

# Cypen & Cypen NEWSLETTER for July 23, 2015

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Never Forget September 11, 2001

And

Always Remember May 2, 2011

**1. REVISIONS TO THE EMPLOYEE PLANS DETERMINATION LETTER PROGRAM:** Internal Revenue Service has announced important changes to the Employee Plans determination letter program for qualified retirement plans. Based on the need of the Internal Revenue Service to more efficiently direct its limited resources, effective January 1, 2017, these changes will eliminate the staggered 5-year determination letter remedial amendment cycles for individually designed plans and will limit the scope of the determination letter program for individually designed plans to initial plan qualification and qualification upon plan termination. The announcement also provides a transition rule with respect to the remedial amendment period for certain plans currently on the 5-year cycle. The IRS is requesting comments on specific issues relating to the implementation of these changes to the determination letter program. In addition to announcing changes that will be made to the determination letter program, the announcement provides that, effective July 21, 2015, the IRS will no longer accept determination letter applications that are submitted off-cycle, except as otherwise described below. In connection with the modifications to the determination letter program described in the announcement, the Department of the Treasury and IRS are considering ways to make it easier for plan sponsors to comply with the qualified plan document requirements. This may include, in appropriate circumstances, providing model amendments, not requiring certain plan provisions or amendments to be adopted if and for so long as they are not relevant to a particular plan (for example, because of the type of plan, employer, or benefits offered), or expanding plan sponsors' options to document qualification requirements through incorporation by reference. Here are the changes to the determination letter program:

- **Elimination of 5-Year Remedial Amendment Cycles.** Effective January 1, 2017, the IRS will eliminate the staggered 5-year remedial amendment cycles for individually designed plans. As of that date, the IRS will no longer accept determination letter applications based on the 5-year remedial amendment cycles. However, sponsors of Cycle A plans, described in section 9.03 of Rev. Proc. 2007-44, will continue to be permitted to submit determination letter applications during the period beginning February 1, 2016, and ending January 31, 2017. Effective January 1, 2017, a sponsor of an individually designed plan will be permitted to submit a determination letter application for a plan on initial plan qualification (that is, a plan for which a Form 5300, Application for Determination for Employee Benefit Plan, has not been filed or for which a Form 5300 has been filed but a determination letter was not issued with respect to the plan, regardless of when the plan was adopted) and for qualification upon plan termination. In addition, a sponsor will be permitted to submit a determination letter application in certain other limited circumstances that will be determined by Treasury and the IRS. Treasury and the IRS intend to request comments periodically from the public regarding the other limited circumstances under which a plan sponsor will be eligible to apply for a determination letter. Treasury and the IRS will identify those circumstances in published guidance on a periodic basis.

- **Transition Period for Individually Designed Plans.** Section 5.03 of Rev. Proc. 2007-44 extends the remedial amendment period for disqualifying provisions described in section 5.03(1) and (2) to the end of a plan's applicable remedial amendment cycle. As a result of the elimination of the 5-year remedial amendment cycles, the extension of the remedial amendment period provided in section 5.03 will not be available after December 31, 2016, and the remedial amendment period definition in Â§1.401(b)-1 will apply. However, the Commissioner intends to extend the remedial amendment period for individually designed plans to a date that is expected to end no earlier than December 31, 2017.
- **Immediate Elimination of Off-Cycle Determination Letter Applications.** Effective July 21, 2015, through December 31, 2016, the IRS will no longer accept off-cycle determination letter applications, as defined in section 14 of Rev. Proc. 2007-44, except for determination letter applications for new plans, as defined in section 14.02(2) of Rev. Proc. 2007-44, and for terminating plans.

IRS Announcement 2015-19.

