Plan Expenses and Cost Cutting

Employers often find themselves trying to accomplish competing goals: providing benefits for employees and managing the costs of running a business. Tough economic times have made this even more difficult. Some employers have stopped making matching or other employer contributions. Others are looking at paying more of the plan’s administration expenses out of the plan’s assets.

ERISA allows employers to pay certain plan expenses with plan assets. Both the IRS and DOL have issued guidance on this subject. Employers should use caution when considering charging expenses to assets, however, because not all types of expenses can be paid from plan assets. The manner in which expenses are paid is also subject to certain restrictions.

Exclusive Benefit Rule

Internal Revenue Code Section 401(a)(2) states that the plan must be established and maintained by the employer for the exclusive benefit of the employees and their beneficiaries. This “exclusive benefit rule” would be violated if plan assets were used to pay for an expense that is considered to be the responsibility of the employer (a “settlor” expense).

Settlor Expenses

Settlor expenses are the responsibility of the employer and may not be charged back to the plan since they are discretionary expenses associated with the employer’s business decisions.

Settlor expenses include plan design costs; legal costs for corporate issues involved in establishing a plan; nonrequired or discretionary plan amendments, such as changing eligibility or vesting features or adding hardship withdrawals or loan provisions; fees associated with correcting a plan error; and fees for filing Form 5500 late.

Operational Expenses

Operational expenses may be charged to the plan since they are necessary to maintain the plan’s qualified status. Operational expenses include plan amendments for required law changes or changes in regulations. Thus, the EGTRRA plan document restatement (and other required plan amendments) and future document restatements (the six-year cycle) may be charged to plan assets. Other operational expenses that may generally be charged to the plan include:

- Plan audit fees
- Qualified domestic relations order (QDRO) and qualified medical child support order (QMCSO) determinations

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Restatement and Amendment Deadlines

Qualified plans must operate in accordance with their plan documents. Ongoing legal and regulatory changes in retirement plan rules frequently require plan sponsors to amend and restate their plans to keep their documents in compliance. Preapproved plans (i.e., master and prototype documents and volume submitter plans) must be rewritten, reviewed and approved by the IRS, and readopted by employers once every six years.

We are currently in the midst of the first six-year restatement cycle, and the EGTRRA document has been approved by the IRS. Employers using preapproved defined contribution plan documents must restate (readopt) them by April 30, 2010.

Cumulative List Concept

In order to know what qualification requirements should be included when a plan is being rewritten, the IRS devised the cumulative list concept. Each year, an updated list is issued containing qualification requirements for plans that must be rewritten the following year. The cumulative list simplifies the amendment and review process by establishing cutoff dates: Generally, any laws and/or guidance issued after one cumulative list is published will automatically be included on the next list for the next restatement cycle.

Here’s an example: The EGTRRA preapproved document was written based on the cumulative list issued at the end of 2004 (IRS Notice 2004-84), and the submission deadline for IRS review and approval was January 31, 2006. Most laws and regulatory changes that occurred after the 2004 Cumulative List are not incorporated into the EGTRRA document restatement. Thus, even though many PPA provisions became effective before the plans were approved in early 2008 and might already have been in operation, virtually no PPA language is incorporated into the approved document.

However, the Treasury Department and the IRS both have the power to, and often do, require interim document amendments to incorporate changes after a cumulative list has been issued. Preapproved plans must make these so-called “snap-on” amendments to incorporate the changes by the prescribed deadline. Required changes since the last restatement cycle will be written into the next document.

PPA Amendment Deadline

The Pension Protection Act of 2006 (PPA), which was enacted after the 2004 Cumulative List was published, requires that plans operate under PPA provisions as each becomes effective but does not require that plans be amended until the end of the first plan year beginning on or after January 1, 2009.

