

Current Developments in Employee Benefits and Pensions (Part II)

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This two-part article provides an overview of current developments in employee benefits, including executive compensation, welfare benefits, and qualified plans. Part I, in the November issue, focused on executive compensation and benefits. Part II focuses on new guidance regarding qualified retirement plans.

EPCRS Update

The IRS published the first update to the Employee Plans Compliance Resolution System (EPCRS) in over two years on September 2, 2008. EPCRS allows plan sponsors to correct plan qualification failures without suffering the severe consequences of plan disqualification. Rev. Proc. 2008-50⁴⁴ retains the basic structure and operation of EPCRS but adds several new correction methods for common plan qualification failures and makes numerous, mostly liberalizing, technical and procedural changes. These changes are effective January 1, 2009, but

may be relied upon voluntarily beginning September 2, 2008.

Guidance for Failure to Implement an Employee's Deferral Election

Appendix A and Appendix B⁴⁵ in Rev. Proc. 2008-50 specify that, where an employee makes a 401(k) elective deferral and that election is not honored, the missed deferral is based on the deferral percentage that the employee attempted to elect, rather than on the average for his or her group.

Guidance for Correcting Catch-Up Contribution Exclusions

Another new method of correction provided in Appendix A involves a failure to provide catch-up contributions. To the extent an employee is improperly excluded from making a catch-up contribution, the correction is a qualified nonelective

⁴⁴ Rev. Proc. 2008-50, 2008-35 I.R.B. 464.

⁴⁵ Appendix A and Appendix B of Rev. Proc. 2008-50 contain guidance on methods of correction

that are deemed acceptable under EPCRS for certain specified failures.

contribution (QNEC) equal to 50% of the missed deferral, but for this purpose the missed deferral is defined as one-half of the catch-up contribution limit in effect for the year of failure.

To illustrate, if an employee is excluded from the ability to make catch-up contributions during 2007 (when the catch-up contribution limit was \$5,000), the missed deferral is equal to \$2,500 and the missed deferral opportunity (and therefore the required QNEC) is \$1,250. The QNEC must be adjusted for earnings through the date of correction.

Various Modified Correction Rules for Improper Exclusions from 401(k) Plans

Rev. Proc. 2006-27,⁴⁶ the last update of EPCRS, specifically stated that the method for correcting the failure to include an otherwise eligible employee in a 401(k) plan did not apply to a plan that allowed participants to make designated Roth contributions. Rev. Proc. 2008-50 now allows the same correction method to be used regardless of whether Roth contributions are available. The corrective QNEC, however, does not enjoy the benefits of a Roth contribution. Instead, it is excluded from income, and distributions are taxable.

Rev. Proc. 2008-50 retains the principle that an actual deferral percentage (ADP) test failure must be corrected before the correction of improper exclusions, but it clarifies that the ADP test is performed without considering the improperly omitted participants. The test results (reflecting any required corrections) are then used to calculate the excluded individual's missed deferrals. After that, the test is not run again. The same rule applies if the employee's deferral election was not honored.

New Guidance on Participant Loan Corrections

Rev. Proc. 2008-50 allows a defaulted loan that originally had a shorter term than the maximum permitted by Sec. 72(p) (five years except in the case of a loan whose proceeds are used to acquire

a principal place of residence) to be reamortized over the longest period for which it could have been taken. Hence, in the case of the typical participant loan with a maximum term of five years, the loan may be reamortized over any term that ends no later than five years from the date of original issuance.

In addition, loans made by a plan that lacks Sec. 72(p) language (or even without any provision for loans at all) may now be corrected under EPCRS, although, as Rev. Proc. 2008-50 observes, they may result in fiduciary violations or prohibited transactions that will have to be dealt with separately under the rules established by the Department of Labor (DOL).

Rev. Proc. 2008-50 also states that the maximum payment amount (the basis for negotiating sanctions under the Audit Closing Agreement Program (Audit CAP)) will now include the amount of income tax that will be due under Sec. 72(p) if a loan failure is discovered upon examination and corrected through the Audit CAP process. While not stated explicitly, because Audit CAP sanctions are paid exclusively by the employer, this presumably means that the participant will be excused from the income tax consequences normally associated with loan failures.