**2. WHITE HOUSE CONFERENCE ON AGING:** The President has directed the Department of Labor to develop a regulation to support the growing number of States trying to promote broader access to workplace retirement saving opportunities for America's middle class workers. About one-third of American workers lack access to a retirement plan at work. For older Americans, inadequate retirement savings can mean sacrificing or skimping on food, housing, health care, transportation, and other necessities. Inadequate retirement savings places greater stress on Social Security and other state and federal efforts to guarantee a level of economic security for older Americans. The regulation that the Department will propose by the end of 2015 will clarify how states can move forward with state-sponsored retirement savings programs, including with respect to requirements to automatically enroll employees and for employers to offer coverage, in ways that are consistent with federal laws governing employee benefit plans. Here are some of the findings:

- States have a substantial interest in taking steps to address the problem of inadequate retirement savings and to protect the economic security of their residents.
- Concerned over the low rate of savings among American workers, some state governments have already passed laws to expand access to retirement savings programs for workers.
- Some states have passed laws to set up state-based savings plans and require employers not currently offering workplace plans to automatically enroll employees into IRAs.
- Some states are looking at ways to encourage employers to provide coverage under state-administered 401(k)-type plans.
- Others have adopted or are considering approaches that combine several retirement alternatives including IRAs, 401(k)-type plans and the Treasury's new starter savings program, *myRA*.
- President Obama has long supported federal legislation that would automatically enroll new workers into payroll deduction IRAs if they lack access to a 401(k)-type plan through their employer. In addition to pushing hard for improvements at the federal level, the Department is taking this step to help state legislators who are eager to create savings opportunities for workers in their state.
- One of the biggest problems states face in expanding retirement savings options is uncertainty about the extent to which the federal Employee Retirement Income Security Act will preempt or nullify their efforts.
- Although the federal courts, not the Department of Labor, are the ultimate decision makers about the extent to which a particular state law is preempted (or nullified) by federal pension law, ERISA preemption should not be an insurmountable impediment to the states' good faith efforts to bolster the retirement security of their workers.
- The Department's proposed regulation is part of the Administration's effort to find ways to make the state and federal laws work together to achieve the common goal of encouraging

- and rewarding expanded retirement savings.
- The Department already has a safe harbor regulation in place that says payroll deduction IRAs in private sector workplaces are not ERISA-regulated employee benefit plans so long as certain conditions are met.
- While some have argued that state initiatives fit into the safe harbor, others have argued that they do not.
- A new regulation just for state sponsored programs can address that question, while mitigating the ERISA preemption risk for states, employers, and others involved in state savings initiatives.

Workers today face greater responsibility for managing their assets for retirement, both while employed and during their retirement years. This greater responsibility is primarily a result of the move away from defined benefit plans (traditional pensions) to defined contribution plans (401(k)-type plans). In a defined benefit plan, the workers' retirement benefits are typically a specified monthly payment for life. In such a plan, an employer or insurance company, rather than the workers, take on the risk of investment loss, and workers do not run the risk of exhausting their retirement savings. But in a defined contribution plan, workers' benefits are dependent on the success of their investments, and they often receive their accumulated savings in a lump sum, which they then must manage for the rest of their lives. Lifetime income options like annuities provide a regular stream of income regardless of lifespan. Yet fewer than one in five defined contribution plans offer annuities, with the share falling sharply over time. As part of a broader initiative designed to increase awareness and availability of lifetime income options in defined contribution plans, the Department of Labor's Employee Benefits Security Administration today published a Field Assistance Bulletin clarifying the duty of an employer in selecting and monitoring an annuity provider for benefit distributions from 401(k) and other defined contribution plans under its Annuity Selection Safe Harbor regulation. The Bulletin is issued in response to questions about the extent of employers' obligations, and provides guidance regarding these issues, including the application of ERISA's statute of limitations to claims relating to annuity selection. Specifically, the guidance addresses concerns about liability by clarifying that an employers' fiduciary duty to monitor an insurer's solvency generally ends when the plan no longer offers the annuity as a distribution option, not when the insurer finishes making all promised payments. The guidance should encourage more employers to offer lifetime income annuities as a benefit distribution option in their 401(k)-type plans. Under Workforce Innovation and Opportunity Act, the Department of Labor, in coordination with the Departments of Education and Health and Human Services, is required to conduct a study that will develop, implement, and build upon career advancement models and practices for low-wage health care providers or providers of early education and child care. The Department of Labor today announced two efforts to achieve this goal:

- DOL is working with ED and HHS to document and synthesize existing evidence on career pathways models and programs, and to catalog the many evaluations of career pathways models and programs that are currently underway. This synthesis and catalogue will allow us to understand what questions have been asked (and/or answered), for which populations, and where gaps in the evidence base exist. A synthesis document will be released in late summer 2015.
- Based on the synthesis, DOL will develop and implement a plan for filling the gaps with new research and/or additional analysis of data that has been collected under existing efforts. This plan will be announced in the fall of 2015.

