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PLAN DISTRIBUTIONS

Maintaining Plan Documents and Procedures for Retirement Plan Required Minimum Distributions

Various types of tax-qualified retirement plans and individual retirement accounts must pay required minimum distributions to participants at their required beginning date. Retirement plan participants that do not timely obtain required minimum distributions of their benefits can face excise tax penalties for these failures, and plan sponsors can face plan disqualification. Plan sponsors and fiduciaries should clearly communicate plan rules and update their documents and procedures to ensure that required minimum distributions are timely taken, especially since the rules have changed in recent years.

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The premise of required minimum distributions (RMDs) from retirement plans under Section 401(a)(9) of the Internal Revenue Code

(Code) is relatively simple: retirement savings cannot accumulate indefinitely without at least an RMD being withdrawn annually when required, which is then subject to applicable taxation. RMDs apply to qualified defined contribution plans (such as 401(k) plans), qualified defined benefit plans, Code section 403(b) annuity and retirement accounts, eligible deferred compensation plans under Code section 457, and individual retirement accounts (IRAs). Most 401(k) plans, for example, allow a participant to delay taking RMDs until April 1 of the year following the later of the year the participant attains age 72 (age 70 ½ for those who attained age 70 ½ before January 1, 2020) or the year the participant retires. However, if the participant is a 5 percent or greater owner of the business, the RMDs must commence by April 1 of the year following the year in which the account holder attains age 72 (70 ½ prior to January 1, 2020), regardless of whether he or she is retired.

Even though the concept of RMDs is simple, the rules and regulations concerning RMDs are lengthy, and they were amended by Sections 114 and 401 of the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), enacted on December 20, 2019, as Division O of the Further Consolidated Appropriations Act of 2019. Notably, the SECURE Act amended the required beginning date for RMDs by delaying the commencement age to 72 instead of age 70 ½. This required beginning date could change again since there are pending bills in Congress commonly referred to as SECURE Act 2.0 that seek to raise the required beginning date to age 75. Also, under Code section 401(a)(9)(H) as added by the SECURE Act, the distributions of an employee's remaining interest in a defined contribution plan to a designated beneficiary after his or her death is subject to a new 10-year payment rule regardless of whether the participant dies before, on, or after, the required beginning date of age 72. Before January 1, 2020, a retirement plan account owner who died before RMDs began would have the entire amount of their benefit distributed to the beneficiary who is an individual either (1) within five years of the participant's death, or (2) over the life of the beneficiary starting no later than one year following the participant's death. In 2020, for most retirement plans and IRAs (not including defined benefit pension plans) an optional waiver of the RMD requirement for that year was also made possible with the Coronavirus Aid, Relief, and Economic Security Act of 2020 (*CARES Act)*, during the COVID-19 pandemic.

Proposed RMD Regulations

Proposed RMD regulations implementing the SECURE Act changes noted above and making other clarifications were issued February 24, 2022. These proposed rules are subject to further changes following the public comment period and June 15, 2022 public hearing. The proposed regulations seek to update existing regulations and guidance to reflect Code section 401(a)(9) amendments made by the SECURE Act that relate to RMDs from qualified plans, Code section 403(b) annuity contracts, custodial accounts, and retirement income accounts, individual retirement accounts and annuities, and Code section 457 eligible deferred compensation plans. The proposed regulations generally would apply for purposes of determining RMDs for calendar years beginning on or after January 1, 2022, or to distributions on or after that date. For the 2021 distribution calendar year, taxpayers were to apply the existing regulations, but taking into account a reasonable, good faith interpretation of the amendments made by Sections 114 and 401 of the SECURE Act for which compliance with the proposed regulations will satisfy that requirement.

For purposes of this column, note the following highlights of provisions in the proposed regulations for defined contribution plans.