Guidance for Correcting Sec. 415 Failures

Rev. Proc. 2008-50 revised the guidance for correcting Sec. 415(c) failures in defined contribution plans. The revised guidance reflects the new final regulations under Sec. 415, which eliminated provisions for correcting excess annual additions through their allocation to a suspense account or the refund of elective deferrals.⁴⁷ Instead, the regulations stated that Sec. 415 violations would be addressed through EPCRS. Previous EPCRS correction guidance for Sec. 415 failures specifically referenced the suspense account rules. For years prior to 2009, the guidance is the same as under Rev. Proc. 2006-27, which simply followed the prior regulations. For failures in years

EXECUTIVE SUMMARY

- Rev. Proc. 2008-50 updated the rules for the Employee Plans Compliance Resolution System (EPCRS), under which qualified plan sponsors correct plan qualification failures and avoid plan disqualification.
- The IRS issued proposed regulations dealing with automatic enrollment arrangements, employer stock diversification, and cash balance and other hybrid plans.
- In Notice 2008-30, the IRS provided guidance on changes, including ones made by the Pension Protection Act of 2006, affecting qualified plan distributions.

beginning in 2009 or later, the guidance is as follows:

1. If the excess is solely attributable to nonelective employer contributions, then:
 - a. If the plan contains a rule under which the excess can be reallocated to other participants' accounts, it must be reallocated.
 - b. If there is no reallocation provision (e.g., if the plan specifies a flat percentage rate of contribution or if every participant is at the Sec. 415(c) limit), the excess must be removed from the participant's account and applied to reduce future employer contributions. (It may not be returned to the employer.)
2. To the extent the excess is solely attributable to elective deferrals or employee after-tax contributions, it must

46 Rev. Proc. 2006-27, 2006-22 I.R.B. 945.

47 See prior Regs. Sec. 1.415-6(b)(6).

be returned to the participants, with attributable earnings. If the plan provides for both types of contribution, after-tax contributions are returned first.

3. If the plan provides for matching contributions, unmatched after-tax contributions and elective deferrals are returned first. If returning unmatched after-tax contributions and deferrals is insufficient to correct the violation, the remaining excess must be apportioned between the deferrals or after-tax contributions and the match (based on the match formula). The deferrals and after-tax contributions are returned, and the attributable match is forfeited and used to reduce future employer contributions.

New Definitions for Overpayment, Excess Allocation, and Excess Amount

Rev. Proc. 2008-50 revises the definitions of the key terms “excess amount” and “overpayment” and coins a new term, “excess allocation.”

An excess amount includes any allocation in a defined contribution plan that exceeds either (1) a specific statutory limit or (2) the amount that can be allocated to a participant’s account under the terms of the plan. The revised definition specifically excludes defined benefit plans (except for allocations of after-tax contributions to a separate account under such a plan) and, unlike the prior definition, does not include overpayments.

An excess allocation is an excess amount for which the Code and regulations do not provide a specific correction mechanism. For example, an allocation to a participant that exceeds the amount permitted under the plan’s terms is both an excess amount and an excess allocation, but elective deferrals in excess of the limits under Sec. 402(g) would only be an excess amount (because the Code permits these deferrals to be corrected by distributing them to the participant).

If there is an excess allocation to a participant’s account under a plan, it is to be corrected in the same manner as a Sec. 415 violation, as described above.

An overpayment is any distribution that exceeds the amount payable to a participant or beneficiary under the terms of the plan or that exceeds a statutory limit. Thus, a distribution from a defined contribution plan that includes an excess amount, or from a defined benefit plan that is greater than the recipient is entitled to under the terms of the plan, is an overpayment. An improper in-service distribution (such as a purported hardship distribution that does not meet the conditions of Sec. 401(k)(2)) is also an overpayment, although this conclusion is not stated clearly and must be inferred from the discussion of correction methods.

To correct an overpayment, the employer must take reasonable steps to recover it from the participant and must notify him or her that the overpayment is not eligible for favorable tax treatment. If the participant does not repay, the employer is required to reimburse the plan for the unrecovered amount, which is then allocated to other participants or applied to reduce future employer contributions. Presumably, no reimbursement is necessary if the overpayment results from a premature in-service distribution because the plan suffers no loss in that case. Rev. Proc. 2008-50 does not, however, address that point.

Relief from Additional Excise Taxes

Rev. Proc. 2008-50 expands the income and excise tax relief, as follows, for corrections made through the Voluntary Compliance Program (VCP). An overpayment that is rolled over into a participant’s or beneficiary’s IRA is subject to an annual 6% excise tax under Sec. 4973. Under Rev. Proc. 2008-50, the IRS will not pursue this tax under the following circumstances:

- The recipient removes the overpayment (plus earnings) from the IRA and returns it to the plan;
- The recipient withdraws the overpayment from the IRA and reports it as a taxable distribution in the year of withdrawal; or
- In the case of an overpayment resulting from an improper in-service distribution,

the plan sponsor shows good cause why relief should be granted.

