the first Required Minimum Distribution to terminated vested participants who attained age 70-1/2 in 2017 and to participants older than 70-1/2 who retired in 2017.

4/15/18

Due date for first required quarterly contribution for 2018, either through cash contributions of a signed election to use available carryover and/or prefunding balances.

4/30/18

For plans with more than 100 participants, provide the 2017 annual funding notice to participants, beneficiaries, labor organizations representing participants and beneficiaries, and PBGC, if applicable. Include a supplement regarding the effect of MAP-21/HATFA segment rate stabilization.

Clean up this April with required minimum distributions

Jennifer Godwin

These days, pension plans face many challenges. One of the most daunting is distributing required minimum distributions (RMDs) at a terminated vested participant's required beginning date (RBD).

The RBD, the required date for all retirement plan participants to commence payments, is akin to cleaning house for the Internal Revenue Service (IRS)—because tax-deferred income must start to be taxed by the statutory date. Ostensibly, this income will be taxed in full within the participant's lifetime.

The fall is a perfect time to take stock of which participants (including alternate payees, spouses, and non-spouse beneficiaries) are required to commence payments by April 1 of the following year. Any corrective actions that need to be taken for those participants who missed their RBDs may be completed before filing Form 5500, a tax form reporting a plan's annual information to the IRS, the U.S. Department of Labor (DOL), and the Pension Benefit Guaranty Corporation (PBGC).

In 2009, Form 5500 was revised and the question "*Has the plan failed to provide any benefit when due under the plan?*" was added to line 4l of Schedules H and I (Form 5500) and line 10f (Form 5500-SF). This question did not have clear instructions or provide examples that identified how the plan possibly failed to provide a benefit. The general consensus among plan sponsors and actuarial consultants in the subsequent years was that the question referred to whether or not the plan had sufficient assets to pay benefits.

Six years later, Form 5500 was revised again to include instructions and an example for the question, and unpaid RMDs were considered a reportable failure. In July 2016, the IRS made additional clarifications, noting that plan sponsors were not required to report ongoing "reasonable efforts" to locate participants or beneficiaries due an RMD at the end of the plan year.

This IRS question coincides with the efforts of other organizations such as the PBGC and the DOL to use the plan sponsor's Form 5500 reporting requirements as a way to help monitor compliance issues. Now more than ever it is important to be aware of bad addresses for participants who are past normal retirement age (NRA), usually defined by a plan document as age 65. What procedures are in place to ensure that a plan can find participants with future RBDs?

Requirements to commence benefits

The Internal Revenue Code (IRC) Section 401(a)(9) requires all qualified plans to distribute a terminated vested participant's entire interest in a qualified plan by the participant's RBD.

The RBD is defined by the IRS as April 1 of the calendar year following the later of the year the participant reaches age 70½ or the year the participant (other than 5% owners) retires. The RBD for a 5% owner is April 1 following the end of the calendar year in which age 70½ is reached, whether or not the participant retires by the end of that year.

The requirement to pay RMDs does not end upon a participant's death. For example, if a participant dies prior to the RBD, a plan that provides a surviving spouse beneficiary benefit must still ensure that payment commences by December 31 of the year in which the participant would have reached age 70½. In the case where a plan allows non-spouse beneficiary designations, commencement of payment must happen no later than December 31 of the year immediately following the participant's death or the entire interest must be paid by the end of the calendar year containing the fifth anniversary of the participant's death. It is important to track the addresses of beneficiaries and alternate payees as well as their appropriate RBDs.

If the plan sponsor fails to distribute benefits by the correct RBD, this has the potential to trigger excise taxes for the participant and plan qualification problems for the plan sponsor.

Corrective action for missed required minimum distributions

Minimum distribution rules are a required element of the plan document. When a plan sponsor does not distribute benefits in a timely manner, compliance issues could lead to the loss of a plan's qualification status.

The IRS offers several different options for plan sponsors to avoid plan disqualification under a program known as the Employee Plans Compliance Resolution System (EPCRS). Any corrections applied should follow the correction method examples outlined by the IRS.

In the case of a failure to pay benefits by a participant's RBD, the correction programs worth consideration are the Self-Correction Program (SCP) or the Voluntary Correction Program (VCP).

The SCP is the first choice for a plan sponsor when correcting errors. When using the SCP, a plan sponsor is eligible to correct the error without notifying the IRS or paying a fee. The SCP may be used by a plan sponsor to self-correct minimum distribution errors—even when the error is significant—as long as the correction is made within two years of the plan year in which the error occurred.

However, when participants or beneficiaries do not receive their distributions by their RBDs, they may be subject to a 50% additional tax on the portion of the benefit that was not paid on time. In this situation, participants would need to review the distribution with a tax advisor and likely attach a Form 5329 to their individual tax returns to request that the additional tax not be applied.

If the SCP is not an option, then the plan sponsor can use the VCP program as long as the plan is not currently under audit with the IRS. The VCP program requires the plan sponsor to both notify the IRS of the error and pay a fee to correct the error. The IRS will then waive the 50% additional tax for participants and beneficiaries—negating the need for each affected participant or beneficiary to apply directly to the IRS for relief from any additional tax penalty.

Procedures preclude reporting errors

To avoid compliance issues, plans that allow participants to defer receipt of payment past the normal retirement date should carefully monitor participants approaching age 70. The best practice is to forge and maintain a connection with participants prior to their RBDs.

Below are several options for maintaining a connection with participants:

- Track any returned mail from required compliance mailings such as annual funding notices, summary material modifications, and summary plan descriptions. Then follow up with an address search.
- Use one or more address search vendors that offer to continuously monitor a pension plan's vested terminated population for unreported deaths. The benefit of a continuous death audit is that, in most cases, preretirement deaths will be identified prior to the participant's RBD. Plan sponsors may also verify that a participant's name matches the Social Security number on file. For mismatch cases, those participants will need additional follow-up to confirm their legal names and Social Security or tax identification numbers.
- Automatically mail normal retirement packets 90 to 180 days prior to the participant's NRA. In addition to the required compliance mailings, auto-generating NRA retirement packets to notify participants of approaching deadlines can prompt participants to complete and return the election forms at their NRAs instead of deferring election to their RBDs. In scenarios where a plan allows deferrals past NRA, if the participant ignores the NRA retirement packet, establish procedures to follow up with an address search to locate and receive retirement forms prior to the participant's RBD.

A recently released IRS memo on October 19, 2017, also outlines actions that can be taken by a plan sponsor to provide relief for failure to commence or make a distribution to a missing participant to whom a payment is due:

- Search plan and related plan, sponsor, and publicly available records or directories for alternative contact information.
- Use any of the following search methods: a commercial locator service, a credit reporting agency, and a proprietary internet search tool for locating individuals.
- Attempted contact via U.S. Postal Service certified mail to the last known mailing address and through appropriate means for any address or contact information.

To date, the DOL has not released safe harbor provisions that a plan sponsor may rely on for avoiding qualification issues for failure to commence or make a distribution to a missing participant to whom a payment is due.

Ultimately, plan sponsors can avoid potentially having to take corrective action via an IRS EPCRS program by proactively managing the possible RMD population. Encourage NRA retirement packet mailings to reduce the intricacy and cost to the plan of paying late retirement benefits. Use continuous death audits and address searches on returned compliance mailings to track plan participants. A Milliman consultant can help you develop standard plan procedures to find and inform participants of both their NRAs and their RBDs.

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