Required minimum distributions are a small but important part of retirement plans. Failure to start making them on time can lead to problems for employers and plan participants. Code section 401(a)(9) requires every qualified plan to begin required minimum distributions (RMDs) on the required beginning date (RBD). If you’re a plan administrator, you hold the responsibility of ensuring the first RMD is made in time to fulfill this requirement.

Failure to pay the first RMD by the RBD results in two compliance problems. First, the plan fails to satisfy Code Section 401(a)(9), which subjects it to disqualification (the correction involving a Voluntary Correction Program (VCP) submission). Second, the participant may be subject to a 50% excise tax on the undistributed RMD (Code Section 4974).

For your protection and your participants, it’s crucial to understand the fine points in the RBD definition regarding both 5%-owner participants and participants who are not 5%-owners. Otherwise you may misinterpret the regulations and inadvertently miss an RBD for some plan participants.
RBD DEFINED (Internal Revenue Code Section 401(a)(9)(C))

For a qualified plan, such as a 401(k), profit sharing or money purchase plan, the broad regulatory definition of RBD is:

- April 1 of the year following the year of attainment of age 70½ for:
  - Owners of more than 5% of the business entity (known as 5% owners), and
  - Individuals who are not 5% owners but who retire before or during the year in which they attain age 70½, or

- For participants who are not 5%-owners who continue to work beyond the year age 70½ is reached, the RBD is April 1 of the year following the year the non-5% owner retires.

PLAN DESIGN OPTIONS

Each retirement plan document defines RBD, and is not required to adopt this broad regulatory definition. For example, a plan document may elect to establish April 1 of the year following the year a participant reaches age 70½ as the RBD for every participant.

A plan designed to permit the delay of RBD for non-5% owners (until retirement after age 70½) will find there are non-5% owner participants who work beyond age 70½ that anticipated starting RMDs at age 70½ to supplement their income. However, in this case RMDs are not permitted before a participant’s RBD, which doesn’t happen until he or she severs employment after age 70½.

Therefore, a plan designed to delay RBD should include an in-service distribution provision to allow the plan to calculate what a participant’s RMD would have been and distribute it when requested, but as an in-service distribution rather than an RMD. The plan document usually will also provide for an in-service withdrawal provision to allow distributions to active participants at a particular age, such as 59½ or 70½. Note: An in-service distribution is subject to the mandatory 20% federal tax withholding.

The law allowing plans to provide a later RBD states that the “while employed delay” for non-5% owners does not apply to IRAs (Code Section 401(a)(9)(C) (ii)(II)). Thus, IRA RMDs must be made by April 1 after the individual attains age 70½, even if payments from the plan are delayed.

RETIREMENT

For RBD purposes, if an employee severs from employment, he or she is considered retired from the employer. The individual’s status with other employers is not considered. Thus, a person may be retired from one job and be subject to RMDs from that employer’s plan while actively working for another employer and not be required to take RMDs from the current employer’s plan. (IRC Section 401(a)(9)(A))

Employees may change their status. For example, an individual over age 70½ who transitions from full-time employee to 800 hours of service a year has not severed service. Thus, as a non-5% owner who is still employed, he or she has not reached RBD.

RBD AND 5% OWNERS

Also for RBD purposes, a 5% owner is an employee who is a 5% owner with respect to the plan year ending in the calendar year in which the employee attains age 70½. (1.401(a)(9)-2 Q&A 2 (b) and (c)).

If an individual was a 5% owner in the year in which he or she reached age 70½, then the individual will always be considered a 5% owner, even if his or her interest is sold at a later date (e.g., after RBD). Conversely, if a participant becomes a 5% owner after RBD, he or she is not considered a 5% owner for RBD purposes.

---

1 Unless the participant arranges for a direct rollover to a qualified plan or an individual retirement account (IRA), or establishes a schedule of payments over his or her lifetime or for at least 10 years.

2 All references to IRAs in this article are to non-Roth IRAs.
For example, assume a 76-year-old 5% owner began taking RMDs from his company’s 401(k) plan when he reached 70½. He is still working for the same company, although he recently sold his ownership interest in the company.