The IRS may waive the 10% additional income tax on premature distributions under Sec. 72(t) if the participant repays the plan, although it may require the plan sponsor to pay an additional VCP fee equal to part or all of the forgone tax. This relief is available only for improper in-service distributions.

New De Minimis Threshold

Under Rev. Proc. 2008-50, corrective distributions need not be made to participants who are entitled to no more than \$75 (increased from \$50). Overpayments and excess amounts of \$100 or less may be left uncorrected (same threshold as before, but now available for self-correction as well as VCP and Audit CAP).

VFCP Calculator

Rev. Proc. 2008-50 allows employers to use the Department of Labor’s online Voluntary Fiduciary Correction Program (VFCP) calculator⁴⁸ as a proxy for a reasonable interest rate, but only where the plan sponsor cannot conveniently avail itself of the other methods for calculating earnings.

New Appendix F Applications

Rev. Proc. 2008-50 significantly expands the Streamlined VCP, under which the IRS processes the application and issues a compliance statement without requiring the employer’s signature. By eliminating back-and-forth mailings and potential negotiation, this procedure expedites the completion of the VCP process. It is available for nine specified qualification defects:

- Schedule 1: Failure to timely adopt an interim or a discretionary amendment.
- Schedule 2: Failure to timely adopt amendments with respect to legislative or regulatory changes.
- Schedule 3: For a SEP or SARSEP, certain failures resulting from eligibility, ADP, contributions, excluded amounts, and excess amounts. This schedule also includes the necessary language to request a waiver of excise tax.

48 Available at <http://askebsa.dol.gov/VFCPCalculator/WebCalculator.aspx>.

- Schedule 4: For a SIMPLE IRA, certain failures resulting from eligibility, contributions, excluded amounts, and excess amounts. This schedule also includes the necessary language to request a waiver of excise tax.
- Schedule 5: Plan loan failures resulting from noncompliance with Sec. 72(p)(2).
- Schedule 6: For 401(k) and 403(b) plans, an employer eligibility failure.
- Schedule 7: Failure to distribute Sec. 402(g) excess deferrals.
- Schedule 8: Failure to pay Sec. 409(a) required minimum distributions.
- Schedule 9: Various failures (disregard of Sec. 401(a)(17) compensation limitations, hardship distributions or plan loans that do not comply with plan documents, or premature inclusion of employees in the plan) that are corrected by a plan amendment conforming the plan to its administrative practices.

Determination Letter Applications in VCP and Audit CAP

If a determination letter request is made as part of a VCP application or an Audit CAP settlement, Rev. Proc. 2008-50 clarifies that the plan will be reviewed based on the current cumulative list and must therefore be updated to reflect the requirements on the list. Rev. Proc. 2008-50 also provides that a failure to adopt an interim amendment must be corrected before the submission of a VCP application (that is, the VCP application must contain an executed interim amendment). This is an exception to the normal rule that allows corrections to be implemented after receiving IRS approval.

Clarification of Retroactive Amendments in SCP

Rev. Proc. 2008-50 clarifies that although only a limited number of failures may be self-corrected under the Self-Correction Program (SCP) by adopting a retroactive plan amendment that conforms the plan's terms to actual operation, a plan

sponsor otherwise eligible for self-correction will not be precluded from using the SCP merely because it must adopt such an amendment to allow a correction to be implemented. A common example is an amendment to authorize QNECs, which can then be contributed to correct an ADP failure.

Extension of the Period for Self-Correction of Significant Operational Failures

Self-correction is available for significant operational failures, provided that plan sponsors make corrections within a specified time. Rev. Proc. 2008-50 permits plan sponsors to complete self-correction shortly after the conclusion of the self-correction period (generally the end of the second plan year following the plan year of the failure) as long as the correction is substantially complete at that time.

Proposed Automatic Enrollment Regulations

The IRS and the DOL issued guidance on the Pension Protection Act of 2006⁴⁹ (PPA) provisions intended to facilitate and encourage the use of automatic enrollment arrangements by 401(k), 403(b), and 457 government plans.⁵⁰ (For convenience, this article will focus only on 401(k) plans, although many of the rules are applicable to 403(b) and 457 plans as well.)

