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Give Your Plan a Check-up

Once a 401(k) plan is in place, it's easy to sit back and take an "I'm done," hands-off attitude toward the plan. But to ensure that your plan will continue to operate effectively, you should periodically review its provisions and features. Here are some questions that may help you with that check-up.

Do you offer employer matching contributions? Countless studies show that plans that offer employer matching contributions have higher participation rates than plans that don't. According to the *51st Annual Survey of Profit Sharing and 401(k) Plans* (reflecting 2007 plan experience), recently released by the Profit Sharing/401(k) Council of America (PSCA), the most popular fixed match is 50 cents for every dollar an employee contributes. Regularly weigh the size of your plan match against the level of employee participation.

Have you evaluated your plan's investment choices lately? To meet your fiduciary duties as a plan sponsor, you must carefully evaluate the continuing suitability of your plan's current investment choices and whether those choices offer enough variety. To help protect against fiduciary liability with respect to investing the plan contributions of employees who do not give directions for investing their accounts, make sure you've chosen a qualified default investment alternative (QDIA) for those contributions. Generally, QDIAs include lifecycle/target-date funds, balanced funds, and professionally managed accounts.

What is your plan's rollover policy? Plans generally must give participants who are receiving an eligible distribution the option to roll the distribution directly to another employer-sponsored retirement plan or an IRA. However, if the amount of all eligible rollover distributions for the year is reasonably expected to be less than $200, the plan doesn't have to offer the direct rollover option. A plan can also specify that any eligible rollover distribution of less than $500 must be rolled over in total if the rollover option is chosen.

Beginning in 2008, employees can make direct rollovers to Roth IRAs. A rollover to a Roth IRA is a taxable event. Note that, while not required, most 401(k) plans (98.2% in the PSCA survey) also accept rollovers from other qualified plans. Accepting such rollovers may make your plan more competitive with other employers' plans. Your plan should have procedures in place to handle all permitted rollovers.

What about required minimum distributions? Make sure that all required minimum distributions (RMDs) are being made. Distributions must be made to retired employees who are over age 70½ and *current* employees over age 70½ who own 5% or more of the company.* A plan can provide, however, that the rule applicable to 5% owners applies to all current employees. RMDs also must be paid to beneficiaries of deceased employees. The timing of such distributions may vary depending upon the participant's age and whether the beneficiary is the participant's surviving spouse. Be sure you are following the terms of your plan.

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* The Worker, Retiree and Employer Recovery Act waives the minimum distribution requirement for calendar year 2009 only. In the case of employees who turn age 70½ in 2009, they will not have to take their first distribution by April 1, 2010. The deadline for their first required minimum distribution (for 2010) will be December 31, 2010.

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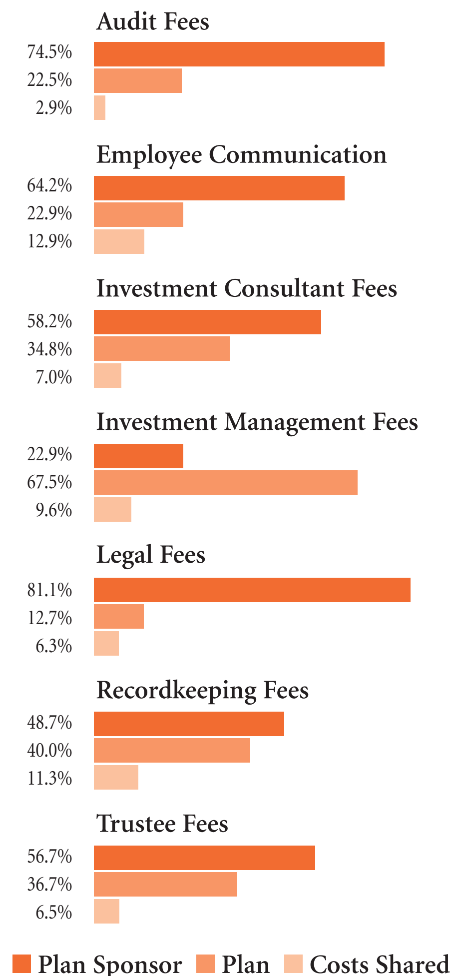
2009 Cost-of-Living Adjustments

The annual inflation adjustments for plan limitations are in. For 2009, most of the limits have increased:

- Maximum annual additions to a defined contribution plan account from $46,000 to $49,000
- Maximum annual benefit from defined benefit pension plans from $185,000 to $195,000
- Maximum annual compensation used to determine qualified plan benefits or contributions from $230,000 to $245,000
- 401(k), 403(b), and 457 plan deferrals and catch-up contributions from $15,500/$5,000 to $16,500/$5,500
- SIMPLE deferrals and catch-up contributions from $10,500/$2,500 to $11,500/$2,500
- Dollar limit used in the definition of "highly compensated employee" from $105,000 to $110,000
- Compensation limit for determining whether officers are key employees for top-heavy plan purposes from $150,000 to $160,000
- Social Security taxable wage base from $102,000 to $106,800

"For 2009, most of the limits have increased . . . ."

Who Pays?



Source: *51st Annual Survey of Profit Sharing and 401(k) Plans*, reflecting 2007 plan experience, *www.psca.org*, 2008

Paying Expenses Out of Plan Assets

With the continued economic uncertainty, some companies are looking to cut business expenses by charging more of the cost of maintaining their retirement plans to the plans themselves. Before taking this tack, though, it's important for you to know what can and cannot be charged to a plan. Otherwise, you take a risk that the payment could be deemed a prohibited transaction.

Plan fiduciaries, including plan sponsors, may use plan assets only to provide benefits to plan participants and beneficiaries and to pay reasonable expenses of administering the plan. However, sponsors sometimes confuse plan-related business expenses — which aren't payable from plan assets — with plan administration expenses.

Sponsors generally can use plan assets to pay these and other types of administration expenses incurred in operating the plan:

- Fees related to maintaining a plan's tax-qualified status, including drafting required amendments and performing required nondiscrimination testing
- Trustee fees
- Recordkeeping expenses
- Certain investment management fees and expenses
- Employee communication expenses for participant disclosure statements
- Costs of computing participant benefits
- Fees for enrollment/election changes
- Fees for participant investment changes/elections
- Expenses for participant loan administration
- Costs of administering qualified domestic relations orders
- Certain legal fees

Other plan-related expenses, including costs related to designing and establishing a plan and certain plan termination fees, are business expenses that should not be paid from plan assets.

Plan Loan and Hardship Distribution Requests

For many employees, the assets in their 401(k) plan accounts represent a majority of their savings. So, not surprisingly, over the past year as money has gotten tighter, employers have seen an increase in requests for plan loans and hardship distributions. If you are receiving distribution requests, the following information should be a helpful review for handling them.

Employers sponsoring 401(k) plans are not required to offer plan loans or hardship distributions. However, many employers include plan loan and hardship provisions in their plans to encourage employees to participate. If employees know they can access the money in their plan accounts if they really need to, they may be more comfortable contributing to the plan.

Plan Loans

Under federal tax law, the maximum amount an employee can borrow from his or her plan account is (1) the greater of $10,000 or 50% of the balance of the employee's account; or (2) $50,000, whichever is less. All of the employee's outstanding loans are taken into account when determining the maximum loan amount.

Most plan loans must be repaid within five years. However, loans used to buy a principal residence may have a longer repayment period. Loans are typically repaid through payroll deduction.

To help control the use of plan loans, many employers impose restrictions, such as loan fees and a minimum loan amount (usually between $500 and $1,000), and place limits on the number of outstanding loans an employee can have at a time.

Hardship Distributions

The plan documents must specify a method for determining eligible hardships. Hardship distributions — unlike loans — are not repaid to the plan. Where a plan uses a facts-and-circumstances method, the plan administrator reviews all relevant facts and circumstances in each individual situation. While the plan generally can allow a hardship distribution for any reason, it must have established rules to ensure that the distribution will be used for an immediate and heavy financial need.

The safe harbor method permits hardship distributions to: (1) pay certain medical expenses incurred by the participant, participant's spouse, or dependents; (2) purchase a principal residence; (3) cover post-secondary educational expenses for the participant, the participant's spouse, children, or dependents; (4) prevent eviction from or foreclosure on a principal residence; (5) pay the funeral expenses of a spouse, parents, children, or dependents; and (6) repair damage to the participant's principal residence that would qualify for the income-tax casualty loss deduction (without regard to whether the loss exceeds 10% of adjusted gross income). Participants generally are prohibited from making elective deferrals to the plan for six months following the hardship distribution.

