Correcting RMD Failures

2019 Fall Tax Meeting
Distributions Subcommittee
October 4, 2019
Background

• Traditionally, RMDs have been a focus area for IRS, but not DOL
• Increase in missing/unresponsive participants due to mobile workforce and other factors
• Increased scrutiny on timely distributions due to DOL terminated vested participant project
• For FY 2018, DOL reported recovering over $807.7 million for terminated vested participants in defined benefit plans
RMD Rules

• Both defined benefit and defined contribution tax-qualified plans, including 403(b) plans, are subject to the required minimum distribution (RMD) rules
• Similar RMD rules apply to IRAs
• To remain qualified, a retirement plan must provide that benefits will commence no later than the required beginning date
• “Required beginning date” generally means April 1 of the year following the year in which (i) the employee attains age 70-1/2 or (ii) the employee retires
• Terms of the plan govern
RMD Rules

• Treasury regulations provide detailed rules on RMDs, including:
  • When must amounts be distributed
    • During participant’s lifetime
    • Following participant’s death
  • How much must be distributed annually
    • Calculated based on lifetime tables described in regulations
Consequences of RMD Failures

• Failure to follow terms of plan document and Internal Revenue Code results in a qualification failure (potential loss of tax-qualified status)

• Excise tax under IRC § 4974
  • 50% of the missed RMD amount for the payee’s tax year
  • Imposed on participant
  • Applies to qualified plans, 403(a) and (b), and IRAs
  • Reported and paid on Form 5329
  • Waiver is available if due to reasonable error and reasonable steps are taken to remedy the shortfall

• Potential breach of fiduciary duties?
Correction of RMD Failures

- Defined contribution: distribute RMD amount plus earnings
- Defined benefit: distribute RMD plus interest calculated using the plan’s actuarial equivalence factors in effect on the date distribution should have been made
- If plan is subject to lump sum restriction under IRC § 436(d), sponsor must make a corresponding contribution to the plan
Correction of RMD Failures

• Self-Correction Program (SCP)
  • Significant (end of 2\textsuperscript{nd} plan year after year in which failure occurs)
  • Insignificant (no time limit on correction)
  • Importantly, no waiver of excise tax is available under SCP

• Voluntary Correction Program (VCP)
  • Sponsor can file VCP application and request waiver of the excise tax for participants and beneficiaries
  • Waiver of excise tax must be specifically requested

• Audit Closing Agreement Program (Audit CAP)
  • Sponsor can correct RMD failure under Audit CAP, and request waiver of excise tax
Correction of RMD Failures

VCP Process
• No longer any reduced VCP fee for RMD failures
• Use Model VCP Compliance Statement Form 14568-H, Schedule 8
  • Can’t use model form if RMD failure relates to beneficiaries
  • Can’t use if other failures occurred (such as 401(a)(14) commencement failure)
• Enclose sample calculations, including earnings calculations
• DB Plans must include AFTAP certification if plan is not under 436(d) restrictions
• VCP does not address fiduciary liability
IRS Guidance on Missing Participants

- TE/GE Memorandum for Employee Plans (EP) Examinations Employees (October 19, 2017)

- Instructs EP examiners not to challenge a qualified plan for violating RMD standards for the failure to commence or make distributions if the plan has taken certain steps:
  - Searched plan & related plan, sponsor & publicly available records
  - Used a commercial locator service, credit reporting agency, or a proprietary internet search tool for locating individuals; and
  - Attempted contact by USPS certified mail to last known mailing address and through appropriate means for any address or contact information (including email and phone)

- Doesn’t address fiduciary duty concerns