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Retirement PLAN news

The duty to collect contributions

The Department of Labor (DOL), through its Employee Benefit Security Administration division, works to protect the benefits of employees in various types of plans, including 401(k)s. Lately, the DOL has been investigating delinquent contributions to qualified retirement plans.

In addition to the obvious problems that arise when plan contributions are not timely deposited, the DOL has found that some plan documents expressly absolve plan trustees from the responsibility of monitoring and collecting delinquent contributions. Based on its findings, the DOL issued Field Assistance Bulletin 2008-1 (FAB 2008-01) to provide guidance regarding delinquent deposits into qualified plans, such as 401(k)s. The FAB addresses two questions:

- When are contributions delinquent?
- Who is responsible for collecting delinquent contributions?

When are contributions delinquent?

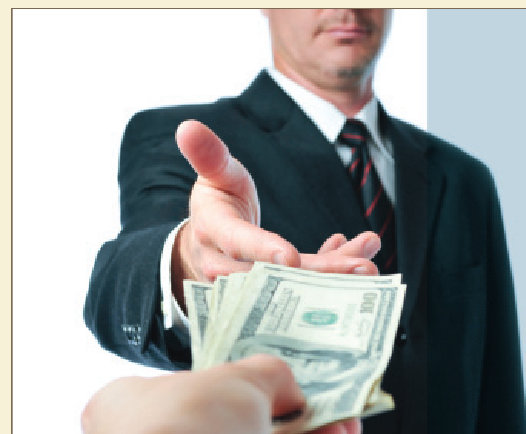
The answer to the first question is straightforward: "Employer contributions are delinquent when they are due and owing to the plan under the documents and instruments governing the plan but have not been transmitted to the plan in a timely manner."

The FAB goes on to say that ". . . when an employer fails to make a required contribution to a plan, the plan has a claim against the employer for the contribution, and that claim is an asset of the plan." Since assets of the plan must be protected, a failure on the part of the trustee to take active steps to ensure that delinquent employer contributions are collected constitutes a prohibited transaction under ERISA. In addition, plan fiduciaries could be held liable.

Who's responsible for collecting delinquent contributions?

The answer to the second question is more complex. The FAB includes a reminder that ". . . the duty to enforce valid claims held by a trust has long been considered a trustee responsibility under common law." The trustee is expected to ". . . use reasonable diligence to discover the location of the trust property and to take control of it without unnecessary delay."

It is the DOL's view that the fiduciary with the authority to appoint the plan's



trustee(s), i.e., the "appointing" or "named" fiduciary — generally the plan sponsor — must ensure that the obligation to collect contributions is appropriately assigned. The authority may be assigned to a trustee (unless the plan document expressly provides that the trustee will be a "directed trustee with respect to contributions") or it may be delegated to an investment manager.

Assigning responsibility

Thus, FAB 2008-01 establishes an affirmative duty for the appointing fiduciary — often the plan sponsor — to assign responsibility for monitoring and collecting contributions. If that authority is not delegated, the appointing fiduciary is liable for plan losses resulting from

(Continued on page 2)

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Deadline for depositing deferrals

In January 2010, the Department of Labor issued final rules on a safe harbor period for depositing deferrals to a pension or welfare benefit plan with *fewer than 100* participants (determined at the beginning of the plan year).

Safe harbor for small plans

To satisfy the safe harbor, contributions must be deposited into the plan no later than the seventh business day following the day on which such amounts would otherwise have been payable to participants in cash. Contributions are considered deposited when placed in a plan account; they do not have to be allocated to specific participant accounts or investments by the seventh day. (There is also a safe harbor for loan repayments that are deposited no later than the seventh business day following the day they are received by the employer.)

Example: Acme Enterprises sponsors a 401(k) plan with 30 participants. The company has one payroll period and uses an outside service to pay employee wages and process deductions. Acme receives information from the payroll service within one business day after paychecks have been issued. Acme checks the information for accuracy within three business days and forwards the withheld employee contributions to the plan. An amount equal to the total withheld employee contributions is deposited with the plan trust on the fifth business day following the date employees receive their paychecks.

No safe harbor for large plans

Large plans, those with 100 or more participants, remain under the regulation to segregate the plan assets and contribute them to the plan as soon as possible.

The duty to collect contributions

(Continued from page 1)

the failure to collect contributions. As an additional incentive for plans to comply, the DOL states that if the responsibility for monitoring and collecting contributions is *not* delegated, the appointed trustee or trustees (including a directed trustee) will be required to take appropriate steps to monitor and collect contributions, even if a trust document says otherwise.

