Workshop 10: Post-Normal Retirement Age and Post-Age 70½ Benefits

Richard A. Block, ASA, MSPA, MAAA
Block Consulting Actuaries, Inc.
El Segundo, CA

Jeffrey D. Wadle, MSPA
Greenspan & Associates Inc.
Encino, CA
Basic Plan Provisions/Assumptions

• Normal Retirement Age is 65. Normal form is a single life annuity
• Actuarial equivalency is 5% pre & 5% 1994 Group Annuity Reserving Table post
• Optional forms, Late and Early Retirement Benefits are actuarial equivalent to the Normal Retirement Benefit
• Examples assume participants have 10 years of service & participation
Definitions

- **Required Minimum Distribution (RMD):** For DC plans, minimum amount a participant must receive after attaining age 70½. For DB plans, it is the commencement of the entire benefit in a permissible form.
- **Required Beginning Date (RBD):** Latest date a participant must start receiving RMDs.
- **Distribution Calendar Year:** Calendar year in which the payment is made to comply with §401(a)(9).
- **5% Owner:** Participant who owns more than 5% of the sponsor (same definition as under §416 for a Key Employee).
- **QJ&S:** Qualified Joint & Survivor Annuity. Normal form of payment for a married participant.
- **APR:** Annuity Purchase Rate. The present value of $1 payable monthly for the life of a participant and beneficiary.
- **ASD:** Annuity Starting Date. The date when payments begin.
- **Actuarial Equivalent Benefits:** Two or more benefits are actuarially equivalent if the present value of each benefit is the same.
Benefits After Normal Retirement Age

• 1.411(b)(5). The rate of benefit accruals may not be reduced on account of the attainment of any age

• Plan X provides that benefit accruals cease after twenty years of participation. This plan does not violate 1.411(b)(5)

• Plan Y provides that benefit accruals cease after Normal Retirement Age. This plan does violate 1.411(b)(5)
Benefits After Normal Retirement Age

- Plan Z’s benefit formula is equal to 5% of plan year pay for each year of participation to a maximum of 20 years. Participant enters the plan at age 50. After NRA, this participant must continue to accrue benefits until age 70 when the participant has 20 years of participation. At age 70, the plan will not recognize additional years of service or increases in pay.

- Plan A’s benefit formula is equal to 50% of pay reduced by the ratio of years of participation to years of participation at NRA but not less than 25 years and accrued using the fractional rule based on participation. Participant enters the plan at age 45. After NRA, the participant’s fraction must recognize additional years of participation in addition to increases in pay.
Actuarial Adjustments After NRA

• Most plans require an actuarial adjustment after NRA so that the adjusted benefit is the actuarial equivalent of the benefit paid in an earlier year (Proposed 1.411(b)-2)
• Benefits are actuarially increased by interest and the shorter life expectancy
• Participant age 66 in a frozen defined benefit plan had an accrued benefit at age 65 of $1,000 a month. The actuarial equivalent benefit at age 66 is:
  \[ \frac{1,000 \times 141.53}{137.93 \times 1.05} = 1,077 \]
• There is no adjustment for survivorship because there is no forfeiture on death
Forfeitures of Benefits

• If the plan provided for a forfeiture on death, i.e., the death benefit is a benefit payable to the surviving spouse that is 50% of the benefit the participant would have been paid assuming an election of a 50% Joint and Survivor benefit on the date of death.

• Note a participant may forfeit in two ways;
  – 1. The value of the survivor annuity is less than the value of the participant’s accrued benefit
  – 2. If the participant was not married, no benefit would be payable
Forfeitures of Benefits

• If the plan provided for forfeitures on death then

• Benefits are actuarially increased by interest, the shorter life expectancy and survivorship

• The actuarially adjusted benefit is then
  – $1,000 \times 141.53 \div 137.93 \times 1.05 \times 1.01157 = 1,090
  – Where 1.01157 is the adjustment for survivorship

• On Post Distribution audits, the PBGC is asserting adjustments for survivorship are required for all plans
Actuarial Adjustments After NRA

• Let’s change the example where the participant is accruing benefits.
• Accrued benefit at NRA (65) = $1,000
• Accrued benefit at age 66 = $1,100
• Actuarially adjusted benefit at age 65 is $1,077
• Benefit payable at age 66 is the greater of the benefit with continued accruals or the actuarial equivalent benefit at the end of the prior year or $1,100
Suspension of Benefits

• Actuarial adjustments after NRA are not required if participants are given Suspension of Benefit Notices

• Notice must include:
  – Benefits will not be adjusted if participant continues employment
  – Description of the plan provisions
  – A copy of those provisions
  – Cite 2530.203-3 and where to find a copy
  – Procedures to appeal suspension
CENTRAL LABORERS. PENSION FUND, PETITIONER
\( v. \) THOMAS E. HEINZ ET AL.

- June 7, 2004 Supreme Court Decision
- Adding or expanding a Suspension of Benefit provision will violate 411(d)(6) unless accrued benefits prior to the change are grandfathered
415 limits may require a suspension of benefits notice

• The current IRS position is that a forfeiture of benefits occurs due to the lack of an actuarial adjustment under the compensation limit or the dollar limit between age 62 and 65.

