employee benefits update

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Know your plan limits
Taking the confusion out of differing plan limits

Are your plan distribution and benefit accrual reduction notices up to date?

Do as I write, not as I say
Avoid mishaps with written ERISA benefits

Keeping up with your employee contributions

Know your plan limits

TAKING THE CONFUSION OUT OF DIFFERING PLAN LIMITS

Defined contribution plans are subject to many annual limits, all of which employers and plan administrators must keep straight. At times these limits can appear to be at odds with each other, leaving many plan sponsors to ask, "How do we know which limit applies?"

Defining the limits

Before reviewing the various pension limits and plan implications, it's important to understand each of them. They include:

Annual additions under Section 415(c). This sets the maximum amount that employees and employers can fund into a defined contribution plan for the year. For 2010, the limit is $49,000. It includes all sources of contributions, including 401(k) deferrals (both Roth and regular), profit sharing contributions, matching contributions, and after-tax dollars. The IRS doesn't include plan earnings, deferral catch-up contributions and rollover contributions in this limit.

A benefits advisor will help monitor deferral and catch-up limits to ensure that the other limits are met if profit sharing and other matching contributions are funded into the plan.

Elective deferrals and catch-up contributions. This is the maximum amount of pretax employee contributions that participants can put into a plan during the year. This includes all elective deferrals, including regular and Roth combined, and applies to 403(b) and 401(k) plans. The 2010 limit

is $16,500 and the catch-up limit for participants over age 50 is $5,500.

If a sponsor maintains both a 401(k) or 403(b) plan and a 457 deferred compensation nonqualified plan, participants may defer a full $16,500 into each of these plans. This is the only exception. If a company sponsors both a 403(b) and a 401(k) plan, the $16,500 applies to both plans combined.

Annual compensation under Sec. 401(a)(17). This is the maximum amount of compensation that the IRS counts for qualified plan purposes. For 2010, the limit is $245,000. This is to cap the amount of compensation used to calculate a pension contribution. For instance, if the contribution is based on 10% of compensation, an employee's amount would be $24,500 vs. some higher amount.

Deductible contributions under Sec. 404(a)(3). This limit is based on 25% of eligible compensation.

It curbs the amount an employer can deduct for funding a contribution into the plan, such as profit sharing or matching contributions. For example, suppose a participant's eligible compensation is $50,000. The maximum contribution the employer plan can make is $12,500.

Understanding the overlap

So how do all these limits work together? For example, maximizing key executives to the full Sec. 415 limit of $49,000 won't work if these contributions cause Sec. 404 to fail. Also, a plan may fail significant tests if certain highly compensated employees elect to defer the full limit of $16,500. Likewise, if Sec. 415 fails, funding a match and profit sharing to maximize Sec. 404 deductions the employer may take won't work.

Here's an example: A company has a profit sharing plan that also offers 401(k) with catch-up contributions for participants over 50 and matching contributions. Several key employees under the age of 50 defer the full Sec. 402(g) limit of $16,500 for 2010, and matching contributions total another $5,000.

Because the Sec. 402(g) limit has been met, there are no additional 401(k) deferrals, pre- or posttax, that can be put into the plan. If the employer wants to put in the maximum profit sharing amount, it will need to consider the Sec. 415 limit ($49,000). The 401(k) contributions and matching contributions reduce the $49,000 so that there's a total of $27,500 in profit sharing contributions available for each individual ($49,000 - $16,500 - $5,000 = $27,500). Again, the Sec. 404 limit should be considered so that the total employer contributions don't exceed 25% of eligible compensation of the participants.

Remember, though, catch-up contributions aren't included in the Sec. 415 limit. Therefore, another $5,500 in catch-up contributions as deferrals, either pre- or posttax, can be made. The total contributions would be $54,500.