**3. SOCIAL SECURITY: DO NOT FORGET THE KIDS:** According to onwallstreet.com when it comes to Social Security, do not forget the kids. Rob Kron, head of retirement education at Blackrock, says dependent benefits, like spousal or survivor benefits for divorced spouses, are "not widely known or understood" by most people, and are often not brought up at informational sessions. "People, including advisors, need to ask about them," he says. "After all, it is not like the Social

Security Administration is going to mail out a letter saying: "Dear Dummy, We have got a whole pile of money you could get, if you would call us and ask for it." If a client old enough to receive Social Security benefits has young children -- an increasingly common situation given that many people divorce and remarry -- it could affect the calculus as to when an older parent should start collecting benefits. While delaying filing for benefits does increase the individual's own benefits in the future, along with potential survivor benefits, waiting may also permanently forfeit children's benefits that will not be available down the road if the child (or children) ages out of eligibility before the retiree hits 70. According to the government, some 4.4 million children in the U.S. receive about \$2.5 billion in Social Security benefits every month as the dependents of parents who are retired, disabled or deceased. These benefits are available to children up through high school age even if only one parent is deceased or is receiving Social Security. Benefits are available to dependent children until they turn 18, but can continue until they are 20 if they are still attending high school. Dependent children who themselves are disabled and who live at home can continue to receive disability benefits on a parent's account until age 19, or beyond, if the disability prevents that grown child from working. The amount a dependent child can receive is 50% of the parent's benefit amount, or 75% of a deceased parent's benefit. For example, if a child has two parents, one at full retirement age and collecting \$2,000 a month in benefits, the child would receive another \$1,000 monthly. However, there is a cap on dependent benefits, which varies depending upon whether the parent (on whose account the dependent benefit is drawn) is simply collecting regular benefits or is disabled and has filed under Social Security Disability rules. The amount of dependent benefits available to a family also depends on the size of the benefit the primary beneficiary is receiving. In general, the maximum available dependent benefit ranges from 50% to 75% of the primary beneficiary's own benefit amount. If there are two dependent children, or a spouse under 62 is also receiving benefits as a caregiver for a dependent child under 16, and the total exceeds the family benefit limit, the various dependent benefits are equally divided among the recipients. The important point to remember is that the total benefits received are capped. In the case of a deceased parent who was eligible to receive Social Security, there is also a family cap on total survivor benefits of 150%-180% of the deceased spouse's benefit amount. This could mean 75% each to a child or to each of two children, or 75% to a child and 75% to a younger surviving parent caring for that child but not eligible to receive his or her own Social Security or survivor benefit yet. If there is a second eligible child too, then the total benefits are divided equally with each of three recipients getting 50% of the deceased's benefit amount. Dependent benefits are available to natural children, adopted children and stepchildren of the Social Security beneficiary. Dependent benefits are also available, under certain specific circumstances, on a grandparent's Social Security account, to children who are now living with a grandparent. To qualify, the grandparent must have been caring for the child or children as legal guardian for a full year before the benefits begin and must be paying for at least half of the child's living expenses.

**4. HOW TO CUT TAXES ON CLIENTS' SOCIAL SECURITY BENEFITS:** This piece is part of a 30-day series on Social Security and retirement income strategies from onwallstreet.com. Some clients will always pay tax on 85% of their Social Security benefits. That is the maximum that can be taxed: for high-income seniors, \$20,000 of benefits would generate \$17,000 of taxable income. Conversely, some clients will owe no tax on their benefits because of relatively low income. In between, savvy planning may help seniors reduce the tax they owe on Social Security benefits. The key is a construct known to the Social Security Administration as "combined income," also called "provisional income." To get this amount, add adjusted gross income to any nontaxable interest income and one-half of Social Security benefits. For example, with AGI of \$30,000 plus \$10,000 of tax-exempt interest and \$18,000 of Social Security benefits, combined income is \$49,000 ( $\$30,000 + \$10,000 + \$9,000$ ). Depending on filing status, a series of combined income thresholds ranges from \$25,000 to \$44,000; the portion of Social Security benefits subject to income tax grows from 0% to 85%, as combined income clears those thresholds. When clients have combined income in the threshold range or slightly higher, tactics to reduce AGI may have the extra advantage of lowering the tax on Social Security benefits. Here is a strategy for a couple with substantial IRAs and little non-qualified