• Therefore, a suspension of benefits notice will be required in this situation. This applies even if the normal plan provisions provide for an actuarial adjustment as 415 prevents this adjustment.
Considerations on RMDs

- Required Minimum Distributions must comply with the §401(a)(9) and its regulations.
- RMDs based on the account balance method are not allowed after 2005 but a payment form of a single payment is permitted.
- Participant must elect from available benefit forms at the Required Beginning Date (RBD) and at any later Annuity Starting Date (ASD).
- Payments must comply with §§415, 411, 417, as well as the Minimum Distribution Incidental Benefit (MDIB) rules.
- Payments must be a valid option under the terms of the plan.
- The benefit form should include a death benefit for a small plan to avoid excess assets in case of death. A term certain annuity is often a good choice.
- Individual may wish to minimize payments.
Benefit at RBD

• Treat the participant as if he or she is retiring
• Provide benefit election form listing all options that are available under the plan
• Benefit election form must show relative values of each optional form
• After participant elects form of benefit, that form continues for that benefit for all future years unless an event occurs to allow a change
• Don’t forget to include spousal consent for any form that is not a QJ&S
• Participant makes no further elections unless it is to change tax withholding
RMD Without Benefit Election

- Participant has not returned benefit election forms or has elected payment without required spousal consent
- Plan Administrator must begin payments by RBD based on the plan’s normal form
  - Normal form is likely a life annuity for unmarried participants
  - Normal form for married participants is a QJ&S
- The result may be a benefit form the participant (or beneficiaries) may not like
Benefit Payable at RBD

- Participant is 70-3/4 at RBD
- Participant’s monthly accrued benefit at RBD is $10,000
- Plan’s QJ&S benefit is 100% continuation to spouse beneficiary
- Participant makes no election
- At the ASD, participant is age 70-3/4 and Spouse is age 55½
- 100% QJ&S payable is: $10,000 x 120.20 / 180.26 = $6,668.15
Single Sum Payable in 1st Distribution Calendar Year-Annuitity Option

- An unmarried participant is 70½ on his ASD of January 1st.
- Participant’s monthly accrued benefit at ASD is $10,000
- Participant elects a Lump Sum
- Lump sum is: $10,000 × 130.83* = $1,308,300
- How much may be rolled?
- Amount that may be rolled is the Lump sum reduced by the annuity for the first distribution calendar year
  - $1,308,300 – 12 × $10,000 = $1,188,300 may be rolled

* § 417(e)(3) rates
Single Sum Payable in 1<sup>st</sup> Distribution Calendar Year-Account Balance Option

- An unmarried participant is 70½ on his ASD
- Participant’s monthly accrued benefit at ASD is $10,000
- Participant elects a Lump Sum to be paid on his ASD
- Lump sum is: $10,000 x 130.83* = $1,308,300
- How much may be is rolled?
  - RMD=Distribution / Life Expectancy
  - RMD= $1,308,300 / 27.4 = $47,748
- Amount that may be rolled: $1,308,300 - $47,748 = $1,260,552

* § 417(e)(3) rates
Single Sum Payable in 2\textsuperscript{nd} Distribution Calendar Year-Annuity Option

- An unmarried participant is 70.75 on his RBD (4/1 after 70\½)
- No payments taken in 1\textsuperscript{st} Distribution Calendar Year
- Participant’s monthly accrued benefit at RBD is $10,000
- Participant's monthly accrued benefit as of the first day of the first distribution calendar year was $9,000 per month.
- Participant elects a Lump Sum to be paid on RBD
- Lump sum is: $10,000 \times 129.76^{*} = $1,297,600
- How much may be is rolled?
- Amount that may be rolled is the Lump sum reduced by the annuity for the first two distribution calendar years
  - $1,297,600 – 24 \times $9,000 = $1,081,600 may be rolled

\* § 417(e)(3) rates
Lump Sum Payable in 2nd Distribution Calendar Year

- Same situation as on prior slide
- Lump sum is: $10,000 x 129.76* = $1,297,600
- How much may be rolled?
  - Alternative 1
    - RMD = Distribution / Life Expectancy x 2
    - RMD = $1,297,600 / 26.5 x 2 = $97,932
  - $1,297,600 - $97,932 = $1,199,668 may be rolled
  - Alternative 2
    -- RMD distribution/ Life Expectancy for 1st year plus RMD distribution / Life expectancy for 2nd year. Cannot subtract 1st year RMD in calculating 2nd year RMD.
    -- RMD #1 = $1,297,600/27.4 = $47,358. RMD #2 = $1,297,600 / 26.5 = $48,966.
  - $1,297,600 - $47,358 - $48,966 ($96,324) = $1,201,276 may be rolled
Accruals

• All benefit accruals through the 1st distribution calendar year must be recognized for payments on or after RBD

• Additional accruals must be recognized no later than the year following the year of accrual on an annualized basis

• Increases in vesting are treated as additional accruals

• If not vested at the end of a distribution calendar year then no payments are due
Actuarial Increases

• **IF** the plan provides for suspension of benefits under §203(a)(3)(B) of ERISA, DOL regulation §2530.203-3 and Treasury regulation §1.411(a)-4 **AND** the notices are provided timely **THEN** actuarial increases are not required between NRA and age 70½

• After age 70½, §401(a)(9) requires actuarial increases for ASDs after age 70½ through the date benefits commence
Actuarial Increases

• Participant (age 65) has a frozen monthly accrued benefit of $10,000.
• Participant is given suspension of benefit notices
• Participant retires at age 75. Benefit must be actuarially increased from age 70½ to 75.
• Benefit payable is: $10,000 \times 121.17 / 103.19 \times 1.05^{4\frac{1}{2}} = $14,625
Actuarial Increases