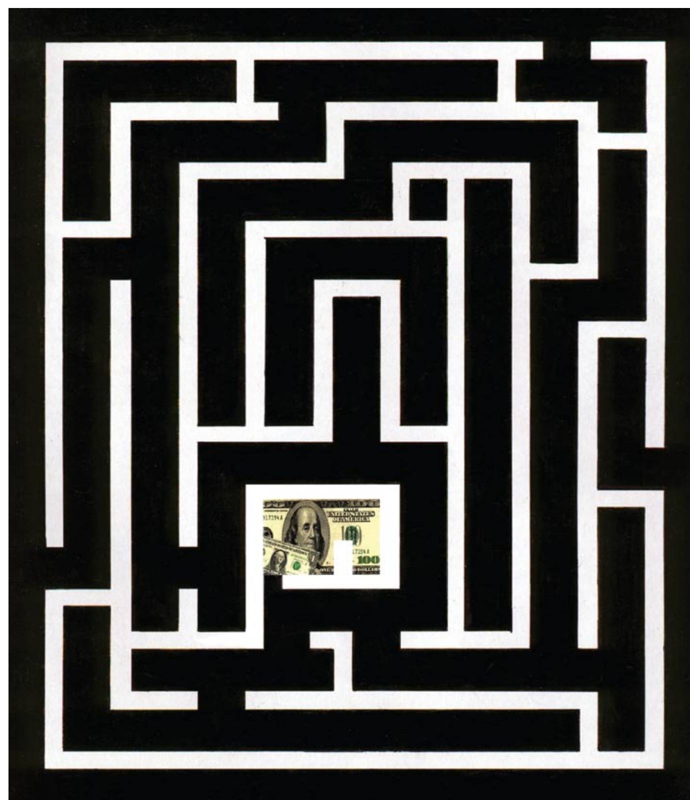
Keeping limits straight

To ensure all limits are met effectively and avoid problems with funding that can lead to errors and plan omissions, work with a benefits advisor. He or she can help you handle discrimination testing for the year to verify these limits are properly met.

He or she can also monitor deferral and catch-up limits to make sure the other limits are met if profit sharing and other matching contributions are funded into the plan. In addition, your advisor can see to it that payroll is set up and administered correctly with proper reporting information (such as deferral amounts and birthdates).

Ending confusion

For most plans, it's best to monitor testing limits when making a retirement calculation or annual funding. You should also check your limits as part of annual discrimination testing and before filing your Form 5500 to make sure there are no overlapping limits. Because of the many variables, consulting a benefits advisor, as mentioned, can be very helpful.



Upcoming compliance deadlines:

7/31 Form 5500 is due or a request for an extension on Form 5558
7/31 Form 5330 to report excise tax on prohibited transactions
7/31 Summary of material modifications due

Are your plan distribution and benefit accrual reduction notices up to date?

A distribution from a retirement plan should be a fairly simple process. Unfortunately, many participants equate such distributions as a withdrawal from the local ATM. Strict rules and guidance control the procedures that sponsors must follow and the circumstances under which a participant can take a distribution. The IRS has made two notable changes to such notices. Let's look at their requirements and implications.

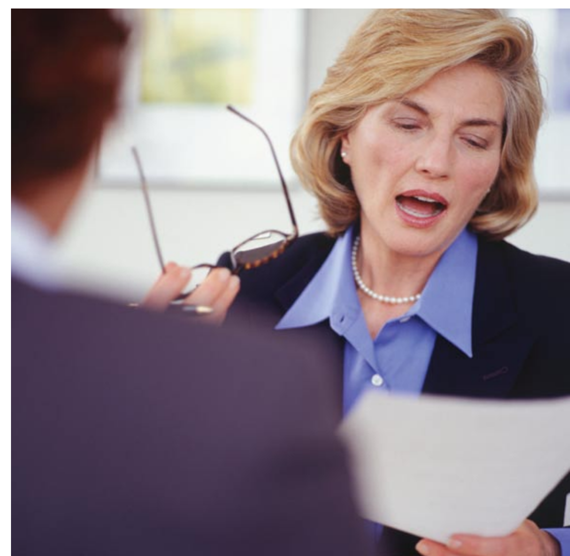
402(f) notice

The IRS requires plan sponsors to distribute a Section 402(f) notice to plan participants taking a distribution from a qualified retirement plan. The last Sec. 402(h) notice was from 2002 and was very outdated — even the IRS warned practitioners to not rely on or distribute it.

