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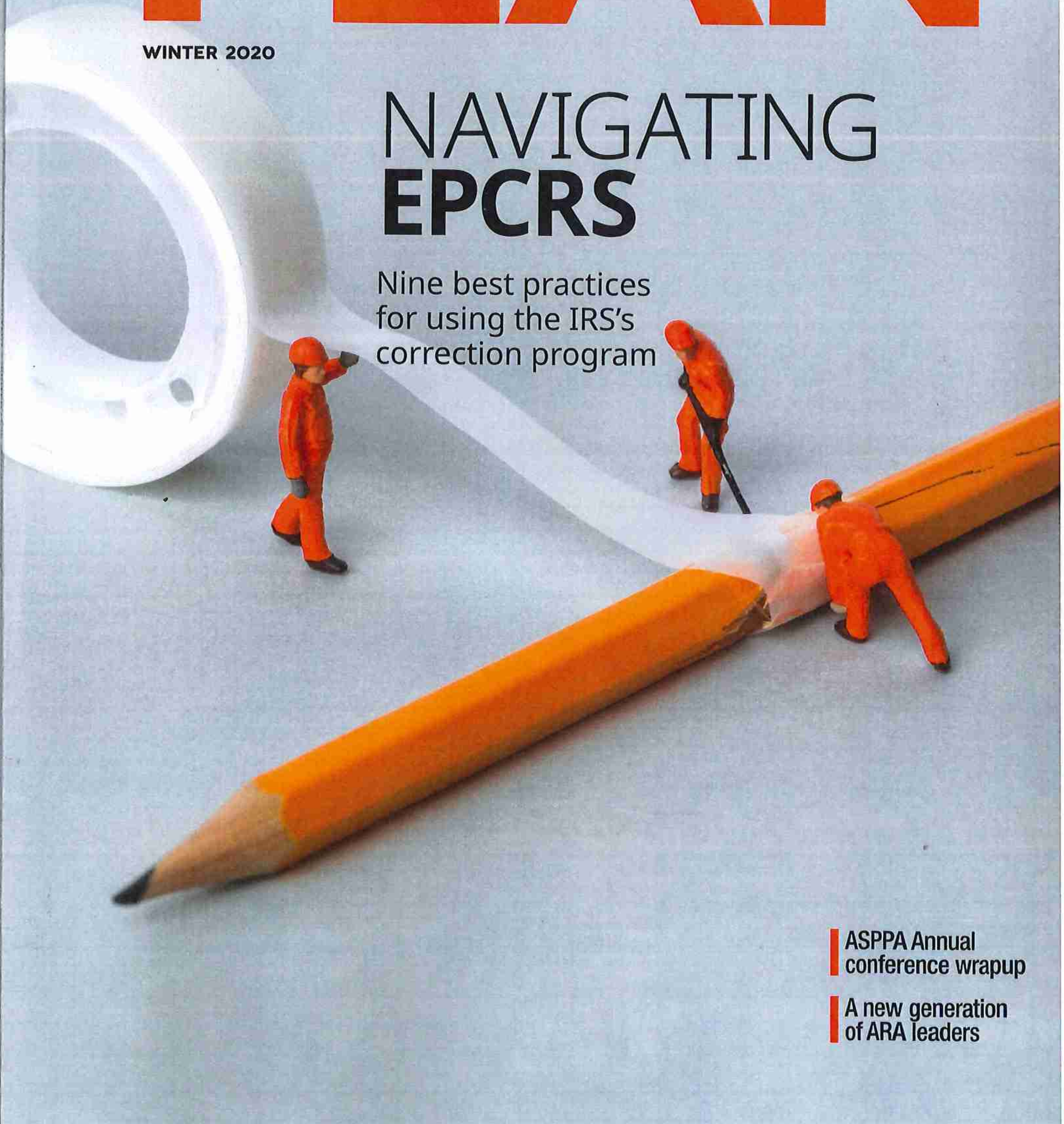