• Participant (age 65) has a frozen monthly accrued benefit of $10,000.
• Plan does not provide for suspension of benefits or notices are not provided
• Participant retires at age 75. Benefit must be actuarially increased from age 65 to 75.
• Benefit payable is: $10,000 x 141.53 / 103.19 x 1.05^{10} = $22,341
• $22,341 exceeds the § 415 limit therefore only $20,556* may be paid!
• Plan violated § 411
• Benefits should have commenced at age 73 to avoid an impermissible forfeiture. This might have required a plan amendment to allow in-service distributions
• *High consecutive 3 year average of § 401(a)(17) limits
Actuarial Increases

- Employee’s monthly benefit payment is $10,000 payable as a life annuity
- Employee accrues an additional monthly benefit of $1,000 at age 71 on January 1st
- Payment of the additional benefit will start at age 72.
- Benefit must be actuarially adjusted for the delay: $1,000 \times 119.23 / 115.29 \times 1.05 = $1,085.88
- Monthly benefit payable at 72 is $11,085.88 for the entire calendar year and all future years plus additional benefit accruals
Effect of actuarial increases for 401(a)(4)

• Post-NRD actuarial increases are disregarded in the calculation of the accrual rate.
• This only applies to actuarial adjustments not greater than an adjustment based on standard interest and mortality tables.
• If additional accrual under plan formula offset by AE adjustment, only net accrual counts for accrual rate.
• Only an actuarial adjustment actually provided by the plan may be disregarded. If a plan provides for no actuarial adjustments, the entire additional accrual counts for 401(a)(4) and cannot be offset by an “imputed” actuarial adjustment.
Effect of actuarial increases for 410(b)

• A participant is benefitting if they would have received an additional accrual under the plan formula disregarding whether it was fully offset by an actuarial increase.

• Do not benefit solely because of an actuarial adjustment. If the plan formula is frozen and an HCE’s benefit increases solely due to actuarial adjustment, no TH minimum is triggered.

• Are excess AE adjustments in excess of a “reasonable” AE adjustment considered benefitting for 410(b) in a manner similar to 401(a)(4). If so, can the standard interest rate and mortality be assumed to be a safe harbor?
Conversions to Certain Payouts

- Participant is age 70½ with a monthly accrued benefit of $10,000 & elects a 15 year certain benefit with annual payments
- Present value on plan rates: $10,000 × 121.23 = $1,212,300
- Present value of benefit divided by present value of $1 payable annually for 15 years on plan rates: $1,212,300 / 10.8986 = $111,234
- Present value on § 417(e) rates $10,000 × 130.83 = $1,308,300
- Present value of benefit divided by present value of $1 payable for 15 years on § 417(e) rates: $1,308,300 / 11.3767 = $114,998
- Participant receives annual payments of $114,998 for 15 years.
Increasing Annuity Streams

• Benefits may be increased by using the following indices:
  – Consumer Price Index
  – Consumer Price Index with a maximum fixed rate. Minimum adjustment may not exceed (a) cost of living index for the year or (b) accumulated excess over the current fixed rate
  – Fixed rate that is less than 5% a year
Death Benefits-Minimum Distribution

Incidental Benefit Requirements (MDIB)

- The primary purpose of a defined benefit plan is to provide retirement benefits
- The plan may provide an “ancillary” death benefit in addition to the annuity for the accrued benefit
- RMD payments must comply with the MDIB requirements
- If no ancillary death benefit is provided, the general incidental benefit rules are deemed satisfied by the MDIB
- If an ancillary death benefit is provided, the annuity, excluding the death benefit, must satisfy MDIB and the total benefits, including the ancillary death benefit, must satisfy the general incidental death benefit rules (which are not well defined)
Death Benefits-MDIB

• Once benefit payments commence, the form of payment dictates the death benefit
• Allowable forms that meet MDIB rules:
  – Joint & Survivor benefit
  – Period certain
  – Life with a period certain
  – Present value as of the ASD less actual benefits paid (Modified Cash Refund)
  – Lump Sum Settlement
Death Benefits-MDIB

• Note: the MDIB rules do not include:
  – Life annuity with a death benefit equal to the present value of the remaining payments
  – 100 x the monthly accrued benefit
• What happens if the plan has a life insurance policy on the participant who turns 70½?
MDIB Limitations on Certain Periods

- Spouse beneficiary - Period certain may not exceed the life expectancy under Joint & Last Survivor Table in §1.401(a)(9)-9. Alternatively, the period certain may use the Uniform Lifetime Table.

- Non-spouse beneficiary - Period certain may not exceed the life expectancy under Uniform Lifetime Table in §1.401(a)(9)-9.
MDIB Limitations On Joint & Survivor Benefits

- Spouse beneficiary-Minimum Distribution Incidental Benefit (MDIB) rules are deemed to have been met if the survivorship percentage is no more than 100%.

- Non-spouse beneficiary-MDIB rules limit the survivorship percentage based on the adjusted age differential on the ASD.

- Adjusted age differential: $2 \times \{\text{Participant Age at ASD (not greater than 70)}\} - \text{Beneficiary Age at ASD-70}$. Age is attained age at ASD. Then look up maximum percentage on chart.
MDIB Adjusted Age Differentials

- Participant age 65 with a non-Spouse beneficiary age 55: $2 \times 65 - 55 - 70 = 5$
- Participant age 67 with a non-Spouse beneficiary age 57: $2 \times 67 - 57 - 70 = 7$
- Participant age 69 with a non-Spouse beneficiary age 59: $2 \times 69 - 59 - 70 = 9$
- Participant age 70 with a non-Spouse beneficiary age 60: $2 \times 70 - 60 - 70 = 10$
### MDIB Limitations On Joint & Survivor Benefits