The current updates to the notice cover the automatic IRA rollover rules and Roth contributions, as well as the following Pension Protection Act (PPA) technical corrections:

Mandatory nonspouse rollover rules. Starting Jan. 1, 2010, PPA permits nonspouse beneficiaries of a participant in a qualified plan, Sec. 403(b) nonprofit arrangement or governmental Sec. 457(b) plan to roll over an account to an inherited IRA. The beneficiary must open an inherited IRA — he or she cannot roll the funds into a traditional or already-existing IRA. And the nonspouse beneficiary may not take a cash distribution and roll the money into an IRA within 60 days, as is the case in normal distributions. The rollover is exempt from taxation and the mandatory rollover requirements.

Roth conversions. Also effective in 2010, a plan participant may elect to roll qualified plan assets



into a Roth IRA. Previously this wasn't allowed, and any Roth conversions of IRAs in general were subject to a modified adjusted gross income limitation. Any conversions from a qualified plan first had to be rolled into a regular IRA and then into a Roth IRA. PPA eliminated these limitations.

The IRS now provides two sample notices: one for Roth distributions and one for regular distributions. A plan must provide the non-Roth notice to a participant who doesn't have a Roth account and the Roth notice to participants who do. Sponsors must provide both notices for participants who have accounts with both types of funds. You can find these sample notices on the IRS Web site: irs.gov.

The 402(f) notice requires a qualified retirement plan to provide participants with a clear written explanation of the rollover rules, income tax withholding rules and tax consequences for failing to roll over funds. Plan sponsors can refer participants to the IRS notice if they have questions regarding a distribution's tax consequence.

The special tax notice is available from the IRS Web site, and companies handling retirement assets should also have copies available. You don't have to customize the notice for your plan, but be sure to indicate your plan name and the participant's name at the top.

204(h) notice

If a company chooses to lessen its funding of a defined benefit plan, the IRS requires what's called a 204(h) notice. It applies only to defined benefit plans; the notice isn't required in defined contribution plans.

IRS regulations provide guidance for the notice requirements for plan amendments that result in a reduction in accrued benefits. Benefit accruals are amounts or benefits that are funded into a plan, and plan amendments cannot affect benefits already accrued. Any reduction in future benefit accruals must follow the plan document terms.

The IRS sample notice provides sufficient explanation to participants regarding the reduction of benefits. You must provide the notice to plan participants within a reasonable time before the plan amendment's effective date. The IRS imposes an excise tax on plan administrators who fail to provide timely notice of a plan amendment reducing benefit accruals.

On notice

Whether you're making participant distributions in a defined contribution plan or reducing benefit accruals in a defined benefit plan, the IRS has the right notice for you. Consult with your ERISA expert to ensure your plan is following the required notices.

Are you ready to file Form 5500?

Are you planning on filing a Form 5500 on July 31? If so, remember that the Department of Labor (DOL) requires all plan sponsors to file their 2009 Form 5500s (with the exception of one-participant plans) electronically using their new EFAST2 system.

Plan sponsors must obtain an electronic signature directly from the DOL and also have e-mail and Internet access to participate in this process. Calendar-year plans ending Dec. 31, 2009, are due July 31, 2010, without extension.

To learn more about the EFAST2 program, visit efast.dol.gov. If you haven't done so already, ensure you have ample time to begin this process.

Do as I write, not as I say

AVOID MISHAPS WITH WRITTEN ERISA BENEFITS

Qualified retirement plan sponsors must ensure that information provided to plan participants is accurate and reliable and follows the plan document provisions. As pointed out by one recent court case, *Ladouceur v. Credit Lyonnais*, poor communication or misinformation has the potential to cause significant problems for a plan sponsor if participants attempt to use incorrect information. This case provides a lesson on what employers may or may not communicate orally to employees about ERISA benefits as compared to what they must put in writing.