In this case, the individual must continue taking RMDs. For the purpose of the requirement to begin RMDs, a 5% owner is determined by the ownership interest with respect to the plan year ending in the year the individual attains age 70½.

If the 5% owner wishes to sell his or her interest in the firm after that date, RMDs must continue, regardless of the individual having sold his or her ownership interest.

Now suppose a 5% owner attains age 70½ on August 31, 2017. He sold his interest in the company on July 12, 2016, and the 401(k)’s plan year is July 1 to June 30. In this scenario, the individual is still considered a 5% owner for RMD purposes.

The individual is a 5% owner in the plan year ending in the calendar year in which he attains age 70½, and the plan year (July 1, 2016 to June 30, 2017) ends in the calendar year in which the 5% owner attains age 70½.

Thus, the RBD is April 1, 2018 and RMDs must continue thereafter.

The plan accepts rollovers of pretax funds from traditional (non-Roth) IRAs. The participant is beyond the IRA’s RBD.

In these circumstances, Rev. Ruling 2004-12 allows a non-5% owner to roll his/her traditional (non-Roth) IRAs – less his/her IRA RMD for the year – into the qualified plan and defer RMDs on the IRA money rolled into the plan until April 1 after retirement.

To recap:

- A traditional IRA owner works and is a non-5% owner, over 70½, 401(k) participant
- Participant’s 401(k) plan:
  - Accepts rollovers from IRAs
  - Permits non-5% owners to defer RBD until April 1st after retirement after 70½
- Traditional IRA owner rolls traditional IRA into 401(k), after taking IRA’s RMD for the year as the RMD may not be rolled to the 401(k)
  - RBD for the funds rolled into the 401(k) from the traditional IRA is deferred until April 1 after the non-5% owner’s retirement

RMDS AND IRA ROLLOVERS

Now let’s assume the following:

- RBD for non-5% owners is defined as April 1 of the year following the later of the year age 70½ is reached or the year of retirement.
- The plan accepts rollovers of pretax funds from traditional (non-Roth) IRAs. The participant is beyond the IRA’s RBD.

In these circumstances, Rev. Ruling 2004-12 allows a non-5% owner to roll his/her traditional (non-Roth) IRAs – less his/her IRA RMD for the year – into the qualified plan and defer RMDs on the IRA money rolled into the plan until April 1 after retirement.

To recap:

- A traditional IRA owner works and is a non-5% owner, over 70½, 401(k) participant
- Participant’s 401(k) plan:
  - Accepts rollovers from IRAs
  - Permits non-5% owners to defer RBD until April 1st after retirement after 70½
- Traditional IRA owner rolls traditional IRA into 401(k), after taking IRA’s RMD for the year as the RMD may not be rolled to the 401(k)
  - RBD for the funds rolled into the 401(k) from the traditional IRA is deferred until April 1 after the non-5% owner’s retirement

IRS Definition of 5% Owner:

A 5% owner is an individual who owns more than 5% of the employer. Family attribution rules apply, i.e., the ownership of a company can be attributed to and from other family members.

According to Internal Revenue Code Section 318(a)(1), an individual is considered to own stock that is owned, directly or indirectly, by or for his or her spouse, * parents, children (regardless of age), and grandchildren.

Ownership is also attributed from legally adopted children.

- Other than a spouse who is legally separated from the individual under a court approved separation agreement.
In summary, the individual participant’s RBD is an important deadline that needs to be properly administered in order to keep the plan sponsor and the participant in compliance and safe.

Proper understanding and administration saves the plan sponsor from VCP filings/sanctions and the participant from a 50% excise tax on any undistributed RMD.

Stay tuned for more on RBDs and RMDs in future articles.

ABOUT THE AUTHOR:
William C. Grossman, ERPA, QPA, APA, MBA
Managing Member of WCG ERISA CONSULTING, LLC

He assists TPAs and financial institutions in complying with IRS and DOL regulations regarding qualified plans, such as 401ks, as well as 403(b)s and IRAs; and has spoken on a wide variety of retirement plan topics at ASPPA and NIPA national conferences.

As a contributing author to PenChecks Trust, Grossman writes about current retirement plan compliance and implementation issues.