Maximum continuation percentages for non-spouse beneficiary

<table>
<thead>
<tr>
<th>Adjusted employee/beneficiary age difference</th>
<th>Applicable Percentage</th>
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</thead>
<tbody>
<tr>
<td>10 years or less</td>
<td>100%</td>
</tr>
<tr>
<td>11</td>
<td>96%</td>
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<tr>
<td>12</td>
<td>93%</td>
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<td>90%</td>
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<td>24</td>
<td>67%</td>
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<td>25</td>
<td>66%</td>
</tr>
<tr>
<td>26</td>
<td>64%</td>
</tr>
<tr>
<td>27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44 and greater</td>
<td>63%, 62%, 61%, 60%, 59%, 58%, 57%, 56%, 56%, 56%, 55%, 55%, 55%, 54%, 54%, 54%, 53%, 53%, 53%, 52%</td>
</tr>
</tbody>
</table>
Examples of Annuity Streams

Benefits with & without 4.99% COLA for participant age 70 with a spouse beneficiary age 55:

<table>
<thead>
<tr>
<th>Form of Payment</th>
<th>Monthly Payment Without COLA</th>
<th>Initial Monthly Payment With COLA</th>
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</thead>
<tbody>
<tr>
<td>Life Annuity</td>
<td>$10,000</td>
<td>$6,567</td>
</tr>
<tr>
<td>100% JS</td>
<td>$6,769</td>
<td>$3,508</td>
</tr>
<tr>
<td>31 Year Certain</td>
<td>$6,645*</td>
<td>$3,578*</td>
</tr>
<tr>
<td>31 Year C &amp; L</td>
<td>$6,406</td>
<td>$3,310</td>
</tr>
<tr>
<td>Life with Cash Refund</td>
<td>$9,104</td>
<td>$5,357</td>
</tr>
</tbody>
</table>

*417(e) rates
Examples of Annuity Streams

Benefits with & without 4.99% COLA for participant age 70 and non-spouse beneficiary age 55

Age adjusted differential = 2 x 70 – 55 - 70 = 15

<table>
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<td>$6,567</td>
</tr>
<tr>
<td>84% J&amp;S</td>
<td>$7,139</td>
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<td>27 Year Certain</td>
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<td>27 Year C &amp; L</td>
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<td>$3,776</td>
</tr>
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</tr>
</tbody>
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*417(e) rates
Permitted Changes in Payouts

• Benefit form may be changed at:
  – Retirement
  – Plan termination
  – Change is allowed to a QJ&S if just married

• If the benefit form is a period certain without life contingencies, then payment amount may be increased at any time as long as the ending date of the period certain is not extended

• Other requirements-Change treated as a new ASD and new payout must comply with §§ 401(a)(9), 415, 411, 417 & MDIB
Multiple Annuity Starting Dates (MASDs)

- MASD when participant changes benefit form
- New ASD for §§ 411, 417 & 415
- Revised income stream must comply with §§ 411, 417 & 415
- § 415 regulations have deferred guidance but § 401(a)(9) regulations did not
Multiple Annuity Starting Dates (MASDs) - § 415 Regulations

• "If a participant has or will have distributions commencing at more than one annuity starting date, then the limitations of section 415 must be satisfied as of each of the annuity starting dates, taking into account the benefits that have been or will be provided at all of the annuity starting dates."
MASDs- § 401(a)(9) Regulations

• Overview of the § 401(a)(9)/ § 415 regulations on MASD. The questions to be answered are:
  – Does the original income stream comply with § 415 as of the 1st ASD?
  – Does the income stream as modified comply with § 415 as of the 1st ASD?
  – Does each modification of the income comply with § 415 at the later ASD?
MASDs Under § 401(a)(9)

• Regulations have not been rescinded
• Regulations do not address situations where the participant is continuing to accrue benefits
• Regulations do not address changes in compensation
• Regulations do not address increases in the § 415 limits
• Conclusion: Do what is reasonable under the specific situation
Cash Balance Plans

• AKA Hybrid Plans, Applicable Defined Benefit Plans, Pension Equity Plans
• Accrued Benefit is defined as an account that represents the present value of the monthly accrued benefit.
• The account balance is increased by pay credits and interest credits.
• **Picture a money purchase plan with a stipulated interest credit**
• Interest credits do not have to be the same as interest under the plan’s definition of Actuarial Equivalency
• Congress is concerned interest credits may exceed a market rate.
• § 417(e)(3) conversion rates do not apply to non-annuity forms of payment
• Typically lump sums are equal to the participant’s account balance
Cash Balance Plans

• The monthly accrued benefit payable at NRA is calculated by increasing the current account balance at the current interest crediting rate to the participant’s Normal Retirement Age.

• Then using the plan’s definition of actuarial equivalency, the projected account balance is converted into an annuity commencing at Normal Retirement Age.
Cash Balance Plans

- Participant is age 70½. Account Balance is $10,000
- Actuarial equivalency assumptions: 5%/5%
  94GAR
- Accrued monthly benefit is $10,000 / 121.17 = $82.53
- RMDs are based on the $82.53 monthly benefit
Cash Balance Plans

• Plan’s interest credit is 5%.
• Actuarial equivalency is 5%/5% 94GAR.
• Participant’s account balance is $10,000
• Participant is age 30
• Normal Retirement Age is 65
• The accrued monthly benefit is calculated as follows:
  • $10,000 \times 1.05^{(65-30)} / 141.53 = $389.74
Cash Balance Plans