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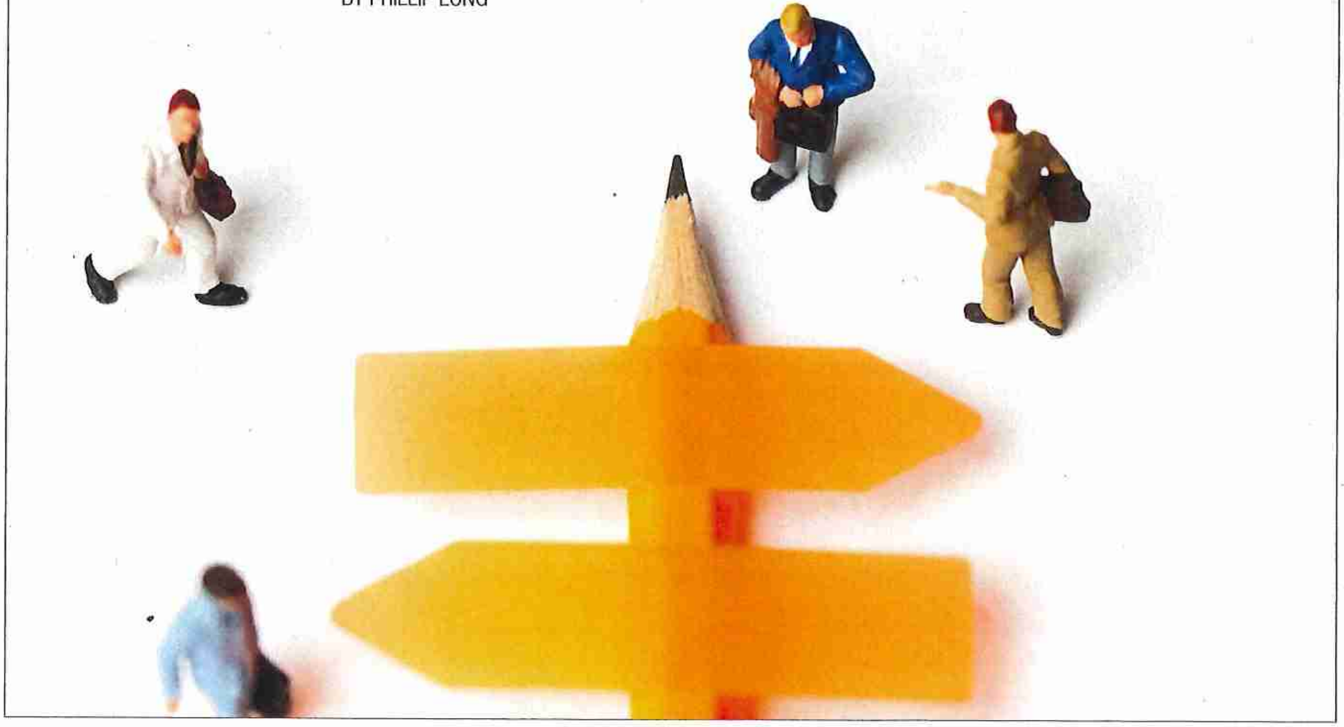

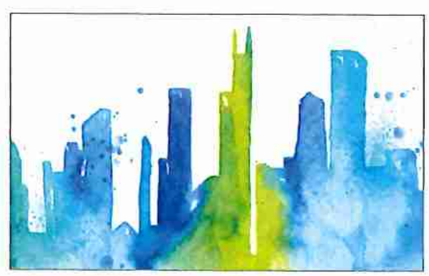

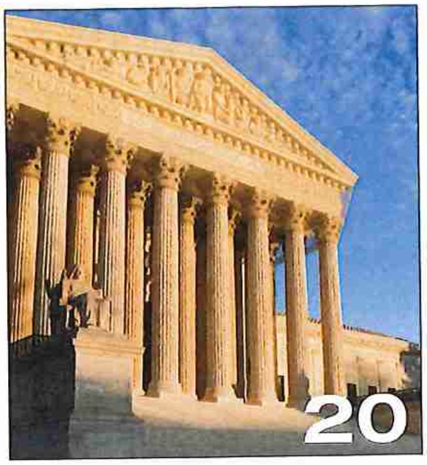

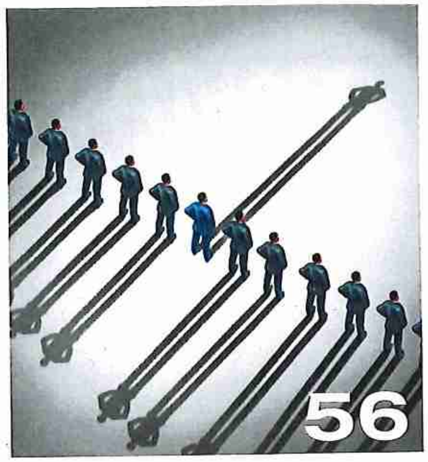

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RMD Compliance Concerns for Plan Sponsors

Failure to satisfy the RMD requirements can result in costly compliance errors.