liquidity. Assume they want \$80,000 of annual pre-tax cash flow. Their Social Security benefits total \$27,000 so they can withdraw \$53,000 from taxable IRAs each year. Over four years they would pay total federal and state income taxes (4.8% in Indiana) of \$38,585. With some planning, this couple might take more (\$72,500) from their IRAs in alternate years and less (\$33,500) in the following years. By stacking IRA distributions every other year, they will use part of the prior year's distribution to fund the next year's household cash flow. This method can reduce their provisional income and save tax in the low-distribution years. They would have the same amount to spend but their total income taxes would be \$34,266 for the four years, for a savings of \$4,319. Another advanced method is presented: a single client needs \$3,800 per month in retirement and his monthly Social Security income is \$2,100. His accountant decided that he should draw \$1,700 per month from his investments as a supplement. The plan is to take out only as much in taxable distributions from the client's IRA each year to keep his Social Security from being taxed. The balance will come from his other accounts. Thus, his accountant might run the numbers and determine that this client can take, say, \$700 a month from his traditional IRA this year and still keep combined income below the threshold for taxation of benefits. (Starting at age 70½, clients will have to take at least the required amounts from their IRAs.) Then the client would take the \$1,000 monthly shortfall from other accounts (perhaps by taking untaxed distributions from money market funds or by selling securities with no unrealized gains) to bring the monthly total to the desired \$1,700, without triggering income tax on his Social Security benefits.

**5. SOCIAL SECURITY: HOW TO GET FREE SPOUSAL BENEFITS:** In the ongoing 30-day series on Social Security and retirement income strategies from onwallstreet.com, married couples can use various claiming strategies to boost income from Social Security. One tactic provides "free" spousal benefits. To see how this method works, suppose Bob Brown, the main family breadwinner, starts his Social Security benefits at age 66, currently the official full retirement age. Once Bob claims his benefit, his wife Mary can claim a spousal benefit: by waiting until age 66 to make this claim, Mary can receive 50% of John's FRA benefit. Once Mary is in the system, receiving a spousal benefit, Bob can suspend his benefit, returning any Social Security payments he received in the interim. Even though Bob no longer receives his benefit, Mary can continue to collect her spousal benefits. If Bob was receiving the current maximum benefit for someone retiring at FRA--\$2,663 a month--Mary's spousal benefit would be \$1,331 a month, or nearly \$16,000 a year. From age 66 to age 70, Mary would receive around \$65,000, including any cost-of-living adjustments. That \$65,000 would be "free" because Mary's own benefit continues to increase by 8% a year, until age 70. Then Mary can switch to her own maximum benefit, if it is higher than the spousal benefit. Bob, meanwhile, can resume his own benefits at age 70, getting the full credit for the delayed start. One example is a couple who were both high income earners, the wife retired early. Now she is collecting one-half of her husband's Social Security benefit while he continues to work. They will both collect their enhanced benefit at age 70. Having always been in the highest tax bracket, they feel some personal satisfaction at getting some benefit now. Or for example: a divorced woman who had not remarried, was able to convince her ex-husband to file and suspend so that she could receive benefits before he did. She was unable to continue to work but not sufficiently disabled to collect Social Security disability benefits, instead, she is getting a spousal retirement benefit. But rules on spousal benefits are complex and filing and suspending may not be necessary. On the Social Security website the rules say: if your ex-spouse has not applied for retirement benefits, but can qualify for them, you can receive benefits on his or her record if you have been divorced for at least two years. Both spouses must have reached their full Social Security retirement age for this to work. As the Social Security Administration explains, if you are under full retirement age when you take a spousal benefit, you cannot abstain from taking a benefit on your own record, and thus, you will be stuck with a permanently lower benefit.

