NAVIGATING DISTRIBUTIONS

THE FIRST QUARTER OF THE CALENDAR YEAR TYPICALLY SEES AN UPTICK IN THE NUMBER OF RETIREMENT PLAN DISTRIBUTIONS AND PARTICIPANT LOANS. This year may be even busier than most, given the relief announced by the IRS for victims of the recent hurricanes and wildfires. Whatever the reason, participant distributions present a complex set of rules for Plan Sponsors to navigate.

Participants can receive distributions from retirement plans for a myriad of reasons. While some are requested by the participant, others are required by regulation. Under current law, a participant is entitled to a distribution from their account upon the occurrence of certain events or, as they are technically known, distributable events. Examples of some common distributable events are:

- Termination of employment (including death or disability of the participant)
- Normal or early retirement
- Meeting the requirements for a hardship distribution (if the plan allows), or
- Attainment of age 70 ½

Different distributable events apply to different types of plans and, to complicate matters further, can even vary by the type of money within the plan (e.g. salary deferral accounts vs. matching accounts). Let's review a few types of distributions which typically occur at this time of year.

REQUIRED MINIMUM DISTRIBUTIONS (RMDS): A participant is required to begin receiving minimum distributions at age 70 ½ from their retirement accounts. This includes qualified plans, like 401(k)s and profit sharing plans, as well as IRAs and SEPs (simplified employee pension plans). These distributions are required to begin by April 1st of the year after the calendar year in which the participant attains age 70 ½. For qualified plans, the RMD can be delayed until the participant retires as long as he/she is not considered a 5% owner.

How much must be distributed? The law requires that the participant receive an annual payment equal to an amount that would distribute the vested balance over his/her life expectancy or over the joint life expectancy of the participant and their beneficiary. Roth IRAs are

an exception in that they are not subject to minimum distribution rules because withdrawal is only required upon the death of the participant. Be careful to note that April 1st is the deadline for the first RMD and the second payment will be required by December 31st of that same year. From then on, payments would be due by December 31st of each year.

It's also important to know that RMD's must be processed in a timely manner or they carry a stiff penalty. If they're not distributed by the appropriate deadline, the amount that failed to be withdrawn is taxed at a rate of 50%!

HARDSHIPS AND LOANS: In a year rife with natural disasters, depending on where you're located in the US, you may experience a higher than normal rate of hardship and loan requests. Though the law requires that this type of distribution be substantiated by an "immediate and heavy financial need", some of these requirements have been relaxed or postponed through the IRS Announcement 2017-15 for those in affected areas. "Affected" areas are those designated for individual assistance by the Federal Emergency Management Agency (FEMA). A full list of the eligible locations to which this applies can be found on FEMA's website at www.fema.gov/disasters. The IRS announcement allows for delayed compliance from certain verification procedures that may be required under the plan's guidelines. To qualify for this relief, hardship withdrawals must be made by March 15, 2018.

Like relief provided for earlier natural disasters (Hurricanes Harvey and Irma), relief for Hurricane Maria and the California Wildfires allows retirement plans to provide loans and hardship withdrawals to employees and certain members of their families who live or work in the areas affected. This relief applies even to plans which do not currently contain provisions for these types of distributions. If a plan does not contain a hardship or loan provision, it is allowed to function as though these provisions are in place as long as the plan is amended by the end of the plan year beginning after December 31, 2017.

Regardless of circumstance, it is important to consult your plan's document and administrator when a request for a hardship has occurred.

TERMINATED PARTICIPANTS: What should you do with plan participants that have separated from service with your company? Terminated employees that have vested account balances should receive documentation explaining how to obtain their distribution from the plan. This information can vary depending on the type of retirement plan, the reason for separation (retirement, death, disability, or termination), and the participant's age. The information typically outlines their options for payment and any possible tax ramifications associated with the distribution. Once a separation has occurred, getting this information to the terminated employee as quickly as possible goes a long way to ensure that you can locate them when the plan allows for the distribution to occur.

MANDATORY CASH-OUTS: What happens when participants that have separated from service with your company are unresponsive? Retirement plans are required to include a provision requiring former employees with vested balances below a certain threshold to be forced to take their money from the plan. These force-out payments are referred to as mandatory cash-outs. All participants below the set threshold for the cash-out have the opportunity to withdraw their balance voluntarily, otherwise their balance must be distributed. After the proper notice period and depending on the amount in question, these accounts can be liquidated. Checks can be sent to the employee or automatically rolled over to an IRA in their name.

