



Deadline for Depositing Deferrals

Almost two years after issuing proposed regulations, the Department of Labor (DOL) has finalized regulations that establish a safe harbor period for the timely deposit of deferrals (and loan repayments) for small plans. The final regulations (effective January 14, 2010) are essentially the same as the proposed regulations with a few minor clarifications.

The general rule is that employee deferrals must become plan assets on the earliest date on which they can reasonably be segregated from the employer's general assets. That rule has not changed — but it has been clarified.

The New Rules

As in the proposed regulations, the final regulations create 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). To satisfy this 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.

The final regulations also include a safe harbor for loan repayments that are deposited into the plan by no later than the seventh business day following the day they are received by the employer.

Contributions will be considered deposited when placed in a plan account. The contributed amounts do not have to be allocated to specific participant accounts or investments by the seventh day.

Example: Acme Enterprises sponsors a 401(k) plan with 30 participants. The company has one payroll period and uses an outside payroll processing 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.

Under the safe harbor, when participant contributions are deposited in the plan by the seventh business day following a pay date, the contributions are deemed to be contributed to the plan on the earliest possible date on which such contributions can reasonably be segregated from the general assets of the company.

If an employer complies with the seven-day period, fine. However, if the employer fails to deposit deferrals or loan repayments by the end of the safe harbor period, losses and interest on the late deposits must be calculated from the



“... employee deferrals must become plan assets on the earliest date...”

actual date on which the contributions and/or repayments could reasonably have been segregated from the employer's general assets and not from the end of the safe harbor period. In the former example, penalties for noncompliance would apply starting five business days from when deferrals were withheld from employee paychecks, since that is the normal time frame for Acme Enterprises to deposit contributions to the plan trust.

Clarifications in the Final Regs

Here are some highlights of the clarifications included in the final regulations.

(continued on page 3)

Inside

An Introduction to Controlled Groups

2

Time to Review Your Fiduciary Liability Coverage?

3

Successor Plan Rule

4

An Introduction to Controlled Groups

The controlled group rules were adopted as part of the coverage and nondiscrimination regulations to ensure that a plan (or plans) maintained by an employer does not discriminate in favor of highly compensated employees (HCEs). A controlled group is considered a single employer for purposes of a qualified plan.

A controlled group of business entities can exist when one business owns a controlling interest in another business or when five or fewer individuals have ownership interests in two or more businesses. In service industries, such as medical practices and accounting, engineering, and consulting firms (among others), a controlled group can exist when an element of control exists and two or more entities are regularly associated in providing services to third parties.

Controlled Group of Corporations

A controlled group of corporations includes a parent-subsidary controlled group, a brother-sister controlled group, or a combination of the two.

Parent-subsidary group: A controlled group exists if one corporation owns an 80% or more interest in another corporation. The situation is a bit more complex where a holding company exists and the ownership interest it holds in other companies varies.

Control is determined by two criteria:

- At least 80% of each entity's interest must be owned by the common parent or by one or more of the other businesses, and
- The common parent must own at least an 80% interest in one or more of the other organizations.

The 80% ownership threshold is determined either by owning stock with 80% of the voting power of all classes entitled to vote or owning 80% of the total value of all shares of all classes of stock. (See Example 1.)

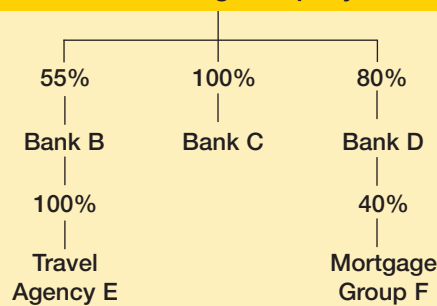
Brother-sister group: Two or more organizations are within a brother-sister group if:

- The same five or fewer shareholders (individuals, estates, or trusts) own at least an 80% controlling interest in each company, and
- The same five or fewer shareholders have an identical ownership among all companies which, in the aggregate, is more than 50%.

In determining which five shareholders to consider, certain family members may be aggregated and treated as one shareholder.

Example 1: Parent-subsidary group

Bank Holding Company A



Controlled group 1: Companies A, C, and D

Controlled group 2: Companies B and E

If stockholder 1 owns 50% of Company A, 20% of B, and 10% of C, his identical ownership in all three companies is the smallest percentage he owns in any one, or 10%. Stockholder 2 owns 25% of Company A, 20% of B, and 15% of C, resulting in an identical ownership of 15%. In the aggregate, stockholders 1 and 2 have an identical ownership of 25%.