The case

Rouse became an affiliate company with Credit Lyonnais after the companies merged. Three Rouse employees met with the HR director to determine how their pensions would be adjusted because of the merger. They questioned whether their pension benefits would include the period of service they'd worked for Rouse. The HR director orally affirmed that the employees' pension service credits would apply for the period of time they'd worked for Rouse. However, nothing was put in writing about the discussion.

After the merger, Credit Lyonnais, the purchasing organization, stated that, as part of the merger, the employees' pension credits would begin with the date they became employed by Credit Lyonnais. The three employees filed breach of fiduciary duty claims against Credit Lyonnais, claiming that they should be able to rely on the oral statements presented by the misinformed HR director.

Through several ensuing legal battles, the courts ruled in favor of Credit Lyonnais, holding that oral promises couldn't vary the terms of an ERISA plan.

Information basics

A summary plan description (SPD) contains all of the necessary information about plan basics including vesting, contribution and distribution rights under ERISA. You must provide it to employees and update it after a stated number of years. Be sure that participants are aware that the terms in the SPD override oral statements.

In the cases of mergers or other events, your SPD may not clearly outline the ramifications for participants. If you amend your plan, distribute a summary of material modifications to employees.

Some suggestions

All communications to employees regarding ERISA benefits must disclose any facts the employer knows or should know are vital to an employee's decisions regarding benefits. This includes vesting and eligibility issues, rollovers, contributions, and other plan funding matters (such as the employer's right to change or terminate future benefits).

ERISA plan sponsors should ensure that key administrators are clear on plan terms. Consulting

ERISA specialists, including attorneys, accountants, third party administrators and investment advisors, is beneficial. If a participant has a specific question, consult with your plan's ERISA specialist before providing a written answer.

In addition, establish a team of plan administrators or personnel to create and monitor an education program for employees. Define their responsibilities in the employee handbook. You may want to limit the number of individuals who are authorized to communicate with employees about ERISA benefits on the employer's behalf. Doing so should help alleviate miscommunication.

Hold employee education sessions regarding your retirement plan and administration — especially if you have merger and acquisition issues. These sessions, along with opportunities for follow-up, should give employees clear guidance as to how to obtain plan information.

Be prepared

As the *Ladouceur* case illustrates, miscommunication involving plan terms can have legal consequences. Providing accurate information will not only benefit participants, but also help ensure proper plan administration and prevent a myriad of problems for plan sponsors.

Keeping up with your employee contributions

Starting in 1996, Department of Labor (DOL) regulations required employers sponsoring retirement plans to deposit employee deferrals into employee benefit plans as of the earliest date on which the employer could reasonably segregate such contributions from the employer's assets. Furthermore, deposits could be made no later than the 15th business day of the month following the month in which the contribution (including loan payments) was withheld from the employees' contribution.

This definition was interpreted many ways by different people. Plan sponsors and service providers focused on the "15th business day" part of this definition, while the DOL focused on the "earliest date" language.

After many years of confusion, the DOL issued final regulations providing a safe harbor rule for determining the timeliness of depositing employee deferrals of retirement and welfare benefit plans. The regulation became effective in January 2010. Now contributions are deemed timely if deposited in the plan no later than the seventh business day following the date on which the contribution (including loan payments) was withheld from the employee's compensation.

The catch? This regulation applies to only "small" retirement and welfare benefit plans. The definition of "small" means no more than 100 participants as of the first day of the plan year. So large plans still have to comply with the old rule.

And what if you fail to make a timely deposit under the new regulation? Untimely deposits of employee contributions result in a prohibited transaction. The employer must calculate the lost earnings due to the participant and deposit the earnings into the plan. In addition, the employer also must pay an excise tax on the earnings. You should report these prohibited transactions to the DOL under the Voluntary Fiduciary Correction Program (VFCP).

It's good news that small plan sponsors now have clear rules to follow on depositing employee contributions. With time, it's possible the DOL will extend this new rule to large plans.

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