Your responsibility regarding cash-outs goes one step further. It is important for plan sponsors to be aware of, and address, the remaining balances left behind by former employees. Not only do the regulations require

the periodic review and distribution of these amounts, but these balances can also affect plan fees, cause additional plan disclosures, and affect IRS filings. Your plan outlines the parameters surrounding force-outs and provides guidance regarding the applicability of the exceptions that may exist, such as balances which drop below $200. The bottom line is that addressing terminated employee account balances as soon as possible can save you valuable time and money in the long run. Having procedures in place to address those balances will put you a step ahead.

Distributions are part and parcel of a plan sponsor's responsibilities as fiduciary. Familiarizing yourself with the distributable events in this article and working with your administrator should make for a simple, straightforward process for both the plan sponsor and participants.

UNDER THE NEW TAX LAW

AFTER MANY ROUNDS OF NEGOTIATIONS, CONGRESS PASSED THE TAX CUTS AND JOBS ACT ON DECEMBER 20, 2017. Though retirement plan limit reductions were included in many iterations of the bill, the ultimate effect on qualified plans was relatively minimal. There are two items of note that were included in the new law affecting loan repayments and IRA conversions.

401(K) LOAN PAYBACK PERIOD GETS EXTENDED! Many defined contribution plans include provisions for a participant to take a loan from their retirement account. The loan is generally limited to 50% of a participant's vested account balance with a maximum of $50,000. The term for repaying a participant loan is typically 5 years and is repaid through payroll deductions. But, what happens to the outstanding loan balance if the participant terminates employment and payments through payroll are not an option? More times than not, the remaining balance is deemed to be in default and the participant will pay taxes, and possibly penalties, on the amount in question. In order to avoid defaulting on the loan, the participant must repay the balance within 60 days of the default date to either an IRA or another qualified retirement plan.

This is no small matter. According to a report published by the Pension Resource Council, the default rate for employees terminating with a loan balance was over 80%!

> *"[It is estimated] that the aggregate outflow from defaulting 401(k) loans is on the order of $6 billion per year."*
>
> *-A NBER Study published April 2015.*

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Not only does this create a tax burden on the participant, it also depletes the total funds that they had previously saved for retirement. The recent Tax Cuts and Jobs Act includes language that has loosened the repayment requirements for participants, giving them more time to repay the loan and avoid unnecessary taxation. Under the new law, the 60-day rollover period has now been extended to the due date of the participant's income tax return (including extensions) for the year in which the default occurred. For example, if a participant took a distribution in January 2018, under the new law, they would have until April 15, 2019 to repay the defaulted loan balance, or even October 15, 2019 if their tax returns were extended. Instead of 60 days, now participants potentially have up to 21 months to repay these defaulted loan amounts.

RECHARACTERIZATIONS OF IRAS… CAN I TAKE A MULLIGAN? Prior to 2018, retirement savers who have utilized traditional pre-tax IRAs have had the right to "convert" all or part of these accounts to a post-tax Roth IRA. The move required that the individual pay the income tax due on the amount converted. The advantage for the taxpayer was that the Roth IRA would continue to grow tax free.

Before the Tax Cuts and Jobs Act, if a conversion was found to be undesirable from a tax standpoint by October 15th of the year following the conversion, it could be re-characterized back to its tax deferred status and continue as a pre-tax IRA. The change could be for any reason, but typically it was reconsidered when either the final tax liability for the individual was higher than anticipated or, due to market decline, the individual could be paying taxes on a diminished amount. Regardless of the situation, the new law eliminates recharacterization so there are no longer any "do-overs". For conversions that occurred in 2017, the recharacterization is still available through October 15, 2018.

Finally, here are a few items that were not included in the new law. Retirement plan changes proposed in the original House version of the bill, such as lowering the age for in-service distributions from pension plans and easing rules on hardship distributions, did not make it into the final legislation. The new law also does not eliminate the life expectancy payout method for retirement plan death benefits, nor does it impose lifetime RMD requirements on Roth IRAs. Though it seemed to be supported, these provisions did not make the final bill.

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