STIFEL

# Retirement Plans Quarterly

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## DOL RELEASES NEW FIDUCIARY RULE

On April 6, 2016, the Department of Labor (DOL) released its long awaited and final rule on the definition of the word “fiduciary." The rule expands the circumstances under which a person can be considered a fiduciary for the first time since the term was initially defined in September of 1974 under the Employee Retirement Income Security Act (ERISA).

While the rule was just released, it was a long time in the making. The DOL originally proposed a rule back in 2010, but due to industry and political concerns, the 2010 version never gained enough traction. The new rule was first introduced in 2015 and opened for public comment. Two written comment periods that produced over 7,000 letters followed, in addition to several days of public hearings. The DOL then attempted to address the concerns of the public by modifying the rule while staying true to the rule’s original intent.

Under the old law, offering investment advice for compensation results in fiduciary status, if it meets each item in the “5-prong test”:

- Makes recommendations as to investing in securities or other property, or gives advice as to their value
- On a regular basis
- According to a mutual understanding
- Serves as the primary basis for decision-making
- Individualized to the plan’s needs

The new law removes the “prongs” test, meaning that there no longer has to be a mutual understanding between the parties that advice will serve as the primary basis for decision-making.

Another significant change is that the rule now applies to IRAs. Previously, the rule only applied to retirement plans governed by ERISA. The new rule also covers advice regarding qualified plan distributions and rollovers from qualified plans to IRAs.

The rule goes into effect in two different stages. On April 10, 2017, the rule’s broader fiduciary definition is applicable. Full implementation of the Best Interest Contract Exemption (commonly referred to as the “BIC exemption” or “BICE”) commences on January 1, 2018. Due to the voluminous nature of the rule (the new version is over 1,000 pages), the financial services industry is still in the midst of interpreting the rule and attempting to understand its implications.

## IRS BACKS OFF PROPOSED CROSS-TESTED PLAN CHANGES

On January 29, 2016, the Internal Revenue Service (IRS) and the Treasury Department proposed regulation to change how certain plans test for nondiscrimination. In order to qualify for tax-favored status, retirement plans must not discriminate in favor of the Highly Compensated Employees (HCEs) in regards to eligibility, contributions, or benefits. The proposed regulations targeted “cross-tested” plans, where contributions tend to favor the older, higher-paid employees in the plan.

The regulations attempted to curb abuse of the current rules, but experts in the retirement plan industry argued that making the rules more stringent would result in smaller companies terminating their plans and, therefore, lessening the retirement plan coverage of U.S. citizens. The IRS and Treasury Department listened and dropped the more controversial provisions, although much of the proposed regulations remain intact.

For more information, see the IRS bulletin: https://www.irs.gov/pub/irs-drop/a-16-16.pdf

Additionally, the IRS released Notice 2016-16, which allows previously prohibited mid-year changes to Safe Harbor Plans. Safe Harbor Plans, which are automatically deemed to pass nondiscrimination tests provided they follow certain rules, could not be amended or changed mid-year except in certain circumstances. The new guidance extends the number of instances that Safe Harbor Plans may be amended mid-year. While certain changes are still prohibited entirely and others may still only be changed at the beginning of a plan year, those in the retirement plan industry view this as a positive development due to the added flexibility given to employers who adopt Safe Harbor Plans.

For a complete list of what is to be allowed, see the IRS bulletin: https://www.irs.gov/pub/irs-drop/n-16-16.pdf

## QUALIFIED RETIREMENT PLAN DISTRIBUTIONS ELIGIBLE FOR A ROLLOVER?

Retirement plans are all about saving, but at some point, assets accumulated must be distributed. At the time of distribution, funds may be rolled to an IRA or another qualified plan in order to maintain tax-deferred status. But, will the distribution be eligible for a rollover? The best way to know if a distribution is an "eligible rollover distribution" can be to check if it is on the list of distributions that may not be rolled over. This list includes:

- A Required Minimum Distribution: Paid in installments based on life expectancy, these distributions must begin by April 1, following the year the participant turns age 70½. Plans may allow these distributions to be delayed until *retirement* from the company sponsoring the plan if the participant does not own more than 5% of the sponsoring employer.
- Under Internal Revenue Code (IRC) Section 72(t), a distribution that is one of a series of substantially equal periodic payments (at least annually) made over:
    - The life or life expectancy of the employee or over the joint lives or joint life expectancies of the employee and the employee's beneficiary, or
    - A specified period of ten or more years.
- A distribution made upon hardship
- Distributions of after-tax contributions made payable to an individual (not a direct rollover)
- Elective contributions (also called "deferrals") and employee "after-tax" (not Roth) contributions that are returned to the employee (together with their allocable income) in order to comply with IRC Section 415 annual contribution limitations ($53,000 or $59,000 including a $6,000 "catch-up").
- Corrective distributions of the following, including their allocable income:
    - Excess contributions: Highly Compensated Employee (HCE) deferrals that exceed the limits of the Actual Deferral Percentage (ADP) test,
    - Excess deferrals: Deferrals that exceed the individual IRC Section 402(g) limits of $18,000 or $24,000 (including a $6,000 "catch-up"), and
    - Excess aggregate contributions: HCE matching and/or "after-tax" (not Roth) contributions that exceed the limits of the Actual Contribution Percentage (ACP) test.
- Participant loans in default that are deemed distributions.
- Dividends paid on employee stock ownership plan (ESOP) employer securities.
- Distributions of premiums for accident or health insurance.
- The costs of current life insurance protection.
- Prohibited allocations in S corporation ESOPs that are treated as deemed distributions.
- A distribution that is a permissible withdrawal from an eligible automatic contribution arrangement, e.g., the distribution to a 401(k) plan participant who opts out of the auto enroll program.

When considering future distributions or when the time for a distribution arises, the above list can help participants determine whether the continuation of a tax-deferred account via a rollover will be available.

## PLAN DISTRIBUTIONS WHILE EMPLOYED?

Unbeknownst to many participants, their plan allows distributions from their profit sharing/401(k) plan while still employed, and they can elect to roll their assets to an IRA. However, whereas the law allows for in-service distributions, as detailed in the list below, the plan's document must include the provisions for them to be available.

In-service distribution opportunities vary per plan contribution type as noted below:

***Profit Sharing Contributions***

Contributed funds that have aged in the plan for at least two years are eligible for a distribution and all funds, contributions, and earnings may be available for a distribution after five years.

***Elective Contributions (Deferrals)***

Participant salary deferrals (pre-tax or Roth) are available for distribution once the participant reaches age 59 ½.

***Matching Contributions***

Employer matching contributions generally have the same availability as profit sharing contributions noted above. However, qualified matching contributions (100% vested) made to pass or avoid (via a Safe Harbor 401(k) plan) the ADP Test, have the same availability as employee deferrals noted above.

### *Rollover Contributions*

Funds that have been rolled into the plan from another qualified plan or an IRA may be available for distribution immediately or whenever desired by the participant.

When available, in-service distributions can offer additional flexibility in financial planning. Participants should check with their plan administrator to determine if in-service distributions are available and if there are any plan specific limitations, for example, based on age or service.

*Decisions to roll over or transfer retirement plan or IRA assets should be made with careful consideration of the advantages and disadvantages, including investment options and services, fees and expenses, withdrawal options, required minimum distributions, tax treatment, and a participant's unique financial needs and retirement planning. Stifel does not offer tax advice. Consult with your tax advisor regarding your particular situation as it pertains to tax matters.*

## THE SIGNIFICANCE OF IRA BENEFICIARY DESIGNATIONS

Many IRA holders are unaware of how the selection of a beneficiary can affect distributions of their IRA assets after their death. Frequently, at the time of the IRA holder's death, it is discovered that the beneficiary designation does not follow the intentions of the IRA holder, which could result in an accelerated payout and taxation.

After an IRA holder dies, inherited IRAs are generally created for the designated beneficiaries in order to receive their portion of the deceased holder's IRA. From these accounts, the beneficiaries receive the inherited assets in the form of Required Minimum Distributions (RMDs). Note that a beneficiary may take more than the minimum required amount at any time. In addition, a beneficiary may "disclaim" his or her share of the inherited IRA funds and the share will be proportionately transferred to the remaining primary (or contingent if no other primary beneficiary is named) beneficiaries' inherited IRAs.

### *Calculating the RMD*

RMDs are determined by dividing the previous year-end balance by a life expectancy (LE) found in IRS LE tables. The amount and timing of RMDs will depend upon whether the IRA holder died before or after his or her required beginning date (RBD), or on or after the RBD. In addition, RMDs will be dependent upon whether the beneficiary is a spouse, a non-spouse, an entity, or a combination thereof. If multiple beneficiaries are named, special rules apply. Note that the terms "recalculate" and "non-recalculated" are used throughout the text. A recalculated LE means that an IRS Life Expectancy Table will be referenced each year for a new LE factor, and non-recalculated means that the LE factor established in the first year will be reduced by one for each subsequent year's RMD.

