STIFEL

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IRS ANNOUNCES COST-OF-LIVING ADJUSTMENTS FOR 2017

On October 27, 2016, the Internal Revenue Service announced cost-of-living adjustments applicable to dollar limitations for retirement plans and other items for tax year 2017. In general, many of the pension plan limitations will not change, because the cost-of-living index did not meet the statutory thresholds that trigger their adjustment.

Annual Limit	2016	2017
Social Security Wage Base	$118,500	$127,200
Annual Compensation Limit	$265,000	$270,000
Key Employee Compensation Limit	$170,000	$175,000
HCE Compensation	$120,000	$120,000
Elective Deferral Limit (401(k), 403(b) & 457)	$18,000	$18,000
Catch-Up Contributions (401(k) & 403(b))	$6,000	$6,000
SEP Minimum Compensation	$600	$600
SIMPLE IRA Deferral Limit	$12,500	$12,500
Catch-Up Contributions (SIMPLE IRA)	$3,000	$3,000
Annual Defined Benefit Limit	$210,000	$215,000
Annual Defined Contribution Limit	$53,000	$54,000

IRA CONTRIBUTION LIMITS REMAIN UNCHANGED

According to IR-2016-141, the traditional and Roth IRA contribution limits remain unchanged at $5,500 for 2017.

Annual Limit	2016	2017
IRA/Roth Contribution Limit	$5,500	$5,500
IRA/Roth Catch-Up Contributions	$1,000	$1,000

Income phase-out limits for IRA if active participant in retirement plan:

Traditional IRA Deductibility	2016		2017	
	Single Filer's AGI:	Married Filing Jointly AGI:	Single Filer's AGI:	Married Filing Jointly AGI:
Full Contribution	‹ $61,000	‹ $98,000	‹ $62,000	‹ $99,000
Partial Contributions	$61,000 – $71,000	$98,000 – $118,000	$62,000 – $72,000	$99,000 – $119,000
Not Eligible	› $71,000	› $118,000	› $72,000	› $119,000

If one spouse is covered by an employer-sponsored plan, the maximum joint compensation for a deductible contribution by the non-covered spouse in 2016: $184,000–$194,000 ($186,000–$196,000 for 2017).

Income phase-out limits for Roth IRA contribution eligibility for 2016 and 2017:

Roth IRA Eligibility	2016		2017	
	Single Filer's AGI:	Married Filing Jointly AGI:	Single Filer's AGI:	Married Filing Jointly AGI:
Full Contribution	‹ $117,000	‹ $184,000	‹ $118,000	‹ $186,000
Partial Contributions	$117,000 – $132,000	$184,000 – $194,000	$118,000 – $133,000	$186,000 – $196,000
Not Eligible	› $132,000	› $194,000	› $133,000	› $196,000

WHEN IS A SAFE HARBOR PLAN APPROPRIATE?

All 401(k) plans are subject to annual coverage and nondiscrimination testing. These two testing requirements are among the most complex administrative tasks of a 401(k) plan. Unfortunately, there is no special exception to avoid coverage testing, as it is required to ensure that the plan covers sufficient rank-and-file employees to be considered broad-based. Coverage testing looks at the number of employees benefitting from the availability of a retirement plan versus the employees that are actually participating in the plan.

Nondiscrimination testing is a measure of whether the Average Deferral Percentage (ADP) of the Highly Compensated Employees (HCEs) does not exceed the ADP of the Non-Highly Compensated Employees (NHCEs) by a certain limit. The counterpart to the ADP test is the Actual Contribution Percentage (ACP) test. The ACP test is less publicized, as it is a rare scenario in which this portion of the nondiscrimination testing creates a failure. The reason being that match contributions often have different eligibility requirements than employee deferrals, and certain groups can be carved out of the test. Each of the the two tests is satisfied if the ADP/ACP of the HCEs is not more than two percentage points or 1.25 times the rate of the NHCE group. If the test is not satisified, corrective action must be taken.

If a plan fails the nondiscrimination testing, corrective action must be taken within 12 months following the close of the plan year. This can be handled through the return/refund of excess contributions, qualifed nonelective contributions, and recharacterization of excess contributions, all of which incur extra cost for the employer impacted. Failing to make timely corrections to the retirement plan could ulitmatley disqualify the plan for its tax-exempt status. Fortunately, there is an option to bypass this testing requirement and avoid tax implications for the HCEs.

