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EXECUTIVE BENEFIT PLANS, INC.
Employee Benefit & Pension Specialists

Plan Insight
A Qualified Plan Newsletter for Plan Sponsors

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IRS Sending Employers a 401(k) Questionnaire

The IRS announced last week that it will be looking at 1,200 401(k) plans by way of a plan compliance questionnaire. Letters from the IRS are expected to go out at the end of May. An employer receiving a letter will be assigned a personal identification number (PIN) to use when filling out the questionnaire online. The employer has 90 days to complete the form, but can get an extension. Answering the questionnaire is "technically voluntary," but an IRS spokesperson made it clear that they want the information.

While this is not "technically" an audit, the IRS is free to use the information to open an audit of your 401(k) plan. Just announced is the audit of 30 colleges and universities – the result of answers to a 2008 compliance questionnaire sent to 400 tax-exempt colleges and universities relating to executive pay and unrelated business income.

If you get this letter from the IRS, use it to help you identify any compliance issues you are asked to disclose. The task of completing the questionnaire should be handled by someone in your organization who is thoroughly knowledgeable about plan compliance. Almost all compliance errors can be corrected either through the IRS Voluntary Correction Program (VCP) or simply by putting the plan in the position it would have been in had the error not occurred, if the plan meets the requirements for correction without submission to the IRS program.

If you have received such a questionnaire and feel we can be of assistance, please contact us.

Small Business Tax Credit for 401k Startup Costs

According to U.S. Department of Labor statistics, 64 percent of all employees in medium and large-sized firms are covered by an employment-based retirement plan, compared with only 34 percent at small firms. One reason cited

Tax Credit Cont'd.

by small businesses for not offering retirement plans are the high costs associated with set-up and administration of a retirement plan.

Startup costs have always been a major hurdle to small businesses who want to start a 401k plan, but a provision of The Economic Growth and Tax Relief and Reconciliation Act (EGTRRA) now helps scale this barrier to employee saving opportunities. EGTRRA implemented a credit for employers to offset the startup cost and the cost of educating employees about the new plan.

For costs paid or incurred in tax years beginning after December 31, 2001, for retirement plans that first become effective after that date, you may be able to claim a tax credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE, or qualified plan (including a 401k). The credit equals 50% of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of $500 per year for each of the first three years of the plan. For plans that become effective after 2002, you can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective.

You must have had 100 or fewer employees who received at least $5,000 in compensation from you for the preceding year. At least one participant must be a non-highly compensated employee. The employees generally cannot be substantially the same employees for whom contributions were made or benefits accrued under a plan of any of the following employers in the three-tax-year period immediately before the first year to which the credit applies.

1. You.

2. A member of a controlled group that includes you.

3. A predecessor of (1) or (2).

The credit is part of the general business credit, which can be carried back or

Tax Credit Cont'd.

forward to other tax years if it cannot be used in the current year. However, the part of the general business credit attributable to the small employer pension plan startup cost credit cannot be carried back to a tax year beginning before January 1, 2002.

To take the credit, get Form 8881, for credit for Small Employer Pension Plan Startup Costs, and the instructions.

Disclosing Plan Information to Participants

Plan disclosure documents keep participants informed about the basics of plan operation, alert them to changes in the plan's structure and operations, and provide them a chance to make decisions and take timely action with respect to their accounts.

The summary plan description (SPD) — the basic descriptive document — is a plain-language explanation of the plan and must be comprehensive enough to apprise participants of their rights and responsibilities under the plan. It also informs participants about the plan features and what to expect of the plan. Among other things, the SPD must include information about:

❑ When and how employees become eligible to participate in the 401(k) plan;

❑ The contributions to the plan;

❑ How long it takes to become vested;

❑ When employees are eligible to receive their benefits;

❑ How to file a claim for those benefits; and

❑ Basic rights and responsibilities participants have under the Federal retirement law, the Employee Retirement Income Security Act (ERISA).