- Plan’s interest credit is 4½%.
- Actuarial equivalency is 5%/5% 94GAR.
- Participant’s account balance is $10,000
- Participant is age 30
- Normal Retirement Age is 65
- The accrued monthly benefit is calculated as follows:
  - $10,000 \times 1.045^{(65-30)} \div 141.53 = $329.78
Cash Balance Plans

• If the participant reaches NRA, then the projection period is zero

• The monthly accrued benefit is the account balance converted into an immediate annuity using the plan’s definition of Actuarial Equivalency
Cash Balance Plans

• Because the account balance is always given an interest credit the monthly benefit is automatically adjusted for delayed retirement

• When the interest credit is less than the actuarial equivalent interest rate, there could be a problem complying with § 401(a)(9) and/or § 411
Cash Balance Plans

- Account balance at age 65 (NRA) is $141,530 which translates to a $1,000 immediate life annuity monthly benefit
- No suspension of benefit notifications are issued
- Interest crediting rate is 4½%
- Actuarial Equivalency is 5%/5% 94GAR
- Account Balance at age 75 is:
  - $141,530 x 1.045^{(75-65)} / 103.19 = $2,129.97
- However the actuarial equivalent benefit at 75 is:
  - $1,000 x 141.53 / 103.19 1.05^{(75-65)} = $2,234.11
Cash Balance Plans

- In order to comply with § 411 and § 401(a)(9), the monthly accrued benefit cannot be less than $2,234.11 at age 75.
- All optional forms must be based on the higher benefit
- For instance, a lump sum settlement would be $2,234.11 \times 103.19 = $230,538
- Even though the account balance at age 75 was $219,792, the plan must pay a lump sum of $230,538 or any other optional form on the greater amount
Advanced Topics

These are presented in the form of questions and answers. If the answer is “proposed”, the correct position is not totally clear and might be arguable.
Questions On 401(a)(9) single sum payments

• The following seven questions relate to the rules regarding a “single sum distribution of an employee’s entire accrued benefit during a distribution calendar year” in IRS regulation 1.401(a)(9) -6 A-1(d).
Question #1

• Which of the following, if any, qualifies as a single sum payment?
  • A) The participant elects a two-payment term certain annuity with one payment for 50% of PVAB in January and the remainder paid in December.
Question #1 continued

• B) The participant elects a partial lump sum for 50% of PVAB in January and later elects a lump sum for the remainder in December.

• C) A participant elects a lump sum to be paid on one date, but it is paid in two checks one week apart (but same monthly age and stability period) in order to facilitate calculation of value of non-cash distribution.
Proposed Answer #1

• A) The IRS reg definition is not specific but it is at least arguable that this qualifies as everything is being distributed in one year and this was elected at the initial ASD.

• B) This is much more questionable. The regulations and presumably plan provisions should require commencement of entire benefit so an initial election for 50% of PVAB should be potentially disqualifying. Perhaps electing to “complete” the entire distribution with the second lump sum could be an EPCRS SCP correction. There should be no excise tax as the entire benefit was distributed.
Proposed Answer #1 continued

C) As distribution of the entire benefit was elected with regard to one ASD, and completed during a period where the PVAB would not change (as same stability period and no change in age), the two payments one week apart should be considered a “single payment”.

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Question #2

• Is the single sum payment method the same as the old account balance method?
Answer #2

• It is similar but it is not identical. The calculation of the non-rolloverable portion is made based on the actual distributions made and not the PVAB at BOY. The actual distribution will be based on the accrued benefit as of distribution date and actuarially adjusted from earlier NRD or accrual date. Therefore, the “RMD” increases the later in the year the distribution is made.
Answer #2-Continued

• In addition, the account balance method allowed a lump sum for only part of the benefit - the single sum payment rule does not. It should also be noted rules similar to the rule for DC plans apply for a distribution made in the year containing the RBD – you cannot subtract the 1st year RMD from the distribution when calculating the 2nd year RMD.
Question #3

• May a participant elect a payment form with an initial lump sum for 50% of PVAB and the remainder paid as an annuity over future years?
Proposed Answer #3

• Yes, this would be a non-decreasing annuity including that initial “lump sum”. But it would not be a “single sum payment” and so that initial “lump sum” would be fully taxable.
Question # 4

• What are the consequences if a single lump sum is entirely rolled over to an IRA? What if this was mistakenly done as a direct transfer? Is this potentially disqualifying and is there an excise tax for a missed RMD?
Proposed Answer #4

- If the participant rolls 100% of the lump sum to an IRA, this is simply an excess IRA contribution, or just possibly, all or a portion could be considered a normal IRA contribution if under limits. This would appear clear and non-controversial.
Proposed Answer #4 continued

• If the administrator/trustee does a direct transfer to an IRA in error, this should not be a disqualifying error or violate 401(a)(9) itself, in the absence of a specific plan provision NOT allowing a direct rollover of amounts ineligible for rollover. Most plans have language specifying that eligible amounts must be allowed to be directly rolled over but no specific language with regard to ineligible amounts. At most there is only an implied rule.
Proposed Answer #4 continued

• Therefore the plan did distribute the RMD so no violation of 401(a)(9). The improper direct rollover is a violation of 402, which is not a qualification section. There is no EPCRS correction needed. This should be treated in the same manner as the participant rolling over an excess amount, except the trustee or administrator may have some need to reimburse the participant for a fiduciary violation to the extent the mistake is their responsibility.
Proposed Answer #4 continued

• There is no excise tax due for a missed RMD. The plan did distribute all of the RMD – the part was improperly rolled over does not result in an excise tax on missed RMD. However, an excise tax due to an excess IRA rollover may apply if the excess amount is not refunded timely.
Excise Tax on Missed RMD