RMD Timing

- If an employee who has a designated beneficiary dies before the employee's required beginning date, or on or after such date, then Code section 401(a)(9)(B)(ii) is satisfied if the employee's entire interest is distributed by the end of the calendar year that includes the 10th anniversary of the employee's death.
- In the case of a defined contribution plan, if the employee has an eligible designated beneficiary (as defined in Code section 401(a)(9)(E)(ii)), the plan may provide either that the 10-year rule applies or that the life expectancy payments rule applies. Alternatively, the plan may provide the employee or the eligible designated beneficiary an election between the 10-year rule or the life expectancy payments rule. However, if a defined contribution plan does not include either of those optional provisions and the employee has an eligible designated beneficiary, the plan must provide for the life expectancy payments rule.
- The 5-year rule in the existing regulations applies to a defined contribution plan if the employee does not have a designated beneficiary or if the employee

died before the effective date of Code section 401(a)(9)(H) and the employee's designated beneficiary elected the 5-year rule. Note that the 5-year rule continues to apply to a defined benefit plan.

Certain Defined Terms

The proposed regulations also provide certain defined terms that will impact RMD administration:

- The new definition of eligible designated beneficiary under Code section 401(a)(9)(E)(ii) is incorporated. Specifically, an eligible designated beneficiary is a designated beneficiary who, as of the date of the employee's death, is (1) the surviving spouse of the employee, (2) a child of the employee who has not yet reached the age of majority, (3) disabled, (4) chronically ill, or (5) not more than 10 years younger than the employee.

  Note that a designated beneficiary within the meaning of Code section 401(a)(9)(E)(i) generally is an individual designated under the plan as a beneficiary who is entitled to a portion of an employee's benefit, contingent on the employee's death or another specified event. If a beneficiary designated under the plan is a person other than an individual, then the employee is treated as not having a designated beneficiary (even if there is another designated beneficiary who is an individual). However, if a beneficiary designated under the plan is a see-through trust, then certain beneficiaries of that trust are treated as the employee's beneficiaries under the plan rather than the trust. In addition, designating a beneficiary that is not an individual does not cause the employee to be treated as not having a designated beneficiary to the extent separate account treatment applies with respect to that beneficiary.
- The proposed regulations provide that a child of the employee reaches the age of majority on that child's 21st birthday (which accommodates the age of majority definition in all of the States). However, the proposed regulations permit defined benefit plans that have used the prior regulations' definition of age of majority (that is, a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26) to retain that plan provision.
- For disability determinations of beneficiaries that are made as of the date of the employee's death, Code section 72(m)(7) provides a standard of disability based on whether an individual is unable to engage in substantial gainful activity. Under the proposed regulations, if, as of the date of the employee's death, a beneficiary is younger than age 18, a standard is applied that requires the beneficiary to have a medically determinable physical or mental impairment that results in marked and severe functional limitations, and that can be expected to result in death or to be of long-continued and indefinite duration. These proposed regulations also provide a safe harbor for the determination of whether a beneficiary is disabled such that if, as of the date of the employee's death, the Commissioner of Social Security has determined that the individual is disabled within the meaning of 42 U.S.C. 1382c(a)(3), then that individual will be deemed to be disabled for purposes of Code section 401(a)(9).
- The proposed regulations include rules for the determination of a beneficiary for purposes of Code section 401(a)(9) in certain situations involving the use of a see-through trust and also provide rules that apply to an applicable multi-beneficiary trust where at least one designated beneficiary is disabled or chronically ill. Under the proposed regulations, a beneficiary of a see-through trust is treated as a beneficiary of the employee if the beneficiary could receive amounts in the trust representing the employee's interest in the plan that are neither contingent upon nor delayed until the death of another trust beneficiary who does not predecease the employee.
- The requirement that beneficiaries must be identifiable is also retained with some modifications to the definition of identifiable. Generally, trust beneficiaries are identifiable if it is possible to identify each person designated by the employee as eligible to receive a portion of the employee's interest in the plan through the trust. Under the proposed regulations a trust will not fail to satisfy the identifiability requirements merely because an individual has a power of appointment with respect to a portion of the employee's interest in the plan. These proposed regulations also provide that a see-through trust will not fail to satisfy the identifiability requirements merely because the trust is subject to state law that permits the trust terms to be modified after the death of the employee (such

as by a court reformation, through a decanting, or otherwise), thus permitting a change in the beneficiaries of the trust.