Utilizing a safe harbor contribution feature in a 401(k) plan can be extremely useful for plans that have an employee base mostly comprised of HCEs looking to max out their contributions to the plan while providing a benefit to NHCEs that have a historically low participation rate. This exact scenario requires additional contributions to the NHCEs while forcing tax implications upon the HCEs through refunded retirement contributions. The safe harbor feature can also be useful to an organization that experiences a high amount of turnover throughout a calendar year or acquires many temp-to-hire employees. A safe harbor plan is also deemed to be a non-top-heavy plan and will automatically satisfy this testing requirement. A top-heavy plan is one that 60% or more of the account balances in the plan belong to the HCEs. The correction for failing a top-heavy test is to provide a benefit of at least 3% of compensation to all eligible employees regardless of whether they are participating in the plan.

In order to implement a safe harbor provision, there are a few conditions that must be met:

Contribution Requirement: The safe harbor contribution requirement will be satisfied if the matching contributions are no less than the basic safe harbor match formula (100% of the first 3% deferred plus 50% of the next 2%, or in effect 4%) or if a safe harbor nonelective contribution (3% of compensation regardless if the employees are contributing) is provided.

Only one of the safe harbor contribution formulas must be provided by the plan to satisfy the requirement to avoid the ADP/ACP tests. Even if an employer would like to provide a benefit that is less than the basic safe harbor match formula but satisfies the safe harbor nonelective contribution formula, the ADP test can still be eliminated. The employer is also afforded flexibility in switching between the basic match formula and the nonelective contribution formula from year to year.

Vesting Requirement: All safe harbor contributions must be 100% immediately vested regardless of the employee's length of service.

Withdrawal Restrictions: The withdrawal of safe harbor assets are restricted to only a triggering event in which the employee has separated service, retired, attained age 59 ½, is disabled, or the plan has terminated. The IRS does not permit the withdawal of safe harbor assets for reasons of hardship or early retirement.

Annual Notice Requirement: Finally, the plan must provide to all eligible employees an annual written notice that outlines their rights and obligations under the arrangement. The notice must be provided within 30 days of the first day of the plan year or within 30-90 days in advance of implementing a new safe harbor plan.

If adopting a safe harbor provision seems to be an appropriate fit for a retirement plan, please keep in mind that there are certain deadlines that apply to this arrangement. As a general rule, a new plan cannot be a safe harbor plan for its first plan year unless the first plan year is at least three months long and the 401(k) portion of the arrangement is in place for three months for the first year. So, to establish a new plan in 2016, the deadline was October 1. If the plan is already in existence, it can add a safe harbor provision mid-year, considering that the annual notice requirement and election opportunity conditions have been met.

DOL GREENLIGHTS STATE-RUN RETIREMENT PLANS

The Department of Labor (DOL) has issued its final ruling on states that run payroll deduction retirement plans. The ruling, released on August 25, 2016, exempts state-run plans from being covered by the Employee Retirement Income Security Act of 1974 (ERISA), as long as they meet certain "safe harbor" conditions, including that the state-run plans must be established in accordance with state law and administered by the state. The state must also be responsible for selecting investment options for the plan, investing the savings, and providing security for the payroll deductions and the savings of the employees. In addition, states must ensure that employees are notified of their rights under the program and enforce these rights.

Employer responsibilities are mostly limited to ministerial tasks, such as submitting payroll deductions and maintaining records. Employers may be asked by state governments to provide official information from the state on the plan to its employees but are not required to do so. Contributions from the employer are not permitted, as employer contributions would automatically subject the plan to ERISA law. Employee participation is to be voluntary, meaning that employees must be given sufficient notice as well as time to opt out of any automatic payroll deductions.

The state-run plan rule comes at a time when approximately one-third of all workers are without access to a retirement plan through their employer. Several states have already enacted laws aimed at addressing this shortfall of retirement plan coverage. Thus far, the legislation from various states ranges from the creation of retirement plan marketplaces that assist employers in voluntarily setting up a plan to full-blown state-mandated retirement plans for employers that do not currently offer a plan. The DOL's rule seeks to encourage other states to consider adopting similar laws without concern about being preempted by ERISA law and also to protect the states that have already adopted such measures.