The SPD should include an explanation about the administrative expenses that will be paid by the plan. This document must be given to participants when they join the plan and to beneficiaries when they first receive benefits. SPDs must also be redistributed periodically during the life of the plan.

A summary of material modification (SMM) apprises participants of changes made to the plan or to the information

Disclosing Plan Information Cont'd.

required to be in the SPD. The SMM or an updated SPD must be automatically furnished to participants within a specified number of days after the change.

An individual benefit statement (IBS) shows the total plan benefits earned by a participant, vested benefits, the value of each investment in the account, information describing the ability to direct investments, and (for plans with participant direction) an explanation of the importance of a diversified portfolio. Plans that provide for participant-directed accounts must furnish individual account statements on a quarterly basis. Plans that do not provide for participant direction must furnish statements annually.

A summary annual report (SAR) is a narrative of the plan's annual return/report, the Form 5500, filed with the Federal government (see Reporting to Government Agencies for more information). It must be furnished annually to participants.

A blackout period notice gives employees advance notice when a blackout period occurs, typically when plans change recordkeepers or investment options, or when plans add participants due to corporate mergers or acquisitions. During a blackout period, participants' rights to direct investments, take loans, or obtain distributions are suspended.

Qualified Plan Fiduciary Responsibilities

Many of the actions needed to operate a 401(k) plan involve fiduciary decision - whether you hire someone to manage the plan for you or do some or all of the plan management yourself. Controlling the assets of the plan or using discretion in administering and managing the plan makes you or the entity you hire a plan fiduciary to the extent of that discretion or control. Thus, fiduciary status is based on the functions performed for the plan, not a title. Be aware that hiring someone to perform fiduciary functions is itself a fiduciary act.

Some decisions with respect to a plan are business decisions, rather than fiduciary decisions. For instance, the decisions to establish a plan, to include certain features in a plan, to amend a plan and

Fiduciary Responsibilities Cont'd.

to terminate a plan are business decisions. When making these decisions, you are acting on behalf of your business, not the plan, and therefore, you would not be a fiduciary. However, when you take steps to implement these decisions, you (or those you hire) are acting on behalf of the plan and thus, in making decisions, are acting as fiduciaries.

<u>Your Basic Responsibilities</u>

Those persons or entities that are fiduciaries are in a position of trust with respect to the participants and beneficiaries in the plan. The fiduciary's responsibilities include:

- Acting solely in the interest of the participants and their beneficiaries;
- Acting for the exclusive purpose of providing benefits to workers participating in the plan and their beneficiaries, and defraying reasonable expenses of the plan;
- Carrying out duties with the care, skill, prudence, and diligence of a prudent person familiar with such matters;
- Adhering to the plan documents; and
- Diversifying plan investments.

These are the responsibilities that fiduciaries need to keep in mind as they carry out their duties. The responsibility to be prudent covers a wide range of functions needed to operate a plan. And, since all these functions must be carried out in the same manner as a prudent person would carry them out, it may be in your best interest to consult experts in the various fields, such as investments and accounting.

In addition, for some functions, there are specific rules that help guide the fiduciary. For example, if your plan provides for salary reductions from employees' paychecks for contribution to the plan, then these contributions must be deposited timely. The law states that this must be accomplished as soon as they can be segregated from the employer's assets timely, but no later than 7 business days following receipt, or following the date the amounts would otherwise have been paid to the employee as compensation.

401k Participant Uptake Linked to Employer - Sponsored Education

What motivates employees to participate in and contribute to voluntary savings plans? According to a new study in Economic Inquiry, the answer lies in how regularly their company holds retirement seminars.

Direct links were found to exist between how often a retirement seminar is offered and increased levels of 401k activity- especially among those employees lower down on the pay scale. Participation rates by non-highly compensated employees are 11.5 percent higher with plans that offer frequent seminars, than those with no seminars. For highly compensated employees, participation is 6.5 percent higher when seminars are more regularly available. In firms where participation is historically low, the number of employer-sponsored seminars spiked-a strong indication that retirement seminars are remedial.