Documentation Requirements for Disabled or Chronically Ill Status

Plan administrators should note that under the proposed regulations, for a beneficiary who is disabled or chronically ill as of the date of the employee's death, documentation of the disability or chronic illness must be provided to the plan administrator no later than October 31 of the calendar year following the calendar year of the employee's death. If the designated beneficiary is chronically ill under any of the definitions in Code section 7702B(c)(2)(A) as of the date of the employee's death, the documentation must include a certification by a licensed healthcare practitioner (as defined in Code section 7702B(c)(4)) that the designated beneficiary is chronically ill. Additionally, in accordance with Code section 401(a)(9)(E)(ii)(IV), if the beneficiary is chronically ill under the definition in Code section 7702B(c)(2)(A)(i), then the documentation also must include a certification from a licensed healthcare practitioner that, as of the date of the certification, the individual is unable to perform (without substantial assistance from another individual) at least two activities of daily living for an indefinite period that is reasonably expected to be lengthy in nature.

For a designated beneficiary who is an eligible designated beneficiary because, at the time of the employee's death, the designated beneficiary is the employee's minor child and that child also is disabled or chronically ill within the meaning of these proposed regulations, the designated beneficiary will continue to be treated as an eligible designated beneficiary after reaching the age of majority (on account of being disabled or chronically ill) only if these documentation requirements are timely met with respect to that designated beneficiary. Similarly, if the employee's designated beneficiary is the employee's surviving spouse and that spouse also is disabled or chronically ill at the time of the employee's death, then the surviving spouse will be treated as disabled or chronically ill for purposes of the applicable multi-beneficiary trust rules only if the documentation requirements are timely met with respect to the surviving spouse.

Consequences of RMD Failures

The failure to timely make RMDs is an operational failure of a tax-qualified plan, which places the plan's tax qualified status at risk and could subject the plan sponsor to penalties. If a plan sponsor does not correct such errors and the failure to distribute RMDs is discovered on an Internal Revenue Service (IRS) audit, the plan sponsor may be required to pay substantial penalties under the IRS Employee Plan Compliance Resolution System (EPCRS) Audit Closing Agreement Program. In addition, participants who do not receive timely RMDs are subject to a 50 percent excise tax on the amount of the RMD not withdrawn and, a participant facing the excise tax could allege their employer breached a fiduciary duty for causing the RMD failure. Participants with failed RMDs must file an IRS Form 5329 with their federal tax return for the year in which the full amount of the RMD was not taken.

The participant's excise tax penalty may be waived if he or she can establish that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall by filing IRS Form 5329 and attaching a letter of explanation. Alternatively, a plan sponsor that corrects RMD failures through the IRS EPCRS with a Voluntary Correction Program submission can request that the 50 percent excise tax be waived for affected participants. A plan sponsor using the self-correction procedure cannot obtain relief for a participant's excise tax. Despite the consequences of failed RMDs, procedures for requesting RMDs are not always clear in plan documents and there is no exception to the RMD requirement even if a participant does not come forward to initiate them.

Waiver of Excise Tax

The proposed regulations provide two situations in which an automatic waiver of the excise tax applies, one of which is based on the automatic waiver in the existing regulation. The first situation in which the automatic waiver applies is when: (1) the employee (or in the case of an IRA, the IRA owner) died before the required beginning date; (2) the payee is an eligible designated beneficiary who did not make an affirmative election to use the life expectancy rule but otherwise is subject to the life expectancy rule pursuant to a plan provision or the regulatory default provision that applies in the absence of a plan provision; (3) the payee did not satisfy the RMD requirements; and (4) the payee elects for the employee's or IRA owner's entire interest to be distributed under the 10-year rule. In that case, once the payee elects the 10-year rule, the payee's RMD in the tenth

calendar year following the calendar year of the employee's or IRA owner's death is the entire account balance.