### *Required Beginning Date (RBD)*

For Traditional, SEP, and SIMPLE IRAs, the RBD is April 1 of the year following the year in which the IRA holder turns age 70½. However, with Roth IRAs, there are no RMD requirements for the Roth IRA holder. Yet, after the death of the Roth IRA holder, beneficiaries must generally take RMDs according to the IRA rules that apply when an IRA holder dies before his or her RBD, as explained in the following text.

### *Death before the RBD*

If an IRA holder dies before the RBD, in addition to a total distribution, other distribution options are as follows:

- **Spouse as sole beneficiary**
  - o **Five-year rule –** Any amount may be taken at any time during the period. However, the IRA balance must be totally withdrawn by December 31 of the year containing the fifth anniversary of the IRA holder's death.
  - o **LE payments –** Distributions are to be taken at least annually over the beneficiary's single LE (recalculated). Payments must begin by the later of December 31 of the year following the year of the inherited IRA holder's death or December 31 of the year the deceased spouse would have reached 70½.
  - o **IRA rollover –** A spouse beneficiary may treat the IRA as his or her own and roll over, or transfer, the IRA into his or her own IRA and elect beneficiaries. RMDs will not be due until the new IRA holder attains age 70½.
- **Non-spouse beneficiary**
  - o **Five-year rule** (same as above)
  - o **LE payments –** Distributions are based on the beneficiary's single LE, and the first RMD must be withdrawn by December 31 of the year following the year of the IRA holder's death. For subsequent RMDs, the LE factor is reduced by one for each year.

  *Note: There are no rollover options for a non-spouse beneficiary.*
- **Multiple beneficiaries**
  - o If separate beneficiary accounts are established, each beneficiary who chooses LE payments may calculate RMDs using his or her own single LE (non-recalculated). If the IRA account is not separated, RMDs will be based on the single LE (non-recalculated) of the oldest beneficiary established in the year following the year of the IRA holder's death.
- **No beneficiary, entity beneficiary, estate beneficiary, or non-qualified trust (defined later)**
  - o **Five-year rule** (same as above)

- **Qualified trust** (defined later)
  - o **Five-year rule** (same as above)
  - o **LE payments –** Based on the LE of the oldest beneficiary identified in the trust (non-recalculated)

***Death On or After the RBD***

If an IRA holder dies on or after the RBD, in addition to a total distribution, other distribution options are as follows:

- **Spouse as sole beneficiary**
  - o **Continue LE payments –** In the year of the IRA owner's death, the RMD is based on the decedent's LE from the IRS Uniform Lifetime Table. For subsequent years, RMDs are based on the longer of the recalculated LE of the spouse beneficiary or the non-recalculated LE of the deceased IRA holder.
  - o **IRA rollover –** After the deceased's RMD for the year of death is satisfied, a spouse beneficiary may transfer or roll the balance of the deceased spouse's IRA into his or her own IRA. Once complete, distributions will be based on the new IRA holder's LE from the IRS Uniform Lifetime Table. If the surviving spouse has not yet reached the RBD, RMDs may be discontinued until that time.
- **Non-spouse beneficiary and multiple beneficiaries**
  - o **Continue LE payments –** After the deceased's RMD for the year of death is satisfied, remaining RMDs must begin by December 31 of the year following the year of the IRA holder's death and be based on:

  1. The single LE (non-recalculated) of the oldest primary beneficiary, if separate inherited beneficiary accounts are not established.
  2. The single LE (non-recalculated) of each beneficiary, if separate inherited beneficiary accounts are established by December 31 of the second year of death.

An entity beneficiary may continue RMDs based upon the decedent's single LE (non-recalculated) established in the year of death.

- **Estate, non-qualified trust (defined later), or entities**
  - o **LE payments –** The remaining payments will be calculated using the remaining single LE factor of the IRA holder, established in the year of death (non-recalculated).
- **Qualified trust (defined later)**
  - o **LE payments –** After the RMD is distributed in the year of the IRA holder's death, subsequent RMDs will be based on the LE (non-recalculated) of the oldest beneficiary identified in the trust.

***Qualified Trust***

In order for a trust to be considered qualified for the purpose of determining life expectancy, it must:

1. Be valid under state law
2. Be irrevocable upon the death of the IRA owner
3. Have identifiable beneficiaries named
4. Provide qualifying documentation or a copy of the trust instrument to the custodian by October 31 of the year after the year of the account holder's death.

***Non-Qualified Trust***

If the trust does not meet these requirements, the IRA will be treated as if no beneficiary is named.

***Conclusion***

Post-mortem distributions and estate planning for IRAs can be extremely complicated, and it is highly recommended that IRA holders consult with a qualified attorney, tax advisor, or investment professional prior to making these important beneficiary designation decisions.



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