• Failure to pay RMD:
  – Participant must pay a 50% excise tax on the shortfall (IRS form 5329 allows waiver of tax for reasonable cause)
  – VCP will consider waiving the excise tax

• Failure to provide actuarial increases
  – Self correction when possible otherwise VCP
Question #5

• The initial accrued benefit commences as an annuity at RBD – possibly because 436 restrictions apply. The annuity is not converted to a lump sum and continues being paid. In a later year, may the participant elect distribution of the additional accrual as a “single sum payment” and roll most to an IRA, while continuing annuity payments on initial accrual? In this context, does “entire” benefit refer to just the additional accrual?
Proposed Answer #5

- Although the regulations are not clear on this, and a strictly literal interpretation might be that this is not allowed, it would appear to be a reasonable non-abusive interpretation and hopefully should be acceptable.
Question #6

• In the initial distribution calendar year, is a lump sum payment of only the accrued benefit at BOY a single sum distribution, if the accrual during the year commences in following year by RBD? Does this depend on whether that additional accrual has accrued by the initial ASD?
Proposed Answer #6

- The regulations include a provision with regard to a single sum payment in the 2\textsuperscript{nd} distribution calendar year that applies only IF the “RMD” for the 1\textsuperscript{st} distribution calendar year has not been paid. This implies that it is possible to have already paid it in the prior year which is consistent with this sort of flexibility.
Question # 7

• An annuity is commenced at RBD. In a later year, after 6 annuity payments are made, the remaining value is converted and paid as a lump sum. What is the non-rolloverable portion of this payment?
Question #7 continued

• A) Calculate the non-rolloverable portion by treating the total of the lump sum and 6 annuity payments as the “single sum payment” dividing the result by life expectancy, and subtract the 6 annuity payments made and not rolled over.

• B) Calculate the non-rolloverable portion of the lump sum separately and the prior 6 annuity payments are simply taxable and do not count as part of the single sum payment.

• C) there is no single sum payment and it is all taxable.
Proposed Answer #7

- Position A) does seem to be arguably reasonable even if you use the life expectancy method. But position B) is safer and would be equivalent to position A) if you use the annuity rule and treat the total annuity payments as only referring to future annuity payments not made. Position C) would be extremely harsh and presumably would have been made clear in the regs if intended.
Questions on commencement of additional accruals

• The following seven questions relate to commencement of additional accruals under 1.401(a)(9)-6 A-5
Question #8

• If the initial accrued benefit commences as an annuity, when do additional accruals after the 1st distribution calendar year have to commence?
Answer #8

- Additional accruals must commence beginning with the first “payment interval” ending in the calendar year following the accrual. A payment interval is not precisely defined but it appears payment intervals are defined as the period ENDING with a payment.
- The payment interval will be defined by the form elected by the participant and spouse in the election forms commencing the initial accrued benefit.
Answer #8-Continued

• Therefore, if the initial accrual commences as an annual annuity with payments due each April 1st, the “payment interval” is April 2nd to April 1st. The additional accruals would need to commence in some form by the following April 1st.

• If the initial accrual commences as a monthly annuity with payments made at the beginning of the month, the payment interval will END on the first day of each month and additional accruals should commence on January 1st.
Question #9

• If the commencement of additional accruals as an annual annuity sets an “annuity payment period” and a deadline for additional accruals to commence, in what form may additional accruals commence?
Proposed answer #9

• The regulations only define the date the additional accruals must commence. They say nothing restricting the form. Therefore, the additional accruals can commence in any permitted form, including an annuity with a different payment period or even a lump sum.

• This will require a new ASD with respect to this additional accruals and election forms will be required to waive the QJSA on those additional accruals.
Question #10

• The 1st distribution calendar year is 2014 and accruals through 12/31/14 commence as an annual annuity on 12/31/14, setting an “annuity payment period” of 1/1 to 12/31. Accruals for 2014 commence as a monthly annuity on 10/1/15, properly adjusted actuarially to such date, (before the deadline of 12/31/15). When do additional accruals for 2015 need to commence?
Proposed answer #10

• As the regulations do not clearly define “annuity payment period”, it is not clear if the annuity payment period is changed by distribution of subsequent accruals or remains fixed as established by initial distribution. However, it would seem more reasonable to use the annuity payment period from the 1st distribution as the deadline, especially as additional accruals could have been paid as a lump sum or even with multiple ASDs.
Question #11

• The initial accrued benefit is paid as a single sum payment lump sum. How and when should additional accruals after the 1st distribution calendar year commence?
Proposed answer #11

• The regulation actually specifies no rule for this. It only specifies commencement of additional accruals in the case of annuity distributions. But it would seem reasonable to use a similar rule, perhaps assuming a payment period of one year ending on the anniversary of the lump sum payment.
Question #12

• If the vested accrued benefit is zero as of the 1st distribution calendar year, when do additional accruals for years after the 1st distribution calendar year need to commence?
Proposed Answer #12

• The regulations specify no clear rule here. Can you impute an annuity payment period based on the “commencement” of a zero benefit? If so, you could “commence” that zero benefit as an annual annuity starting 12/31 of the 1st distribution calendar year, giving you the latest date to commence future accruals.