The second situation in which an automatic waiver applies is in the case of an individual who had an RMD requirement in a calendar year and died in that calendar year before satisfying that RMD requirement. In this situation, the individual's beneficiary must satisfy the RMD requirement by the end of that calendar year. However, if that beneficiary fails to satisfy the RMD requirement in that calendar year, then the excise tax for the failure to take the distribution is automatically waived provided that the beneficiary satisfies that requirement no later than that beneficiary's tax filing deadline (including extensions thereof).

RMDs and Missing Participants

Administration of RMDs also has been historically complicated when there are missing participants. The IRS Overview of Form 5500 Examination Procedures [Internal Revenue Manual 4.71.1. dated February 25, 2022] provides that when examiners review plan distributions, they must verify that the RMD requirements of Code section 401(a)(9) have been satisfied. These IRS Examination Procedures incorporate a May 2021 IRS field directive that was issued to examination agents on missing participants and beneficiaries and RMDs, and they provide a note that when the only reason a plan fails to make an RMD is because the participant or beneficiary is missing, the plan's qualified status should not be challenged. The caveat is that before a participant or beneficiary is considered missing, a diligent search for that individual must be conducted, which includes all of the following steps: (1) a search for alternate contact information (address, telephone, or email) contained by the plan, related plan, plan sponsor and publicly-available records or directories; (2) use of a commercial locator service, a credit reporting agency or a proprietary internet search tool for locating individuals; and (3) the mailing of a contact letter sent by United States Postal Service via certified mail to the last known address and to any other alternate address found. If a plan does not follow these steps to locate missing individuals and RMDs to those individuals are not made when due, then the IRS employee plan examiner can challenge a plan's tax qualified status for violation of the RMD requirements.

In recent years, the US Department of Labor (DOL) has also expanded its plan audits to include a review of RMDs and plan sponsor attempts to locate missing participants and beneficiaries as part of its review of plan sponsor fiduciary practices and responsibilities. While the results of these audits may differ, DOL auditors can require plan sponsors to establish procedures for locating missing individuals and making required RMD payments as part of their fiduciary responsibilities. In the DOL's view, plan fiduciaries have a duty to maintain accurate and up to date contact information for participants and beneficiaries so that they receive all applicable plan information which would include communications regarding RMDs. In 2014, the DOL issued Field Assistance Bulletin No. 2014-01 (FAB 2014-01), which addressed the missing participant issue in the context of a terminated defined contribution plan (for example, 401(k) plan). On January 12, 2021, following the Employee Benefits Security Administration's (EBSA) completion of a nationwide compliance initiative, the DOL issued Missing Participants-Best Practices for Pension Plans. These best practices outline steps that the fiduciaries of defined benefit and defined contribution plans can follow to ensure that plan participants and beneficiaries receive their benefits.

What Should Plan Sponsors and Fiduciaries Do at This Time?

The recent statutory and regulatory changes create the potential for administrative errors. To avoid errors, plan sponsors and fiduciaries should ensure that RMD provisions are timely amended in their plan documents, their administrative procedures are up to date, and the revised rules are communicated to participants. In light of the evolving RMD guidance, and the complexities involving missing participants and beneficiaries, plan sponsors and fiduciaries should ensure that they maintain updated RMD procedures and plan documents. Considerations include:

- Amending plan documents. The SECURE Act and CARES Act generally require employers to amend their plans by the end of the plan year starting in 2022 (later deadlines apply to governmental and certain collectively bargained plans). The IRS did not include these changes on the 2021 Required Amendments List, which would have extended the deadline to Dec. 31, 2023. Unless the IRS issues other guidance, plan sponsors can reasonably assume the statutory deadline for these amendments will apply—December 31, 2022, for calendar-year plans not subject to a later deadline.

Any optional provisions related to the 2020 RMD waiver as set forth in IRS Notice 2020-51 also must be documented in the plan amendment to reflect the operation of the plan. In the event a plan must be terminated prior to the plan amendment deadline due to a corporate transaction or otherwise, the plan must be amended and brought up to date to reflect all legally required or other optionally administered plan amendments as of the plan termination date. Summaries of material modifications to summary plan descriptions, or new summary plan descriptions incorporating the updated rules, must also be timely issued to participants and beneficiaries.