Ordinarily, required amendments like those for PPA changes could be made up until a plan’s due date for filing its tax return for the 2009 plan year. However, the IRS has indicated that there may be anti-cutback issues (which, if not correctly handled, would reduce a benefit already earned by the participant) if the PPA amendment is not completed before the end of the plan year. (The IRS plans to publish a list of anti-cutback issues.) This amendment deadline applies to both interim and discretionary amendments made pursuant to statutory PPA provisions and any PPA-related regulations. Thus, the EGTRRA restatement deadline of April 30, 2010, is not applicable to the PPA amendment, and plans may need to be amended for PPA before they are restated for EGTRRA. In this case, the PPA amendment should then be brought over to the EGTRRA restatement.

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Individually Designed Plans and PPA

Individually designed plans that are off-calendar-year Cycle D plans have an opportunity to meet the deadline for adopting PPA language by the last day of their 2009 plan year. To accomplish this, they may elect to be Cycle E plans, which would change the submission period to between February 1, 2010, and January 31, 2011. These plans will be Cycle D plans for the following restatement cycle, which has a submission period of February 1, 2014, through January 31, 2015. In this case, employers would not have a full five years between cycles.

HEART, EESA, and WRERA Amendments

The amendment for the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) is not due until the 2010 plan year, although some plans are incorporating HEART and PPA provisions at the same time. The Emergency Economic Stabilization Act of 2008 (EESA) amendment is also not due until the 2010 plan year, but some plans are incorporating EESA and PPA provisions at the same time. An amendment for the provision suspending required minimum distributions, part of the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), is not due until the 2011 plan year. The IRS has promised guidance on the scope and timing of the amendment.
The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), enacted December 23, 2008, contains provisions pertaining to distributions made to nonspouse beneficiaries. The requirements are effective for plan years beginning after December 31, 2009, and affect the distribution options and mandatory tax withholding rules of distributions for nonspouse beneficiaries.

The provision allowing a nonspouse beneficiary the option of rolling over a deceased participant’s plan balance to an inherited IRA was introduced by the Pension Protection Act of 2006. There have been subsequent changes, but WRERA clears up the confusion and provides new rules.

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Many plan sponsors have already updated their plans to allow this type of transaction. Sponsors who already offer this option — as well as sponsors who don’t — may not be aware of the changes that WRERA requires starting in 2010.

No longer optional. Under WRERA, the nonspouse beneficiary rollover distribution is a required plan provision. Thus, all qualified plans must allow for nonspouse beneficiary distributions by direct rollover.

Mandatory withholding applies. An equally important change is that nonspouse beneficiary distributions will be considered “eligible rollover distributions,” thus making them subject to mandatory 20% tax withholding and notice requirements. Changing this type of death benefit to an eligible rollover distribution will now result in a 20% mandatory tax withholding on any amounts not directly rolled over to an inherited IRA.

Notice requirements. If they have not already been doing so, plan sponsors must begin providing nonspouse beneficiaries with the 402(f) notice, also known as the “Special Tax Notice” or “Rollover Notice,” when a distribution is requested. The normal 30- to 180-day time frame for this notice applies.

Take heed. All plan sponsors should ensure that these requirements are met and that distributions to nonspouse beneficiaries have federal income tax withheld appropriately. Special explanations may have to be provided to nonspouse beneficiaries so that they fully understand the tax impact of their decisions beginning next year.

Plan Expenses and Cost Cutting (continued from page 1)

- Required fidelity bond
- Reporting and disclosure
- Third-party administrator fees
- Trustee and/or custodian fees
- Certain investment advisory and management fees
- Fees for participant enrollment/investment and election changes
- Check writing and distribution processing
- Loan initiation and annual administration
- Accountant fees
- Appraisal fees
- Actuarial fees

Reasonable plan administrative expenses may be charged to the accounts of former employees and beneficiaries, even though the accounts of current employees are not charged.

Allocating Charges

Expenses charged to the plan may be assessed pro rata (based on account balance) or per capita (based on equally sharing the expense among all the participants). This issue has been addressed in DOL Field Assistance Bulletin 2003-3 and IRS guidance.