**6. PRE-PAYING PENSIONS SAVES MILLIONS:** Public agencies have three decades to pay down unfunded pension promises -- but some will not wait that long according to International Foundation of Employee Benefits. Newport Beach, Laguna Beach, Huntington Beach, Irvine and Villa Park are

among those paying more than the California Public Employees' Retirement System requires. This will allow them to pay off unfunded liabilities early and thus save millions down the line. Newport Beach's "fresh start" plan aims to eliminate unfunded liabilities in just 19 years instead of 30. CalPERS requires \$23.6 million from Newport this year; it will get \$26.8 million instead. Paying more now should save about \$129 million over the long haul, because money invested early will have extra years to grow. It is a prudent financial decision of some cities that actually might be a sign not of struggle but of solid advanced planning -- from communities that are fortunate enough to have the resources to do this. Laguna Beach has set aside \$5.6 million over the past two years to cover all CalPERS increases through 2020. Advance payments on Laguna's unfunded liability should save \$21 million over the next 30 years. Irvine is two years into a 10-year plan to almost fully fund its pensions, which should save about \$33 million over the long haul. Irvine will borrow \$5 million a year for 10 years from its Asset Management Plan fund, and use it to pay down unfunded liabilities. Irvine already has made \$18 million in accelerated payments to CalPERS, with another \$5 million to be made this year. Huntington Beach is sending \$1 million more per year to cover public safety liabilities, which will shave five years off the amortization schedule and save \$54 million for taxpayers. Villa Park paid off a \$253,525 pension bill last year, which will reduce its payment to CalPERS by almost \$100,000 this year alone.

**7. GOOD NEWS: RETIREMENT INCOME STILL BEING UNDERCOUNTED:** Blogger Andrew Biggs writing in *Forbes* says good news: new Census data still undercount retirement income from IRAs/401(k)s. Retirees \$266 billion better off than we thought. Last year, Syl Schieber and I wrote in the *Wall Street Journal* about how popular statistics on retirement income dramatically understate the amounts that retirees collect from IRAs and 401(k)s. These statistics show that Americans are highly -- and increasingly -- dependent on Social Security for their retirement income, causing many to conclude that Americans face a "retirement crisis" and that personal saving plans such as IRAs and 401(k)s have failed. Yet the Census Bureau's Current Population Survey, which is used by the Social Security Administration in its popular Income of the Aged series, defines as "income" only regular payments such as the monthly checks retirees receive from Social Security or traditional "defined benefit" pensions. Irregular payments, such as as-needed withdrawals from "defined contribution" 401(k) plans and Individual Retirement Accounts, are not counted as income. Our op-ed, which drew on a more detailed paper co-authored by Schieber and Billie Jean Miller, compared the income that the CPS claims retirees receive from IRAs and 401(k)s to the income that retirees report to the IRS. Since you are required to pay taxes on IRAs and 401(k)s when you collect benefits, IRS data should do a pretty good job of catching these income sources. IRS data is not perfect: low-income retirees may not need to file returns, and for confidentiality reasons IRS data is not as detailed as other data sources. But these figures showed that the CPS was capturing far less retirement income than IRS data. We wrote: "for 2008, the CPS reported \$5.6 billion in individual IRA income. Retirees themselves reported \$111 billion in IRA income to the Internal Revenue Service. The CPS suggests that in 2008 households receiving Social Security benefits collected \$222 billion in pensions or annuity income. But federal tax filings for 2008 show that these same households received \$457 billion of pension or annuity income." So if you are relying on the CPS or SSA publications that rely on CPS statistics, you will probably conclude that a) Americans do not have nearly enough retirement income, and b) that IRAs and 401(k)s are not particularly good retirement saving vehicles. The problem is that you are drawing those conclusions by ignoring the income that American retirees derive from IRA and 401(k) plans. Not a good research strategy. Analysts at the Social Security Administration have been well aware of these income measurement issues. Indeed, SSA's policy shop has been a leader in drawing attention to them. Recently, the Census Bureau introduced new questions to the Current Population Survey designed to better measure asset income, including retirement income from IRAs and 401(k)s. The results of the updated CPS are reviewed in a new article by Craig Copeland of the Employee Benefit Research Institute. For Americans age 65+ in 2013, the CPS using the old questions picked up \$254 billion in combined income from traditional pensions (private sector, state and federal), 401(k)s, IRAs, and annuities. Using the new questions, the CPS captured \$324 billion in income from those sources, a 28%