ADP/ACP Safe Harbor

PPA amended Secs. 401(k) and (m) to create a design-based ADP/ACP safe harbor for 401(k) plans with automatic enrollment features that meet certain requirements relating to (1) automatic deferrals, (2) employer contributions, and (3) notices to employees. Plans with these qualified automatic contribution arrangements (QACAs) will be treated as satisfying the ADP and actual contribution percentage (ACP) nondiscrimination tests.⁵¹

To satisfy the automatic deferral requirement, a plan must set its default deferral percentage for automatic enrollees at no less than 3% during the initial

period, which begins when the employee first participates in the QACA and ends on the last day of the following plan year. Thus, the initial period could last almost two full plan years.⁵²

After the initial period, the minimum default deferral percentage increases by one percentage point for each of the next three plan years, so the minimum default deferral percentage must be at least 4% in the first plan year after the initial period, at least 5% in the second plan year after the initial period, and at least 6% in the third plan year after the initial period and thereafter. A plan can always establish higher default deferral percentages, but never higher than 10%.⁵³

A plan's default deferral percentages must apply uniformly to all eligible employees, meaning everyone eligible to participate in the arrangement. However, the proposed regulations would provide that a plan does not fail this uniformity requirement merely because the default deferral percentage varies for the following reasons:

- The percentage varies based on the number of years an eligible employee has participated in the QACA;
- The rate of elective contributions under a cash or deferred election that is in effect on the effective date of the default percentage under the QACA is not reduced; or
- The amount of elective contributions is limited so as not to exceed the Sec. 401(a)(17) covered compensation limit, the Sec. 402(g) elective deferral limit (determined with or without catch-up contributions), or the Sec. 415 limit on annual additions.⁵⁴

The employer contribution requirement can be satisfied in either of two ways. One way is for the employer to make a 3% nonelective contribution on behalf of each nonhighly compensated employee who is eligible to participate in the automatic enrollment feature. The other way is for the employer to make matching contributions to eligible nonhighly compensated employees on a dollar-for-dollar

49 Pension Protection Act of 2006, P.L. 109-280.

50 REG-133300-07.

51 Sec. 401(k)(13).

52 Sec. 401(k)(13)(C)(iii)(I).

53 Sec. 401(k)(13)(C)(iii).

54 Prop. Regs. Sec. 1.401(k)-3(j)(2)(iii).

basis up to 1% of compensation, and then on a 50-cent-per-dollar basis up to 6% of compensation.

If the plan makes matching contributions to satisfy the employer contribution requirement, it will need to meet additional standards to pass the ACP test. Specifically:

- Matching contributions may not be provided for elective deferrals exceeding 6% of compensation;
- The matching contribution rate for highly compensated employees cannot exceed the rate for nonhighly compensated employees;
- The rate of matching contributions may not increase as the rate of an employee's elective deferrals increases; and
- The rate of matching contribution for any rate of elective deferral by a highly compensated employee may be no greater than the rate of matching contribution for the same rate of elective deferral by a nonhighly compensated employee.

Whether the employer chooses the nonelective or the matching contribution option to satisfy the contribution requirement, the employer's contributions must become 100% vested after no more than two years of service. These employer contributions will also be subject to the same withdrawal restrictions that apply to employee elective deferrals.⁵⁵

Finally, in order to satisfy the notice requirement, employers must give each employee eligible to participate in the automatic enrollment feature a notice that explains:

- The employee's right to elect not to make elective deferrals and to elect a different rate of elective deferral than the default deferral rate; and
- How the employee's elective deferrals will be invested if he or she fails to make an investment election.⁵⁶

After receiving the notice, employees must have a "reasonable period of time" before the first elective deferral contribution to make an affirmative election of contributions and investments. The proposed regulations would specify that the

notice timing requirement is deemed satisfied if the notice is given to each eligible employee at least 30—but no more than 90—days before the beginning of each plan year. For employees who become eligible after the 90th day before the start of a plan year, the proposed regulations would provide that the timing requirement is deemed satisfied if the notice is provided on or before (but no more than 90 days before) the date the employee becomes eligible.⁵⁷

Permissive Withdrawals

One concern some plan sponsors had with automatic enrollment was that automatic enrollees would opt out after a short period of time, leaving the plan with many small accounts to administer. As a result, the PPA created a special rule permitting plans to distribute "erroneous automatic contributions" within 90 days of an automatic enrollee's first elective contribution (see Sec. 414(w)). These corrective distributions are treated as compensation rather than as plan distributions. As a result, otherwise applicable withdrawal restrictions and the 10% penalty tax on early withdrawals do not apply. In addition, these "erroneous automatic contributions" do not count for nondiscrimination testing purposes.