Fiduciaries who either actively participate in the breach of a co-fiduciary or who, by their action or inaction, enable the breach to occur may be liable. A fiduciary with knowledge of a breach by a co-fiduciary will only avoid liability by making "reasonable efforts to remedy the breach."

In the event that the delinquent contributions are not deposited, the "DOL expects the trustee, or the appropriate party, to inform the DOL of this situation." The DOL further stressed that under ERISA, plan documents cannot absolve a plan fiduciary from taking appropriate action to remedy the known breach of a co-fiduciary.

The DOL's conclusion

"The responsibility for collecting contributions is a trustee responsibility. If a plan has two or more trustees, the duty may be allocated to a single trustee. A plan may also provide that a named fiduciary may direct a trustee as to this responsibility or may appoint an investment manager to take on this duty. To the extent the nature and scope of the trustee's responsibilities are specifically limited in the plan documents or trust agreement, it is generally the responsibility of the named fiduciary with the authority to hire and monitor trustees to assure that all trustee responsibilities with respect to the management and control of the plan's assets (including collecting delinquent contributions) have been properly assigned to a trustee or investment manager."

In other words, the onus is on the named fiduciary — often the plan sponsor — to ensure that someone is assigned the duty of collecting contributions.

Unanswered questions

FAB 2008-01 assumes a situation where the trustee and investment manager are a corporate entity. However, it is not clear how the above guidelines should be applied to a self-trusteed plan. In this situation, who would be appointed to monitor contributions and collections? Indeed, who would want to take on this responsibility and potential liability?

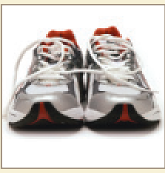
How does this FAB help?

This FAB helps protect participants whose deferrals have been deducted from their pay but not deposited into the plan by requiring plan trustees to remind the plan sponsor to deposit late deferrals. It also requires the trustees to inform the plan sponsor of their responsibility to notify the DOL if deposits are not made. This often provides the necessary incentive. (**Note:** When deferrals are deposited late, interest is also due.) This FAB also applies to other plan contributions.

Ongoing audits

The DOL has stated that an overwhelming number of filings in its Voluntary Fiduciary Compliance Program (VFCP) involve late deposits. Hopefully, a future modification to the VFCP will include de minimis criteria to provide a self-correction method.

Audit efforts by the DOL continue to find delinquent deposits. In addition, the DOL is reviewing plan documents for language that relieves the trustee of responsibility for collecting contributions. In such cases, the DOL may seek a plan amendment.



Back to basics: Catch-up contributions

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) added a section to the Internal Revenue Code that permits individuals age 50 or older to make "catch-up" contributions. Catch-up contributions are generally perceived as a great tax incentive for older participants nearing retirement.

There are, however, administrative issues that need to be carefully handled.

Must a qualified plan be amended to permit catch-up contributions?

Yes. The catch-up contribution is an optional plan provision, so a qualified plan must be amended to permit catch-up contributions. Generally, the plan must be amended by the end of the first year in which the catch-up provisions are first used.

Who is eligible to make catch-up contributions?

Any eligible participant who reaches the age of 50 at any time during the calendar year is eligible to make catch-up contributions. A catch-up contribution may be made at any time during the calendar year that includes the participant's 50th birthday.

If a participant is "catch-up eligible," there are four ways catch-up contributions may be made:

- The participant contributes more than the annual IRS limit for elective deferrals ($16,500 in 2011).
- The participant contributes more than a plan-imposed elective deferral limit.
- The plan fails the actual deferral percentage (ADP) discrimination test and excess contribution amounts due to be distributed as a refund are instead recharacterized as catch-up contributions if the participant has not reached the catch-up contribution limit for that year. (**Note:** The recharacterized amount may not exceed the catch-up limit for the year.)
- The participant contributes an amount that, usually together with other plan allocations, exceeds the IRC Section 415 annual additions limit ($49,000 in 2011).

What is the universal availability rule?

The universal availability rule says that if an employer's plan offers catch-up contributions to any employees, it must offer them to all employees covered by the plan, regardless of whether they are in different divisions of the company. (Collectively bargained employees and nonresident aliens are excluded from this requirement.) The rule also requires all deferral plans sponsored by the employer to offer catch-up contributions. There are special rules for controlled groups of companies and union plans.