BY GARY BLACHMAN & SHALINA SCHAEFER

At age 70½, the IRS requires plan participants to begin taking required minimum distributions (RMDs) from all employer-sponsored retirement plan accounts funded with pre-tax contributions. The RMD rules also apply to IRA-based plans such as SEPs, SARSEPs and SIMPLE IRAs, and to inherited Roth IRAs when someone other than a spouse is a beneficiary.

Since RMDs can significantly wear away accumulated retirement savings, it is essential to minimize them if possible. However, RMDs and the withdrawal process are quite complicated. Fortunately, there are some solutions that can be implemented to protect plan sponsors and their participants.

If the IRS discovers an RMD violation upon audit, the consequences for the plan sponsor can be severe. A plan sponsor's history of not correctly processing RMDs can lead to disqualification of the entire retirement plan. Fortunately, the IRS does not rush toward plan disqualification and typically permits the plan sponsor to correct the error in a way that is least harmful to plan participants. Even still, the IRS can make the life of a plan sponsor extremely uncomfortable if RMD failures are discovered upon audit. Following are four tips to avoid that situation.

How to Calculate RMDs

Your RMD is calculated by dividing the balance in your tax-deferred accounts as of Dec. 31 of the immediately preceding calendar year by a life expectancy factor prescribed by certain IRS tables in IRS Publication 590-B. There are three life expectancy tables:

- The Uniform Lifetime Table is used to calculate RMDs during your lifetime unless your sole designated beneficiary is your spouse who is more than 10 years younger than you.
- The Joint and Last Survivor Table is used to calculate RMDs during your lifetime, but only if your sole designated beneficiary is your spouse who is more than 10 years younger than you. This table produces a lower RMD payment in recognition of the longer life expectancy of your spouse beneficiary.
- The Single Life Expectancy Table is used to calculate RMDs after your death with respect to your beneficiaries.

The RMD must be calculated separately for each IRA owned by an individual, but the total RMD amount can be withdrawn from one or more of the IRAs. This same aggregation rule applies to 403(b) contracts. However, RMDs from other types of retirement plans, such as 401(k) plans and 457(b) plans, must be taken separately from each of those accounts.

1. REVIEW CURRENT RMD PROCESSES AND IDENTIFY COMPLIANCE CONCERNS

Plan sponsors can benefit from taking a proactive approach to review records of current and former employees and determine any compliance concerns with processing RMDs. When errors are identified, the plan sponsor should take prompt action under the IRS's correction procedures to preserve the plan's qualified status. As part of the correction process, the plan sponsor can also request waiver of the penalty tax on behalf of affected participants. In an effort to encourage compliance, the IRS has made these correction procedures fairly straightforward and much less costly to the plan sponsor than correcting an error under IRS audit.

2. ESTABLISH AND FOLLOW MISSING PARTICIPANT PROCEDURES

Sometimes RMD errors occur because the plan sponsor is unable to locate former employees who are due an RMD. In these situations, the IRS has issued field guidance that directs examiners not to challenge a plan for failure to comply with the RMD rules in cases where the plan has taken specific steps to locate the participant and those steps have not been effective. A plan sponsor that adopts and follows the guidance considered by IRS examiners should be able to demonstrate its efforts to locate missing participants and avoid sanction under audit.

3. ADOPT A DEFAULT RMD PAYMENT PROCEDURE

Plans that are not subject to qualified joint and survivor annuity rules generally may be amended to provide that RMD payments will be automatically distributed to employees who do not respond within a certain timeframe. This aids in plan compliance and protects the participant who would be subject to the 50% penalty tax for failure to timely take an RMD payment. This amendment requires coordination with the recordkeeper, and even if the plan may permit automatic distributions, not all recordkeepers are administratively able to make distributions without participant consent.

4. EDUCATE PARTICIPANTS ABOUT THEIR RESPONSIBILITY TO TAKE RMDs

As with most plan provisions, it is extremely important for plan sponsors to educate their employees regarding RMDs, particularly as the employees approach retirement age. Plan sponsors should work with their recordkeeper to ensure that employees receive notification of their requirement to begin taking RMDs, and the potential penalties for not taking RMDs.

A failure to satisfy the RMD requirements can result in costly compliance errors for both participants and plan sponsors. For this reason, it is important for plan sponsors to provide appropriate education so that participants fully understand the RMD rules. PC

Editor's Note: The is the first of a two-part series on RMDs. Look for Part 2, on taxpayer concerns with RMDs, in the Spring issue.

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