- Developing and/or updating RMD procedures for locating participants and making required RMD payments to participants. In light of the IRS guidance for diligent participant searches, and DOL best practices to mitigate the problem of missing or nonresponsive participants, plan sponsors and fiduciaries should consider establishing a timeline and process for participant outreach and searches well in advance of their required beginning date, documenting steps taken for locating missing participants, unresponsive participants and beneficiaries, and putting procedures in place for managing missing participants' accounts. These procedures might include:
  - Keeping accurate plan participant census data up to date for current and former employees and beneficiaries by seeking re-confirmation of important contact information, and self-auditing information to make appropriate follow-ups. Updates might be obtained through requests distributed in plan communications with a reminder to advise the plan of contact information changes. This also may be included in online platforms where participants are expected to log in to access their account information.
  - Conducting missing participant searches via tactics that might include:
    - Reviewing related plan (such as a health plan) and other employer records (such as payroll records) for participant, beneficiary, and next of kin/emergency contact information.
    - Contacting designated plan beneficiaries (for example, spouse and/or children) and the employee's emergency contacts (in the employer's records) for updated contact information or requesting that they forward a letter to the missing participant.
    - Using free online search engines, public record databases (such as those for licenses, mortgages and real estate taxes), Social Security Death Index, obituaries, and social media to locate individuals.
    - Using a commercial locator service, a credit-reporting agency, or a proprietary internet search tool to locate individuals.
    - Attempting contact via the United States Postal Service certified mail, or private delivery service with similar tracking features to the last known mailing address.
    - For unionized employees, consider reaching out to the union's local offices and through union member communications to find missing retirees.
    - Registering missing participants on public and private pension registries using appropriate privacy and cyber security protections (for example, National Registry of Unclaimed Retirement Benefits), and publicizing the registry through emails, newsletters, and other communications to existing employees, union members, and retirees.
    - Participating in the national online database of lost and found retirement accounts, if established, which has been proposed in retirement bills in recent years.
  - Keeping a log of undeliverable mail, email, and uncashed checks for follow-up actions.
  - Ensuring that, in the event there is a conversion of the plan to a new service provider or a corporate transaction, the appropriate plan data is transferred and provision is made for missing participant searches.
  - Working with third-party administrators and recordkeepers to ensure missing participant procedures comply with the guidance issued by the DOL and the IRS, and keeping detailed audit trails of the efforts made to communicate with participants and beneficiaries.
  - Updating procedures for the different types of RMD distributions to participants, designated beneficiaries, eligible designated beneficiaries, and various types of trusts (being mindful of the new definitions applicable to these payees), and incorporating the documentation requirements the regulations will require for each type of individual and/or trust.

- Reviewing service provider agreements to determine scope of available RMD services, assistance in locating missing participants/beneficiaries, and meeting RMD timelines, and making any necessary changes or updates to the scope of such services to address the new requirements and documenting the reasonableness of any fees for such services.
- Developing a communication strategy to make participants and beneficiaries aware of RMD requirements, including a timeline to reach out to participants well in advance of their required beginning dates so appropriate action can be taken to locate them before RMDs are missed, and update summary plan descriptions and other benefits guides for the amended rules.
- Ensuring plan records and beneficiary designation records are up to date.
- Conducting a self-audit to determine any RMD operational failures and undertaking appropriate corrective action under the IRS EPCRS self-correction or voluntary correction programs.
- Monitoring new legislation and final regulations and updating plan documents and procedures accordingly.

Conclusion

There are many RMD rules to administer, and further guidance on RMDs will almost certainly be issued. Plan document provisions and procedures need to be reviewed in accordance with that guidance and updated accordingly. The key to compliance will be adherence to well-developed policies and procedures to timely administer RMDs in accordance with the applicable rules, ensure participants and beneficiaries can be located, and ensure participants understand their RMD requirements. Plan sponsors that monitor their demographics and RMD processes will avoid errors and be prepared for an audit of RMD procedures and fiduciary responsibilities. The issuance of further guidance on these issues should be monitored so that it can be timely addressed. ■

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