• Note that a “fictional” annual annuity payment period ending 12/31 would allow commencement of additional accruals as a MONTHLY annuity starting 12/31 – so only one month of taxable income in following year. Not unreasonable if only created that by taking a full year of taxable income in 1st distribution calendar year, but aggressive if that first year income was zero.
Proposed Answer #12 continued

• Commencing a “zero” benefit to set an annuity payment period is an aggressive position and, if trying this, it may help to actually do “election forms” for that zero benefit. But a safer alternative is to use a more reasonable default rule when the initial benefit is zero. An implicit commencement deadline of January 1 is probably more conservative than necessary – commencing by April 1 of the following year is probably fairly safe.
However, if the initial accrued benefit was positive but just very small, it would seem that commencing that small benefit as an annual annuity starting 12/31 of the 1st distribution calendar year should set the favorable annuity payment period. A vesting schedule with a minimum 1% rather than 0% would work well with here if the NRD is after RBD.
Question #13

• The initial accrued benefit commenced as a monthly annuity so the annuity payment period ends at the first day of each month. Therefore additional accruals must commence immediately on the January 1st following the year of accrual. This is administratively difficult. Is there any relief and how does it work?
Proposed Answer #13

• Yes, the regulation provides that the plan does not fail merely because of an administrative delay as long as the commencement is “as soon as practicable”. This is not specifically defined but it is unlikely the IRS would question any reasonable argument justifying a delay to calculate benefits and process distribution forms.
Proposed Answer #13-Continued

• However, the regulations do specify a deadline of “as soon as practicable” so it would be prudent to not delay it to a date where it would be hard to justify a reason for the delay. Commencing on December 31 might be hard to justify.
Question #14

• The additional accruals for 2015 are supposed to commence 1/1/16 as the initial accrued benefit commenced as a monthly annuity. The administrative delay rule postpones commencement to July 1 and a monthly annuity is elected. If you use the administrative delay rule for additional accruals, how much must be distributed in 2016?
Proposed Answer #14

• The regulations require that the total payments in the year must be no less than the amount to be paid if the additional accrual commenced on time. Therefore, 12 monthly payments must be received and presumably a monthly annuity starting July 1 with 6 “catch-up” payments would be required. Or perhaps an annuity with an initial payment on July 1 equal to 7 monthly payments.
Proposed Answer #14-Continued

• However, if the benefit commences as an annual annuity or a lump sum, no adjustment would be required as the amount paid would still be equal to or greater than the amount paid with timely commencement.
Questions on missed RMDs,

• The following six questions deal with the impact of missed RMDs, including EPCRS correction and excise taxes.
Question #15

- What is the correction under EPCRS for a missed RMD?
Answer #15

- The correction is to make distribution to catch up on the missed RMDs, adjusted with interest, in the year of correction. The corrective distribution is taxable income in the year of correction, not the year it should have been paid.
Question #16

- The RBD was 4/1/14 but this was missed and no election forms were prepared or distribution commenced in 2014. This is discovered and corrected in 2015. As the RBD was 4/1/14 and no QJSA waiver done prior to that date, is the default QJSA forced?
Proposed Answer #16

- It would not be reasonable under EPCRS to require a QJSA as a default as that would not correct the qualification defect of the participant not being able to elect an optional form. Therefore, a reasonable correction would be to allow the participant and spouse to elect any permitted form “as of” the RBD and distribute any missed payments with interest.
Proposed Answer #16 continued

• If the elected form is a monthly term annuity starting 4/1/14 and correction is made 7/1/15, the missed monthly payments from 4/1/14 to 6/1/15 would be paid with interest on 7/1/15 and then the remaining annuity would commence. If a lump sum is elected, that should be paid with interest but the non-rolloverable portion should include the amount for THREE years.
Proposed Answer #16 continued

• However, if election forms were provided to the participant and spouse timely prior to RBD, and they were not returned, the default QJSA is probably forced – at least that should be assumed if self-correcting.
Question #17

• If you correct missed RMDs through EPCRS, what is the potential excise tax?
Proposed Answer #17

• The “RMD” for purposes of the excise tax is the amount that would have been paid for a year if a permissible annuity form was elected or, if the form elected was not permissible, the QJSA which would provide the greatest payments.
Proposed Answer #17-Continued

- It seems reasonable to use the “impermissible annuity” rule in the case where no form was elected. So the excise tax should probably be on the what the QJSA payments would have been, even if the EPCRS correction provides for a different form.
Question #18

• What if an annuity is commenced under the RMD rules but some annuity payments are missed or made late. How is that corrected and what is the potential excise tax?
Proposed Answer #18

• The correction would also be simply making up the missed payments with interest at the correction date. As a form was elected, there should be no issue of retroactive elections. The excise tax is just the difference between what should have been paid and what was paid.
Proposed Answer #18 continued

• This can result in a situation where there is a qualification failure but no potential excise tax. If payments are due at the beginning of each month, but payments for 1/1/14 to 7/1/14 are missed and made up with interest on 8/1/14, there is no possible excise tax as actual payments during the year exceed what should have been distributed.
Question #19

• May the excise tax be waived through EPCRS? What are the criteria?
Yes, the IRS will usually waive the excise tax if corrected through VCP. But no such provision if corrected under SCP. Whether you could get the IRS to waive the excise tax with the tax form, without going through VCP, is questionable. But clearly much better chance if going through VCP.
Proposed Answer #19 continued

- It is likely the IRS will waive the excise tax under VCP if the error was not caused or under the control of the participant, which should cover nearly all participants who are not owners, trustees or administrators. Possible tax benefit to the participant from having the distribution in a later year hopefully will not be relevant in this case.
Proposed Answer #19 continued

- For an owner, trustee or administrator, it is more likely the IRS will not agree to waive the excise tax under VCP if it appears the “error” might have been deliberately caused for tax advantage. The difference in tax rates from original year to correction year might be relevant here.
Question #20