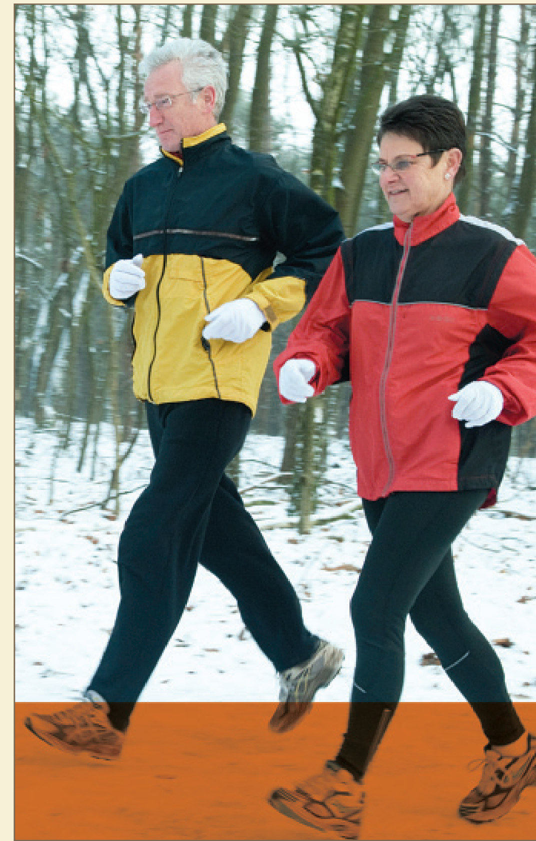
Are catch-up contributions included in testing?

Catch-up contributions are not part of the ADP test. They are also not included when determining current year contributions for key employees for top-heavy testing purposes. Most importantly, catch-up contributions are not included in the Section 415 annual additions limit.

However, matching contributions made on catch-up contributions must be included in the plan's actual contribution percentage (ACP) test. And catch-up contributions made in prior years are included in a plan's year-end balance when determining if a plan is top heavy.

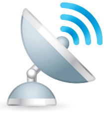
What happens when there is an ADP test failure?

A failed ADP test means excess contributions must be returned. When a plan has more than one highly compensated employee (HCE), the "leveling process" must be followed. If the person whose deferral amount is reduced is catch-up eligible, and he or she has not reached the catch-up contribution limit for the year, then the excess must be recharacterized as a catch-up contribution (up to the catch-up limit).



Example 1: Following a 2010 ADP test, an HCE had excess contributions of $8,800. If the employee is catch-up eligible but has not made any catch-up contributions, then $5,500 (the maximum catch-up amount for 2010) of the excess contributions would be recharacterized as a catch-up contribution. The remaining $3,300 would be refunded.

Example 2: A second HCE who is also eligible to make catch-up contributions had an excess contribution of $6,000. But that HCE had already made a catch-up contribution of $2,000 for 2010. In this case, $3,500 would be recharacterized, bringing the individual's total catch-up contribution amount for the year up to the limit of $5,500. The remaining excess contribution amount of $2,500 would be refunded to the HCE.



RECENT developments

IRS phone forums

The IRS offers free phone forums that may be of interest to plan sponsors. Each forum covers a specific aspect of retirement plans and is presented by IRS employees. Previous phone forum topics include participant loans, plan correction issues, in-plan Roth rollovers, and retirement plan distributions. Transcripts and handouts from previous phone forums are archived on the IRS website. To learn about future phone forums and view prior presentations, go to *www.irs.gov/retirement/article/0,,id=218995,00.html*.

IRS hardship distribution tips

The IRS has posted "Do's and Don'ts of Hardship Distributions" on its website (*www.irs.gov/retirement/article/0,,id=243722,00.html*) to help remind plan sponsors of the document requirements and guidelines that must be followed before making a hardship distribution to a plan participant. It is crucial for plans to follow these rules to avoid the risk of disqualification. There is also a link to the IRS's Employee Plans Compliance Resolution System (EPCRS), which provides guidance for employers that need to correct mistakes involving hardship distributions.

PBGC bankruptcy termination

The PBGC issued final rules stating that if an underfunded single-employer pension plan terminates while its contributing plan sponsor is in bankruptcy, the date on which the sponsor's bankruptcy petition was filed will be treated as the termination date for the plan. So when a sponsor is in bankruptcy and the plan terminates, the amount of PBGC guaranteed benefits in priority category 3 (PC3) will be established as of the date of the bankruptcy filing rather than the plan termination date. In most cases, this will reduce the amount of guaranteed benefits and the amount of benefits in PC3.

Circular 230 updated

The updated Circular 230 recently released by the U.S. Treasury Department covers paid tax-return preparers for the first time. As a result, the preparers will be subject to competency examinations, continuing education requirements, and the rules and sanctions of Circular 230. In addition, preparers must have a paid tax-preparer identification number (PTIN). These changes will provide the IRS with better oversight of this group of tax professionals. At this time, only some of the forms filed in conjunction with a retirement plan require the services of a paid tax-return preparer. The most important one is Form 5330 relating to the payment of excise taxes.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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