Example 2: Brother-sister group

Ownership in company

Stockholder	Co. A	Co. B	Co. C	Identical Ownership
1	50%	20%	10%	10%
2	25%	20%	15%	15%
				25%

There is no controlled group among Companies A, B, and C, since the identical ownership is less than 50%. However, when looking at just Companies B and C, there is a different result.

Example 3: Brother-sister group

Ownership in company

Stockholder	Co. A	Co. B	Co. C	Identical Ownership
1	100%	15%	15%	15%
2	0	40%	50%	0
3	0	40%	20%	0
	100%	95%	85%	15%

There is a controlled group among Companies B and C, since the three stockholders together own more than 80% of B and C and their identical ownership is greater than 50%.

Ownership in company

Stockholder	Co. B	Co. C	Identical Ownership
1	15%	15%	15%
2	40%	50%	40%
3	40%	20%	20%
	95%	85%	75%

Combined group: Three or more corporations are a controlled group if each is a member of a parent-subsidary or brother-sister group of corporations and one is:

- A common parent corporation included in a parent-subsidary group and
- Is also included in a brother-sister group of corporations.

Example 4: Combined group

An individual stockholder owns 80% of Corporation X and 85% of Corporation Y, thus forming a brother-sister controlled group. Y owns 100% of Corporation Z, thus forming a parent-subsidary controlled group. Since Y is the parent in a parent-subsidary group and is also part of a brother-sister group, a combined controlled group exists between X, Y, and Z.

Partnerships, Proprietorships, etc.

The statute provides that rules similar to those prescribed for a controlled group of corporations are applicable to a controlled group of unincorporated businesses.

Time to Review Your Fiduciary Liability Coverage?

Your fiduciary liability coverage may not be what you think it is. Many liability insurers have cut back on coverages that once were considered routine. So, you may want to review your fiduciary liability policies to make sure they still provide adequate protection. Below we answer some common questions about fiduciary liability coverage.

Do we need more coverage than the fidelity bond required by pension law? Yes. Retirement plan fiduciaries face personal liability exposure that will not be protected by a fidelity bond. The pension law (ERISA) generally requires that every fiduciary of an employee benefit plan and any other person who handles plan money be covered by a fidelity bond. The fidelity bond protects the retirement plan against misappropriation of funds by individuals handling the plan's assets. However, the fidelity bond does not protect against claims for losses sustained because of a breach of fiduciary duty.

What protection does fiduciary liability insurance provide? Fiduciary liability insurance provides protection for trustees and other plan fiduciaries in the event of a breach of fiduciary duty. These policies typically cover settlements or judgments. Wrongful acts that may be covered by fiduciary liability insurance include: negligent investment practices, failure to diversify investments, failure to file required reports, conflicts of interest, errors in computing eligibility,



“... make sure they still provide adequate protection.”

and inadequate instructions to beneficiaries that cause a loss of benefits.

Can the plan purchase the fiduciary liability insurance? Yes, however, the policy must allow the insurer to seek recourse against the fiduciary if it is determined that the fiduciary breached his or her duty to the plan. Commonly, the plan sponsor purchases the insurance as part of the overall compensation package of company executives who assume responsibility over the company's benefit plan.

What should we look for in a fiduciary liability insurance policy? Fiduciary liability insurance coverage varies widely from policy to policy, so it's important to check what is covered in your policy and determine if you need additional coverage.

Occurrence or claims-made policies. Most policies are claims-made policies that only cover claims made and reported during the policy period. Look to obtain an occurrence-basis policy that covers all acts that occurred during the policy period, no matter when claims are made.

Aggregation of wrongful acts. If multiple wrongful acts may be treated as part of an interrelated series of wrongful acts, negotiate to eliminate this provision. Otherwise, this aggregation provision may allow the insurer to allocate a new claim as part of a prior claim, which may limit what is paid on the claim.

Nonrecourse riders. If the policy is purchased with plan assets, the policy must allow the insurer to recover any paid losses from the fiduciary whose breach caused the loss. To protect themselves, individual fiduciaries can purchase nonrecourse riders. Under a nonrecourse rider, the insurer waives its subrogation rights against the fiduciaries in cases that do not involve fraud, willful neglect, or criminal wrongdoing.

Defense costs. To ensure adequate defense coverage, fiduciaries may want to purchase a separate defense policy, since many policies count any costs of defending an action against the overall policy limit. Also, a policy may require you to accept defense counsel appointed by the insurer. Purchasing a separate defense policy will allow you to name your own defense counsel.

