

403(b) Perspectives



Insights into the Administration of §403(b) Tax-Sheltered Arrangements

WINTER 2014

Required Minimum Distributions

A 403(b) participant severed from service in 2004. He was born on August 29, 1942, and his beneficiary is his 20-year-old grandson. He has no pre-1987 403(b) assets. The required beginning date (RBD) for this 403(b) participant is April 1 of the year after he attains age 70½. In this example, the participant would attain age 70 on August 29, 2012, and then attain age 70½ six months later on February 29, 2013. The participant's RBD is April 1, 2014.

The required minimum distribution (RMD) amount for 2013 is calculated by dividing the value of the participant's 403(b) assets as of December 31, 2012, by the factor obtained from the IRS's Uniform Lifetime Table. The factor is based on the highest age the participant will attain in the calendar year for which the distribution is being made, an IRS term known as the "distribution calendar year." The first distribution calendar year is the year the participant attains age 70½, 2013 in this example. In 2013, the participant will attain age 71. The table factor for age 71 is 26.5. If the participant has a value of \$265,000 on December 31, 2012, the \$265,000 is divided by the factor of 26.5 and the RMD is \$10,000.00.

The deadline for making an RMD is normally the December 31st of the calendar year for which the RMD is attributed. The distribution of the first year's

RMD may be delayed until April 1 of the year after age 70½ is reached (April 1, 2014, in our example). If the first RMD is taken on April 1, 2014, it will result in the participant having to take the second RMD by December 31, 2014.

The second RMD is calculated by taking the value of the participant's account on December 31, 2013 and dividing by the factor for the age attained in 2014 (age 72), which is 25.6. This process is repeated in each subsequent year. The tables are found in IRS Publication 590.

What if the participant (born in 1942) was married to someone born December 23, 1961? If the spouse is more than 10 years younger than the participant, the joint life table is to be used to determine the factor for calculating the RMD, which will result in a lower RMD amount.

Using our example, the December 31, 2012 account value of \$265,000 is divided by the joint life factor based on the attained ages of the participant and spouse in 2013, specifically 71 and 52. This provides a joint life expectancy factor of 33.3 years and results in an RMD of \$7,957.96.

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Required Minimum Distributions

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Specific RMD Rules That Apply to 403(b) Plans

The RMD rules that specifically apply to 403(b) plans are found in IRS Regulation §1.403(b)-3.

RBD for all participants is the later of April 1 after the year age 70½ is attained or after the year in which the employee retires. The 5% owner rule, which applies to qualified plans, does not apply to a 403(b) plan.

For purposes of applying the Minimum Distribution Rules, 403(b)'s will be treated like Individual Retirement Annuities. Annuity payments from a 403(b) will satisfy §1.401(a)(9)-6T provided the relationship between the annuity payment and the retirement income accounts is not inconsistent with any RMD rules prescribed by the Commissioner of the IRS.

The surviving spouse of an employee is not permitted to treat a Section 403(b) contract of which the spouse is the sole beneficiary as the spouse's own Section 403(b) contract.

Aggregation of RMD From More Than One 403(b)

The RMD may be calculated for each 403(b) that the individual owns and then the aggregate of the entire 403(b) RMD amounts for the year may be withdrawn from any one 403(b) (just like the IRA

rules). However, if the individual has a 403(b) of his/her own AND a 403(b) upon which he/she is a beneficiary, the individual's 403(b) minimum may not be aggregated with the 403(b) minimum for which the individual is a beneficiary.

Pre-1987 403(b) Contribution Issues

The RMD rules apply to post-1986 contributions and earnings. The pre-1987 funds are not subject to the RMD rules provided records have been kept to distinguish the pre-1987 amounts. If the records cannot distinguish the pre-1987 amount, then all the funds are subject to the RMD rules. The pre-1987 amount is not used in the calculation to determine the RMD. The pre-1987 amounts must satisfy the incidental benefit rules of 1.401-1(b)(1)(i) meaning that the plan must be for the primary purpose of providing retirement benefits for the participants. Pre-1987 amounts need not be distributed until the participant attains age 75.

Amounts distributed in excess of the RMD will be considered to be from the pre-1987 amount. If a pre-1987 amount is rolled over, it is considered part of the post-1986 amount. If it is moved from one 403(b) plan to another by a trustee-to-trustee transfer, the pre-1987 money retains the pre-1987 status provided the new trustee retains the separate recordkeeping of the pre-1987 amounts. ■

2014 COLA Limits

The IRS has released the cost-of-living adjustments (COLAs) applicable to the dollar limitations for pension plans (and other items) for the 2014 tax year.