increase. Even then, however, the increase in overall retirement incomes due to more accurately counting IRA and 401(k) benefits is not massive, because even the revised CPS does not find large amounts of retirement income coming from IRAs and 401(k)s. But there is reason to believe the CPS is still understating retirement, even with new-and-improved questions. One reason is that a different data source, the Survey of Income and Program Participation, has long asked about retirement income from assets. And, according to SSA analysts, the SIPP's aggregates still fall short: "the SIPP asks about distributions from retirement plans, but comparisons with IRS data indicate that the SIPP greatly underestimates the amounts of such distributions." So it could be that, even with better questions, surveys are not as good as administrative data at picking up the as-needed withdrawal approach that most retirees use with IRAs and 401(k)s. To check, I did a quick comparison of the new CPS figures with IRS data on income from retirement plans. The IRS has not released figures for 2013, so I used 2012 data adjusted upward by the growth rate from 2011-2012. These adjusted figures show, for individuals aged 65 and over, \$168 billion in taxable IRA distributions and \$423 billion in taxable income from pensions and annuities, for a total of \$590 billion. The aggregated IRS data do not break out traditional pensions from 401(k)s, so we compare total pension and annuity income. By restricting to taxable income for older households, I am hoping to catch actual income that retirees spend rather than rollovers from one retirement plan to another. This combined \$590 billion in income from retirement plans far exceeds the \$324 billion reported by the revised CPS. In other words, it is likely that retirees are still doing substantially better than even the new CPS reports. And that is good news for retirees. Does this mean that everything is hunky-dory? Not at all. Most truly low-income retirees do not have IRAs and 401(k)s. Survey data cannot under-report what they do not have. But the "retirement crisis" theme is that it is not just the poor who are not prepared, but middle class and even upper income people as well. These are the folks who have defined contribution pensions. A more accurate picture of their retirement income is likely to be a more encouraging picture as well. The figures above are from IRS totals, not the more detailed micro-data that Schieber and Miller used for their article. And there are definitional issues that mean that things do not always match up precisely. But these figures lead me to conclude that the Current Population Survey, and the SSA publications that rely on it, still are not catching all the income that American retirees receive from IRAs and 401(k). If you want to know how well prepared Americans are for retirement and what we should do to improve retirement saving, these are important questions to answer.

**8. IRS WEBINAR ON CORRECTING RETIREMENT PLAN MISTAKES:** On August 4, 2015 at 2:00 p.m. Eastern Time, the Internal Revenue Service will hold a free webinar about Revenue Procedures 2015-27 and 2015-28 modifications to Revenue Procedure 2013-12 to encourage voluntary compliance by:

- Promoting early correction of elective deferrals failures in retirement plans, including auto enroll plans
- Making it easier to fix ongoing IRC 415 annual addition limit failures in certain plans
- Clarifying the rules for recovering certain overpayments paid to plan participants
- Paying reduced compliance fees under the Voluntary Correction Program for required minimum distribution failures and certain participant loan failures

Register and you will receive a confirmation  
at: <https://www.webcaster4.com/Webcast/Page/925/9463>.

**9. ON SECOND THOUGHT...MAYBE THEY WERE WRONG?:** This telephone has too many shortcomings to be seriously considered as a means of communication. The device is inherently of no value to us. Western Union internal memo 1876.

**10. APHORISMS:** I have reached the age where "happy hour" is a nap.

**11. TODAY IN HISTORY:** In 1989, FOX-TV tops ABC, NBC and CBS for 1st time (America's Most Wanted).

**12. KEEP THOSE CARDS AND LETTERS COMING:** Several readers regularly supply us with suggestions or tips for newsletter items. Please feel free to send us or point us to matters you think would be of interest to our readers. Subject to editorial discretion, we may print them. Rest assured that we will not publish any names as referring sources.

**13. PLEASE SHARE OUR NEWSLETTER:** Our newsletter readership is not limited to the number of people who choose to enter a free subscription. Many pension board administrators provide hard copies in their meeting agenda. Other administrators forward the newsletter electronically to trustees. In any event, please tell those you feel may be interested that they can subscribe to their own free copy of the newsletter at <http://www.cypen.com/subscribe.htm>.

**14. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.**