Punitive damages or fines. Since most policies will not pay punitive damages, you may want to negotiate coverage of punitive damages. Even if a policy covers the 20% penalty tax on fiduciary violations, it may not cover the 15% initial excise tax on prohibited transactions.

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SIMPLE IRAs and SARSEPs. SIMPLE IRAs and SARSEPs are also subject to the final regulations because they are cash-or-deferred arrangements. However, SIMPLE IRAs have a 30-calendar-day deadline (instead of a seven-business-day deadline) to make deposits in both ERISA and the IRC.

Deposit-by-deposit basis. The safe harbor is available on a deposit-by-deposit basis. Thus, if one payroll misses

the safe harbor deadline, all other payrolls during the year may still use the safe harbor.

Safe harbor is optional. Using the safe harbor rule is optional, not mandatory. Nor is the safe harbor the only way for employers to meet their obligation to deposit deferrals or loan repayments on the earliest date on which they can reasonably be segregated from the employer's general assets.

Large plans not included. The DOL does not believe it has the information it needs to extend the safe harbor (or a variation of it) to large plans at this time. Thus, large plans are still subject to the “as soon as administratively feasible rule.” The official examples in the regulations cite a situation in which a two-business-day period is “as soon as administratively feasible.”

Successor Plan Rule

Under the successor plan rule, an employer may not terminate a 401(k) plan and then start a new one for at least 12 months after the original plan is terminated. The 12-month waiting period begins on the date that all elective deferrals have been distributed from the terminated 401(k) plan, not the date of the resolution terminating it.

Why is there a successor plan rule?

Generally, distributions of elective deferrals may not occur before a participant attains age 59½. Congress did not want employers avoiding this restriction by terminating a plan, making distributions, and then immediately starting another 401(k) plan. Thus, the rule that employers may not establish a successor plan and still receive favorable tax treatment on the distribution of the original plan amounts was adopted.

What is the successor plan rule?

Generally, a successor plan is defined as any other defined contribution plan established or maintained by the employer that is in existence at any time between the termination date of the original 401(k) plan and 12 months after the distribution of all the original 401(k) plan's assets. If a successor plan is established within that 12-month period, there is no plan termination distributable event to permit the distribution of elective deferrals. As a result, both the original 401(k) plan and its successor may lose their tax-qualified status, resulting in substantial penalties to the plan sponsor and, possibly, the participants.

“The timing of the termination of a 401(k) plan is crucial. . . .”

Are there exceptions to the successor plan rule?

Yes. A successor plan is defined as a money purchase, profit sharing, or other qualified defined contribution plan. Other plans *may* be established after a 401(k) plan has been terminated without the 12-month wait. These plans include Employee Stock Ownership Plans (ESOPs), defined benefit plans (including cash balance plans), 403(b) plans, 457(b) plans, SIMPLE IRAs, or Simplified Employee Pension plans (SEPs).

What is the 2% rule exception?

An additional exception applies if fewer than 2% of the eligible employees in the terminating 401(k) are eligible participants in another plan of the employer during a period that begins 12 months before the termination and ends 12 months after the termination. Under these circumstances, the other employer plan is not considered a successor plan. Eligible employees in the 401(k) plan being terminated are those who were benefiting under the plan as of the termination date.

How does the successor plan rule work?

Example 1. An employer terminates its 401(k) plan on August 19, 2010, and distributes all elective deferrals by December 20, 2010. A new 401(k) plan may not be established until 12 months after the distribution of all elective deferrals. Hence, a new 401(k) plan may not be established before December 20, 2011.

Example 2. Assume the same employer establishes a profit sharing plan as of January 1, 2011, instead of waiting until December 20, 2011. This will result in the loss of favorable tax benefits by both the terminated 401(k) plan and the new profit sharing plan because the new plan was established during the restricted period.

Note that the termination of a qualified plan that has no elective deferrals will not trigger the successor plan rule.

Example 3. A profit sharing plan is being terminated and a 401(k) plan is established within 12 months of the distribution of the profit sharing plan's assets. Since the plan being terminated did not permit any elective deferrals, the successor plan rule does not apply.

Does the successor plan rule apply if plan termination is due to the sale of employer assets or stock?

The timing of the termination of a 401(k) plan is crucial in determining whether the successor plan rule applies to the proposed distributions. If the 401(k) plan is terminated *before* the sale of the assets of the business or the entity becomes part of the buyer's controlled group (because of the acquisition of its stock), there are no successor plan issues. However, if the plan is terminated *after* the acquisition is completed, then the employer who maintains another plan or establishes a new plan will be subject to the successor plan rules.

Can We Help?

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