IRS Limits

	2014	2013
403(b), 401(k), SARSEP, and 457 Plan Deferrals/Catch-up	\$17,500/\$5,500	\$17,500/\$5,500
SIMPLE IRA/401(k) Plan Deferrals/Catch-up	\$12,000/\$2,500	\$12,000/\$2,500
Compensation defining Highly Compensated Employee*	\$115,000	\$115,000
Compensation defining a Key Employee Officer	\$170,000	\$165,000
Defined Benefit Plan Limit on Annual Benefits	\$210,000	\$205,000
Defined Contribution Plan Limit on Annual Additions	\$52,000	\$51,000
Maximum Compensation Limit for Allocation Purposes	\$260,000	\$255,000
SEP Minimum Compensation for a Contribution	\$550	\$550
IRA Contributions/Catch-up	\$5,500/\$1,000	\$5,500/\$1,000
Social Security Taxable Wage Base (SSTWB)	\$117,000	\$113,700

*2013 amount for use in 2014 plan-year tests

Saver's credit. The IRS has increased the AGI limit for the saver's credit for 2014. The limit for married couples filing jointly is \$60,000 (up from \$59,000). For heads of household, the limit is \$45,000 (up from \$44,250). For all other filers {single, married filing separately, or qualifying widow(er)}, the limit is \$30,000 (up from \$29,500). ■

Reduction or Suspension of Safe Harbor Contributions

 On November 14, 2013, the Internal Revenue Service (IRS) issued final regulations on the reduction or suspension of safe harbor contributions in certain circumstances.

New Rules for Reducing or Suspending a Safe Harbor Contribution Midyear

The final regulations permit an employer that sponsors a safe harbor 401(k) or 403(b) plan that is providing either a guaranteed safe harbor nonelective contribution (NEC) or a safe harbor matching contribution to reduce or suspend the safe harbor contribution midyear. Under these new regulations, there will be identical rules for reducing or suspending either a safe harbor matching contribution or a safe harbor NEC.

There are two ways an employer may stop or reduce a safe harbor contribution:

1. The employer must be operating at an economic loss as described in Section 412(c)(2)(A) for the plan year; or
2. The employer must include language in the annual safe harbor notice explaining that the plan may be amended during the plan year to stop or reduce the safe harbor contributions, but that the employer must furnish a supplemental notice at least 30 days before any reduction or suspension occurs.

Prior Guidance

The final regulations differ from previous guidance in that prior rules allowed for a safe harbor matching contribution to be amended out of a plan midyear without the employer having to satisfy a business hardship situation, or without the employer having to provide eligible employees with a statement in the safe harbor notice prior to the beginning of that plan year explaining that the plan could be amended during the year to reduce or suspend the safe harbor contribution. The existing safe harbor matching rules remain in effect until plan years starting on or after January 1, 2015.

Under the 2009 proposed regulations for stopping or reducing a safe harbor NEC, in order for the employer to suspend or reduce a safe harbor NEC midyear, the employer was required to satisfy all four of the business hardship criteria factors that are listed under Section 412(c)(2).*

Final Regulation Requirements

The new requirement under the final regulations that only Section 412(c)(2)(A) — the employer is operating at an economic loss — is to be satisfied will make it easier for employers providing the safe harbor NEC to qualify for this type of relief. However, if the annual safe harbor notice incorporates language referring to a possible amendment to reduce or suspend safe harbor contributions, the employer may reduce or suspend a safe harbor contribution midyear without even having to meet Section 412(c)(2)(A).

The following is a list of the IRS requirements an employer must satisfy if it decides to reduce or suspend safe harbor contributions midyear:

1. All eligible employees must be provided a supplemental notice of the reduction or suspension;
2. The reduction or suspension of the safe harbor contribution is effective no earlier than the later of the date the amendment is adopted or 30 days after all eligible employees are provided with a supplemental notice of the suspension or reduction;
3. Eligible employees are given a reasonable opportunity (including a reasonable period after receipt of the supplemental notice) prior to the reduction or suspension of the safe harbor contribution to change their CODA elections, and if applicable, their employee contribution elections;
4. The plan is amended to provide that the ADP/ACP test will be satisfied for the entire plan year in which the reduction or suspension occurs, using the current year testing method; and
5. The plan satisfies the safe harbor contribution through the effective date of the amendment.

Supplemental Notice

The supplemental notice requirement is satisfied if each eligible employee is given a notice that explains:

1. The consequences of the amendment that reduces or suspends future safe harbor contributions;
2. The procedures for changing their cash or deferred elections, and if applicable, their employee contribution elections; and
3. The effective date of the amendment.

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Reduction or Suspension of Safe Harbor Contributions

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Applicability Date

The amendment to the requirements for permitted midyear reductions or suspension of safe harbor matching contributions applies for plan years beginning on or after January 1, 2015.

For reductions or suspensions of safe harbor NECs, these regulations generally apply to amendments adopted after May 18, 2009, the effective date previously provided in the proposed regulations.

Proration of 401(a)(17)

The preamble of the proposed regulations stated that a plan that reduced or suspended NEC or matching safe harbor contributions during a plan year must prorate the otherwise applicable compensation under Section 401(a)(17) in accordance with the requirements of Section 1.401(a)(17)-1(b)(3)(111)(A). Commentators asked for clarification of this and in the preamble of the final regulations, it states that such an explanation is beyond the scope of the 401(k) and (m) regulations. Thus, this

requirement to prorate the 401(a)(17) compensation limit is in the preamble of the final regulations.

*Code Section 412(c)(2) "Determination of business hardship

For purposes of this section, the factors taken into account in determining temporary substantial business hardship (substantial business hardship in the case of a multiemployer plan) shall include (but shall not be limited to) whether or not—

- (A) the employer is operating at an economic loss,
- (B) there is substantial unemployment or underemployment in the trade or business and in the industry concerned,
- (C) the sales and profits of the industry concerned are depressed or declining, and
- (D) it is reasonable to expect that the plan will be continued only if the waiver is granted." ■