• Annuity payments are due at the beginning of each month as a permissible RMD annuity form. Not understanding the form, the administrator pays all of the monthly payments due 1/1 through 6/1 on 1/1, so 5 payments are made early. What is the consequence of this?
Proposed Answer #20

- This might be considered a qualification issue and perhaps the correction is to have the participant pay back some interest. Or perhaps the early payments are considered an “overpayment” under EPCRS and are implicitly corrected when they are due (paid back when they did not get scheduled payment).
Proposed Answer #20-Continued

• Alternatively, perhaps they are simply prohibited transactions as the participant is a disqualified person. They were not entitled to that distribution until payment due date, and had no benefit other than the annuity, so the amounts were still “trust assets” until the payment due date.
Question #21

• How do the RMD rules apply to a DC plan with annuity options governed by the QJSA rules, such as a MP plan?
Answer #21

• The account balance method for DC plans can only be used if the QJSA is properly waived. The default form of payment, in the absence of a QJSA waiver, is to commence a QJSA from the ENTIRE account balance by RBD, presumably by purchase of an annuity. Given this, best not to wait until last minute to do election forms.
Answer #21
-Continued

- As the participant does not have the option of commencing an annuity from part of the account balance, the relative value election forms can be somewhat difficult. If a lump sum is elected, the QJSA that is waived is not actually available in that amount.
Questions regarding the “no new ASD” rule

• The following three questions relate to the rule in 1.401(a)(20) A#10(d)(2) which provides that there will not be a new ASD for additional accruals after NRD if benefits at NRD have commenced. These questions will only be discussed depending on remaining time and interest in this topic.
Question #22

- What does a plan need to do to use this rule?
Answer #22

• Technically nothing – it is actually the default rule in the regulations and a plan must specify otherwise to have a new ASD. However, most plans are written or interpreted to require a new ASD and, as this rule is not often used, best to include a specific rule implementing it if you want to use it.
Question #23

• How would you prepare election forms if you are using this rule?
Answer #23

• Very carefully! Presumably, the participant is waiving the QJSA (or electing it) for future accruals also – there are no further elections. So some relative value disclosure with respect to future accruals is probably required.
Question #24

• If this rule is used, how does it apply for 415 MASD and the 436 restrictions?
Proposed Answer #24

• With regard to 415, the regulations specifically exclude this rule from consideration. Therefore, there will be a new ASD for 415 even if not for other purposes. So cannot use this to get out of M ASD issues.
Proposed Answer #24-Continued

• With regard to 436, it is not yet clear. However, the 436 regulations use a specific definition of ASD and do not simply refer to the definition under 417. Therefore, it is likely that this is a new ASD under 436 even if not under 417 and no election forms. This would be similar to 415 although the 436 regulations are not as specific.
Proposed Answer #24 continued

• If this is the case, it calls into question whether this provision is valid anymore. If a participant elected a lump sum at NRD, distribution of future accruals in that lump sum form could not be “locked-in” due to 436.

• Perhaps a reasonable compromise would be that the distribution form is locked-in UNLESS it is prohibited under 436 and then new election forms and a new ASD is established.
Questions regarding ancillary death benefits for RMD

- The following two questions relate to the rule in 1.401(a)(9) -6 A-1(c) which provides that an ancillary death benefit in addition to a commenced annuity will not violate the increasing annuity rule. These questions will only be discussed depending on remaining time and interest in this topic.
Question #25

• What are the requirements for this ancillary death benefit?
Proposed Answer #25

• The ancillary death benefit may not be paid as part of the accrued benefit or under any optional form. Therefore, it is questionable whether this death benefit can be defined as a function of the commenced annuity or be linked to any elected optional form. So a death benefit of “PVAB of remaining annuity” may not work.
Proposed Answer #25 continued

• The ancillary death benefit, along with other benefits provided to a survivor, must meet the general incidental benefit rule, INCLUDING survivor benefits under a QJSA. Therefore, if a QJSA is commenced and a spouse is very young, there may be no room for any ancillary death benefit. The benefit, excluding the ancillary death benefit, must also meet the MDIB rule. An annuity without an ancillary death benefit is deemed to pass the general incidental benefit rule if it passes MDIB.

• Unfortunately, there is next to no guidance on the general incidental benefit rule, although the IRS seems to accept the general principle that you pass if the present value of expected payment to beneficiaries is no more than 50% of total present value.
Question #26

• Will an ancillary death benefit in an amount roughly equal to the annuity PVAB usually pass the general incidental benefit rule?
Proposed Answer #26

• If the commenced annuity is a SLA, and the ancillary death benefit is equal to annuity PVAB (although note it needs to not be linked so specifically), it will easily pass, if you only consider the perspective from the date the annuity commenced.

• However, if there was a sizable pre-commencement death benefit, the plan may only have satisfied incidental benefit rules due to the assumption of no post-commencement death benefit. So the incidental benefit rules may not be satisfied if you are required to look back to prior years. It is not clear if this is required.
Question # 27

- This question will only be discussed if time permits and there is an interest.
- A non-5% Owner elects a lump sum distribution of his entire accrued benefit on 3/1/16 and rolls it all to an IRA. He then terminates on 8/1/16. What are the consequences?
Proposed Answer #27 – very speculative

• There are no consequences. The distribution was for 100% of the accrued benefit so there is no possible way the plan RMD was not satisfied. The only issue is whether the entire distribution qualified for rollover. At the date of distribution, it was NOT required by 401(a)(9) and therefore it was fully eligible for rollover.

• There is nothing in the law that would change the rollover eligibility of a distribution due to a later event (i.e. the termination of employment). If this was the case, it would also retroactively effect tax withholding requirements.