



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:



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- The participant contributes more than the annual IRS limit for elective deferrals (\$16,500 in 2011; \$17,000 in 2012).
- 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; \$50,000 in 2012).

What is the universal availability rule?

The universal availability rule says that if an employer’s plan offers catch-up
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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 2011 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 2011 and 2012) 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.

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

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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 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



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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.

Is Employee Education Passé?

No doubt about it. More and more employers are incorporating automatic enrollment and investment features into their retirement savings plans. Does this mean employee investment education will become a thing of the past?

Not likely. No matter how many automatic features your plan adopts, your employees will always have a choice: to join or not to join the plan. Providing them with financial education may help them make the right choice. If they're knowledgeable, there's a better chance they'll see the value of participating in your plan and feel empowered to make the most of the benefit you're providing.

Education and Participation

The majority of employers look at employee education as a way to improve overall plan participation. In the Profit Sharing/401(k) Council of America's (PSCA) most recent annual survey,* 78.6% of the employers surveyed said one of the reasons they offer employee

education is to increase participation. About 30% said increasing participation is the primary reason they offer educational information. Some of the other reasons employers give for employee education are to increase appreciation for the plan, to increase deferrals, to improve asset allocation, to introduce plan changes, and to reduce fiduciary liability.

Educational Materials

The most common types of educational materials these sponsors use are enrollment kits, in-person seminars/workshops,

Internet/intranet sites, e-mail, newsletters, fund performance sheets, and individually targeted communication (see chart).

Most of the employers (66.4%) rely on their current plan providers for employee retirement education. Other sources used by the sponsors surveyed include third-party retirement education (20.7%) and advice (35.0%) firms. Slightly more than a third of plan sponsors create their own education programs.

* PSCA's 54th Annual Survey of Profit Sharing and 401(k) Plans (for the 2010 plan year)

Types of Educational Materials Plan Sponsors Use	(% of sponsors)
Individually targeted communication	40.4%
Fund performance sheets	44.0%
Newsletters	48.9%
E-mail	52.5%
Internet/intranet sites	59.3%
In-person seminars/workshops	63.5%
Enrollment kits	70.2%

Source: PSCA's 54th Annual Survey of Profit Sharing and 401(k) Plans

2012 Inflation-adjusted Plan Limitations

The IRS has announced the 2012 cost-of-living adjustments for plan limitations. As you can see below, after essentially remaining the same for an unprecedented three years, most of the limitations have risen due to inflation.

	2012	2011
Defined contribution plan dollar limit on annual additions	\$50,000	\$49,000
Defined benefit plan limit on annual benefits	\$200,000	\$195,000
Maximum annual compensation used to determine benefits or contributions	\$250,000	\$245,000
401(k), 403(b), and 457 plan deferrals/catch-up	\$17,000/\$5,500	\$16,500/\$5,500
SIMPLE deferrals/catch-up	\$11,500/\$2,500	\$11,500/\$2,500
IRA contribution/catch-up	\$5,000/\$1,000	\$5,000/\$1,000
Dollar limit used to define highly compensated employee	\$115,000	\$110,000
Compensation limitation defining key employee (officer) for top-heavy plans	\$165,000	\$160,000
Social Security taxable wage base	\$110,100	\$106,800

Can We Help?

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