Despite the potentially growing presence of state-run retirement plans, any employer that already offers a retirement plan, such as a 401(k), 403(b), SEP IRA, or SIMPLE IRA to its employees is automatically exempt from any state requirements. Furthermore, ERISA plans offer employers significant tax deductions, allow the employer to save for his/her own retirement, and still provide the employees of the company with higher contribution limits and a greater chance to successfully save for retirement than state-run plans. In addition, Stifel Financial Advisors offer assistance to business owners who wish to set up a new ERISA plan, enhance an existing one, or in some cases add an additional plan to further enhance the business owner's tax deductions and ability to save for retirement.

REQUIRED MINIMUM DISTRIBUTION DEADLINES

Each year, certain individuals must take required minimum distributions (RMDs) from their IRA or retirement plan. RMDs apply to traditional IRAs, Simplified Employee Pension Plans (SEP IRAs), Savings Incentive Match Plan for Employees (SIMPLE IRAs), and all qualified retirement plans (QRPs). RMD rules also apply to beneficiaries who inherit IRA and qualified retirement plan assets. The deadline for taking RMDs is generally December 31 each year, beginning in the year in which the IRA holder turns age 70½.

With Roth IRAs, there are no required distribution rules for owners. However, beneficiaries who inherit Roth IRAs must take RMDs. A spouse beneficiary, on the other hand, may roll (transfer) the deceased spouse's Roth IRA into his or her own Roth IRA where RMDs are not required. Also, it is important to point out that Roth 401(k) rules are different in that 401(k) distribution rules prevail, so RMDs are required for owners and the beneficiaries who inherit them.

First IRA RMD Deadline

IRA owners are required to begin taking distributions from their IRAs in the year in which they reach age 70½. However, an individual may choose to delay the first RMD until April 1 of the year following the year the IRA owner turns age 70½. If the first RMD is delayed, the IRA owner will be required to take two RMDs for the year following the year he or she turns age 70½.

First QRP RMD Deadline

The same rule of mandatory distributions applies to QRPs (including Roth 401(k)s). However, if the participant is still employed at the QRP sponsor and the plan allows, the required beginning date is April 1 of the year following the later of: the calendar year in which the participant turns 70½ **or the calendar year in which the participant retires.** Note that 5% or greater owners of the business are not allowed this extension and must begin RMDs from the plan in the year they turn age 70½. Also note that participants who are age 70½ or older and terminating their employment are required to withdraw the year's RMD from the plan prior to rolling the remaining assets into an IRA.

Roth 401(k) participants who desire to delay taking RMDs may consider a direct rollover of their Roth 401(k) assets into a Roth IRA before reaching the year they turn age 70½.

RMDs for Beneficiaries

Beneficiaries who inherit IRAs and QRPs must also take RMDs, and December 31 is the deadline each year for the withdrawal. Note that RMD options for beneficiaries of inherited QRPs may be different than RMD options for beneficiaries of inherited IRAs because of plan document restrictions. Therefore, QRP beneficiaries may want to consider a direct rollover into inherited IRAs (permissible under provisions of the Pension Protection Act of 2006). Once the assets are received into an inherited IRA account, all IRA RMD rules and deadlines will apply.

Spouse beneficiaries have the choice to directly roll the deceased spouse's QRP assets into an inherited IRA or roll them into their own IRA, which would delay the start of RMDs until the spouse beneficiary turns age 70½.

Aggregating RMDs

IRA owners who have multiple IRAs, consisting of traditional, SEP, and/or SIMPLE IRAs, may take the RMD from each IRA or they may aggregate the total amount and withdraw from any one or more of the IRAs. Note that participants in QRPs may not satisfy RMDs from their IRAs and participants who have assets in more than one QRP must withdraw an RMD from each QRP (no aggregation allowed) with the exception of participants in multiple non-ERISA 403(b) plans, who are allowed to aggregate RMDs between all 403(b) plans in which they participate.

It is important for individuals who have assets in multiple IRAs or plans to consider the value of each. Understanding which type of plan assets may be aggregated and which may not is crucial to insure that proper RMDs are satisfied by the deadline each year.