Hardship distributions generally are limited to the amount of the employee's total elective contributions as of the date of distribution minus the amount of any previous hardship distributions.

Please talk with us if you have questions about plan loans, hardship distributions, or your plan's provisions for them.

"To help control the use of plan loans, many employers impose restrictions . . . ."

Plan Check-up *(continued from page 1)*

Are plan loans being administered properly? Verify that plan loan balances don't exceed the law's maximum amount, that all loans are on schedule to be repaid within five years (except loans to finance the purchase of a principal residence), and that any other plan-specific limits are being met.

What if you find you have made a mistake operating your plan? You may be able to quickly and cost-effectively correct the error through the IRS's Employee Plans Compliance Resolution System (EPCRS). EPCRS lets plan sponsors correct failures to satisfy plan qualification requirements and avoid possible disqualification of the plan. A recent EPCRS update* expanded the list of errors for which correction guidance is provided.

* Rev. Proc. 2008-50, 8/14/2008

Back to Basics: Guidance on Missing Participants

The Department of Labor's (DOL) Field Assistance Bulletin 2004-2 provides defined contribution plans with guidance on a difficult topic: locating missing participants. The guidance emphasizes that the employer has a fiduciary responsibility to attempt to locate missing participants when a plan is being terminated or when a former employee with $5,000 or less is being involuntarily cashed out and a distribution election cannot be secured.

Four Mandatory Search Methods

The DOL provides four efficient and relatively inexpensive search methods that all fiduciaries must use to find missing participants before any further steps may be taken. They are:

- Use certified mail.
- Review related plan records (e.g., other retirement and welfare benefit plans) for a newer address for the participant. If privacy issues arise (a common concern with health plans), a letter may be forwarded asking the participant to contact the administrator of the retirement plan.
- Contact the participant's designated beneficiary.
- Use a letter forwarding program, such as the IRS program (*www.irs.gov/retirement/article/0,,id=110106,00.html*) or the Social Security Administration program (*www.socialsecurity.gov/foia/html/ltrfwding.htm*).

Optional Search Methods

If these efforts are unsuccessful, an employer may use additional search methods (such as Internet search tools, commercial locator services, and credit reporting agencies). If the cost of the optional search is being charged to the participant's account, the employer should consider whether the cost is greater than the amount in the participant's account.

Distribution Options

If the participant cannot be located, the employer may choose from the following distribution options:

Automatic Rollover to an Individual Retirement Account. If a missing participant's account is $5,000 or less, the DOL permits the account to be automatically rolled over into an IRA. When terminating a plan, the DOL has some advice for accounts over $5,000. "As an enforcement matter," fiduciaries should use the guidance for investment products that is provided in the automatic rollover safe harbor provisions for accounts of $5,000 or less. This allows the fiduciary to avoid liability for the future investment performance of the IRA investments. Note, however, that the DOL's prohibited transaction exemption, which permits a direct rollover into the same institution's IRA, does not apply to amounts over $5,000.

Alternative Arrangements. If a plan fiduciary is unable to locate an automatic IRA rollover provider, it may consider certain alternatives. However, the employer should consider that these alternatives will result in an immediate tax liability for the participant. When using a federally insured bank account, the employer must consider all available information and restrictions on such accounts and review interest rates, guarantee periods, and associated bank charges. The participant must have an unconditional right to withdraw funds from the account.

If relevant state law permits, a fiduciary may transfer the missing participant's funds to the state's unclaimed property fund. However, a state cannot force an ERISA plan to transfer unclaimed accounts to its state fund.

Note: The DOL's preference is the IRA rollover option.

Not Applicable for Annuity Option Plans

These rules may not be used by employers who sponsor money purchase plans or defined contribution plans that have an annuity payment option, or by employers who maintain another qualified retirement plan (other than an employee stock option plan).

Pension Protection Act Updates

The Pension Protection Act of 2006 (PPA) extends the Pension Benefit Guaranty Corporation's (PBGC) missing participant program to terminated defined contribution plans. As soon as the PBGC regulations are issued for DC plans, this method will also be available.

The DOL amended the rules for terminating plans to require that an inherited IRA be established for a missing beneficiary of a deceased participant.

Can We Help?

Our firm offers a broad range of employee benefit plan services. If we can be of service to you, please call.

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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