Pro rata allocation: Expenses are allocated based on the value of the assets in each individual’s account.

Per capita allocation: Expenses are allocated on an equal dollar or percentage basis to each participant’s or beneficiary’s account, regardless of the value of the individual’s assets. This may be used for allocating certain fixed plan expenses, such as recordkeeping, legal, auditing, annual reporting, claims processing, and similar administrative expenses.

Fees that are based on account balances, such as investment management fees, should be charged on a pro rata basis because a per capita charge would appear to be arbitrary. Fees for services that provide investment advice to individual participants may be charged on either a pro rata or per capita basis, regardless of a participant’s actual utilization.
Preview of Changes for 2010

The year 2010 is the effective date of a number of retirement plan changes. Following is a preview of coming attractions — at least the ones we know of at this point.

DB(k) Plans
PPA introduced the DB(k) plan effective January 1, 2010. This new qualified plan is available to businesses with at least two and not more than 500 employees. The DB(k) permits a defined benefit plan to accept elective deferrals. The defined benefit component must either provide a minimum formula of 1% of final average pay for up to 20 years of service or use a cash balance design. The 401(k) component must provide for automatic enrollment with a minimum deferral rate of 4% of pay (with no automatic annual increase) and a fully vested employer matching contribution of 50% on the first 4% of compensation deferred. Any additional employer contributions — matching or nonelective, which are permitted — must be fully vested after three years of service. Additional details include:

- Uniform provision of contributions and benefits is required.
- Permitted disparity may not be used.
- The plan satisfies the top heavy rules.
- The ADP/ACP tests are satisfied by the 4% automatic deferral and the 50% employer match on the first 4% contributed.
- Amounts deferred or matched above those minimums will be subject to ADP/ACP testing.

At press time, we were still awaiting detailed guidance for the DB(k) from the IRS.

RMDs for 2010
WRERA permitted participants to waive their required minimum distribution (RMD) amounts for the 2009 distribution calendar year (DCY). The following rules apply for the 2010 DCY:

- Participants who had been receiving RMDs prior to 2009 must receive an RMD for 2010.
- Participants who turned age 70 1/2 in 2009 and did not take an RMD for the 2009 DCY by April 1, 2010, must take an RMD for the 2010 DCY by December 31, 2010.
- Participants who will turn age 70 1/2 in 2010 (and were therefore not affected by the WRERA provision waiving RMDs for the 2009 DCY) have until April 1, 2011, to take their first RMD.

Charitable IRA Donations End
The PPA provision allowing IRA owners age 70 1/2 or older to donate up to $100,000 a year to a qualified charitable organization (and apply the donation amount toward their RMD for the year) ends December 31, 2009. This provision, which was set to expire at the end of 2007, was extended by EESA. Note: The WRERA provision allowing 2009 RMDs to be waived may have reduced the number of taxpayers who took advantage of this opportunity.

402(f) Notice Changes
The 402(f) notice, commonly known as the “Special Tax or Rollover Notice,” must be provided to individuals prior to their receiving a distribution. The notice explains everything participants need to know about distributions including eligible rollover options and distribution rules, various tax consequences, and myriad other distribution details.

“The notice explains everything participants need to know about distributions. . . .”

Even though the IRS required the notice to be updated in 2007, the long-awaited IRS model notice wasn’t issued until 2009. The model notice includes important language about designated Roth distributions, distributions from automatic enrollment arrangements, distributions to individuals currently serving in the military, and much more. The effective date for implementing the information in the newly released model notice is January 1, 2010.

Mandatory Nonsnoue Rollovers
For plan years beginning after December 31, 2009, allowing nonsnoue beneficiaries to roll over their benefit will be a mandatory plan provision. Distributions to nonsnoue beneficiaries will now be considered “eligible rollover distributions” subject to the 20% mandatory federal tax withholding and 402(f) notice requirements.