"The Effects of Financial Education in the Workplace: Evidence from a Survey of Employers" taps a previously unexploited source - the KPMG Peat Marwick Retirement Benefit Survey - to conduct a detailed investigation into employer-based retirement training programs.

In the KPMG survey, 1,100 public and private employers were chosen randomly and interviewed initially and again the following year. The authors then evaluated the relationship between education and behavior.

Employers offer retirement education for many reasons. In addition to helping employees prepare for retirement, these seminars introduce workers to the value of the company's existing pension plan and help stave off subsequent demands on employers for more generous plans.

"Assistance with financial planning may also enhance employee loyalty, improve labor relations, and boost morale," the authors contend. So for many reasons, when it comes to honing financial-decision making skills, the more education offered, the better.

Good News for Many Safe Harbor 401(k) Plans

A number of plan sponsors and plan advisors have inquired about the obligation to a safe harbor 401(k) plan in

Good News – Safe Harbor Cont'd.

the event the down turn in the economy requires the company to suspend the safe harbor contribution. Until now, only a safe harbor 401(k) plan which utilizes a matching safe harbor contribution was permitted to suspend the matching contribution and continue to operate the plan. A plan which utilizes the nonelective safe harbor contribution (typically a 3% fully vested contribution to all eligible employees) was not permitted to suspend the 3% contribution during the year without terminating the plan.

Fortunately, on May 18, 2009, the Internal Revenue Service ("IRS") published proposed amendments to certain Treasury Regulations to provide an employer incurring a "substantial business hardship" an alternative to terminating the 401(k) safe harbor plan. An employer meeting certain requirements can reduce or suspend a required safe harbor nonelective contribution without losing their plan's qualified status.

I. Background.

A 401(k) plan is a qualified retirement savings plan which allows eligible employees to make a cash or deferred election with respect to their wages. In order to qualify under federal income tax laws, a qualified 401(k) plan must satisfy certain nondiscrimination requirements. A 401(k) plan must pass either the "actual deferral percentage" ("ADP") test or one of the safe harbors. A plan that intends to be a safe harbor 401(k) plan must meet the following requirements:

a. adopt a safe harbor 401(k) plan that specifies whether the employer will make a safe harbor matching or nonelective contribution;

b. maintain the safe harbor 401(k) plan throughout a full plan year subject to certain exceptions (explained below);

c. notify each eligible employee within a

Good News – Safe Harbor Cont'd.

reasonable period before the beginning of each plan year of rights and obligations under the plan; and

d. make either matching or nonelective contributions at least as great as the rates required by its safe harbor.

There are exceptions to the general requirement that an employer continue a safe harbor 401(k) plan throughout a full plan year. First, a new 401(k) plan may have a short plan year for the first plan year only. For any other safe harbor 401(k) plan, an employer may either:

i. amend a plan to reduce or suspend safe harbor matching contributions on future employee elective contributions for a plan year, or

ii. terminate its safe harbor plan during the plan year.

II. Substantial Business Hardship.

Under the proposed regulations, an employer that experiences a "substantial business hardship" may amend its safe harbor plan to reduce or eliminate the plan's safe harbor nonelective contribution. First, the plan must be amended prior to the end of the plan year to reduce or suspend the safe harbor nonelective contribution. Second, following the amendment, the plan must provide that the ADP test (and any other nondiscrimination requirements) will be satisfied for the entire plan year in which the safe harbor nonelective contribution is reduced or suspended. Second, all eligible employees must be given a "supplemental notice". Also, The reduction or suspension of the safe harbor nonelective contribution can occur no earlier than 30 days after giving eligible employees the supplemental notice. The IRS has stated that, to the extent the final regulations are more restrictive than these proposed regulations, they will not be applied retroactively.

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