Qualified Charitable Contributions (QCDs)

The Pension Protection Act of 2006 allowed traditional IRA holders who have attained the age of 70½ the opportunity to donate assets in their IRA to qualified charitable organizations. If done correctly, the distributions are tax-free and not included as ordinary income. Distributions also count toward the individual's required minimum distribution (RMD) for the year. The Consolidated Appropriations Act of 2016 made QCDs a permanent option for IRA holders, with an annual limit of $100,000 per Social Security number.

Failing to Take Distributions

Failure to take RMDs on a timely basis can be very costly, as IRA owners, QRP participants, and beneficiaries who fail to take a correct RMD in any year are subject to a 50% penalty on the amount of the RMD that was not withdrawn. To avoid this costly mistake, now is the time of year to make sure that all RMDS have been completed for 2016.

ROTH IRA 2016 CONVERSION

December 31 is quickly approaching. Individuals who wish to capitalize on a Roth IRA conversion for 2016 must do so before the end of the calendar year. Roth IRA conversions are subject to taxation for the calendar year the transaction is completed. Do not confuse the 2016 conversion deadline with the deadline for making a 2016 Roth IRA contribution, which is April 17, 2017.

Also remember, individuals must include in their gross income distribution amounts from a traditional IRA that would have had to be included in income if they had not converted the amount into a Roth IRA. These amounts are normally included in income on an individual's return for the year that these amounts were converted from a traditional IRA to a Roth IRA.

Again, the deadline for 2016 Roth IRA conversions is December 31, 2016. **Conversions are not allowed to be completed until April 17, 2017, for prior year amounts.**

WAIVER OF 60-DAY ROLLOVER REQUIREMENT

Distributions from employer-sponsored plans and IRAs are generally excluded from an individual's income if the amount is rolled over into an eligible retirement plan within 60 days from the distribution. On August 24, 2016, the IRS issued **Revenue Procedure 2016-47**, which gives guidance for individuals who have received IRA distributions and have missed their 60-day deadline. The guidance allows for IRA holders to self-certify that they satisfy the requirements of the Revenue Procedure and are allowed an exception to the 60-day rollover limitation. Prior to this guidance release, individuals could request a private letter ruling from the IRS. For a private letter ruling of a 60-day rollover waiver, the cost per was increased to $10,000, making this solution impractical for rollovers of small distributions. Effective immediately, **Revenue Procedure 2016-47** and the self-certification process offers IRA holders another solution.

The Self-Certification Process

Under this new guidance, IRA holders may certify that a rollover contribution satisfies the conditions of the Revenue Procedure by completing and signing the model letter included in the appendix of Revenue Procedure 2016-47 (or a substantially similar letter). The IRA holder must present this to the plan administrator or financial institution that received the rollover. In addition to the letter, the following conditions must be met:

- The IRS has not previously denied a rollover waiver request related to the rollover contribution.
- The contribution must be made to the plan or IRA as soon as practicable after the reason(s) for the delay no longer prevent the taxpayer from making the contribution. Rollovers made within 30 days of this date are deemed as satisfactory.
- The rollover contribution satisfies all requirements for a valid rollover (except for the 60-day limitation).

Reasons for Waiving the 60-Day Rollover Requirement

In order to self-certify for the 60-day rollover exception, one or more of the following situations must have occurred:

- Financial institution error
- Misplaced and uncashed the distribution check
- Mistakenly believing that the rollover was placed in an eligible plan
- Severe damage to the individual's principal residence
- Death of a family member
- Serious illness of the individual or a family member
- Incarceration of the individual
- Restrictions imposed by a foreign country
- Postal errors
- IRS levy proceeds returned to the taxpayer
- Delays by the distributing financial institution in providing information required to complete the rollover

Although the certification is not a waiver by the IRS of the 60-day rollover limitation, the IRS will ordinarily honor certifications that individuals qualify for a waiver of the 60 day rule. Individuals using the certification process must keep detailed records and be aware that if the IRS later determines during the course of an audit or examination that the requirements for the waiver were not met, they may be subject to additional taxes and penalties.

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Stifel, Nicolaus & Company, Incorporated | Member SIPC & NYSE | www.stifel.com
One Financial Plaza | 501 North Broadway | St. Louis, Missouri 63102