Only eligible automatic contribution arrangements (EACAs) may offer the permissive withdrawal option. An EACA, as defined by Sec. 414(w)(3), is an arrangement:

- Under which a participant may elect to have the employer make payments as contributions under the plan on behalf of the participant or to the participant directly in cash;
- Under which the participant is treated as having elected to have the employer make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage);
- Under which, in the absence of an investment election by the participant, contributions are invested in accordance with the DOL's qualified default investment alternative (QDIA) regulations (the proposed regulations would clarify that this requirement applies only if the plan is otherwise subject to ERISA); and
- That satisfies specific notice requirements.⁵⁸



55 Sec. 401(k)(13)(D).

56 Sec. 401(k)(13)(E).

57 Regs. Sec. 1.401(k)-3(d)(3).

58 Prop. Regs. Sec. 1.414(w)-1(b).

The proposed regulations would reaffirm that plans may offer the permissive withdrawal option but are not required to do so. The proposed regulations would also provide that plans offering the permissive withdrawal option would not have to make it available to all employees eligible under the EACA. For example, it would be permissible for a plan to make the withdrawal option available only to employees who did not make any elective contributions before the EACA was effective. However, 401(k) and 403(b) plans may not condition permissive withdrawals on electing not to make future elective contributions because that would violate the Sec. 401(k)(4)(A) contingent benefit rule or the Sec. 403(b)(12)(A)(ii) universal availability requirement.⁵⁹

The uniformity requirement for EACAs is like the uniformity requirement for QACAs. As a result, the proposed regulations would allow the same differences in contribution rates for EACAs as are permitted for QACAs. The notice requirement for EACAs also is similar to the notice requirement for QACAs. Thus, the proposed regulations would apply the same timing rules to the EACA notice that are applied to the QACA notice.

As noted, permissive withdrawals are included in the participant's gross income in the year of distribution. (However, permissive withdrawals of designated Roth contributions are not included in gross income because the participant made the contributions on an after-tax basis.) These permissive withdrawals are not subject to the Sec. 72(t) 10% penalty and are not eligible for rollover. The proposed regulations would require employers to report distributions under permissive withdrawals on Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, Etc.⁶⁰

Any matching contribution an employer makes for amounts distributed under a permissive withdrawal must be forfeited and treated as any other forfeiture under the plan's terms. These

amounts may not be returned to the employer or distributed to the employee.⁶¹

Effective date: The QACA and EACA rules are effective for plan years beginning on or after January 1, 2008. Likewise, the IRS's regulations are proposed to be effective for plan years beginning on or after January 1, 2008. Until the IRS issues final regulations, plans may rely on the proposed regulations.

Coordinated Notices

On November 15, 2007, the IRS issued a sample participant notice that 401(k) plans can use to satisfy the notice requirements for QACAs, EACAs, and QDIAs. The sample notice is available on the IRS's website at www.irs.gov/pub/irs-tege/sample_notice.pdf.

Model 403(b) Plan and Guidance on Complying with Final 403(b) Regulations

The IRS published final regulations under Sec. 403(b) in July 2007.⁶² These regulations reflected numerous amendments made to Sec. 403(b) over the past several decades and provided comprehensive guidance under Sec. 403(b), including the requirement that Sec. 403(b) contracts must be maintained under a written plan.

Subsequently, the IRS issued model plan language for use by public schools adopting a written plan, or amending an existing plan, to comply with the final regulations under Sec. 403(b).⁶³ The adoption by a public school employer of the model language on a word-for-word basis, or the use of language that is substantially similar in all material respects, will be treated as meeting the requirements of Sec. 403(b).

Plans must be amended to comply with the final regulations no later than the first day of the first tax year beginning after December 31, 2008. For calendar tax years, the deadline would be January 1, 2009. To maintain Sec. 403(b) status, the plan must be operated in accordance with the plan language from the effective date of the

language, and the plan must continue to satisfy all other requirements of Sec. 403(b).

Any public school employer may comply with the written plan requirements of the 2007 regulations by adopting the IRS model provisions. A public school employer's plan will be treated as meeting the requirements of Sec. 403(b) to the extent the model language is adopted. The adoption of all the model language by a public school has the same status as a private letter ruling stating that the plan satisfies Sec. 403(b). To obtain this reliance, the employer must adopt the model language word for word or use language that is substantially similar in all material respects.

Other employers may use the IRS model language to comply with Sec. 403(b), but adoption by such employers does not carry the same level of reliance because additional or revised provisions may be necessary to comply with the final regulations.

Proposed Rules for Employer Stock Diversification

The IRS proposed regulations implementing PPA's employer stock diversification rules under Sec. 401(a)(35) for 401(k) and other defined contribution plans.⁶⁴ Effective for plan years beginning on or after January 1, 2009, these proposed rules would require applicable defined contribution plans on at least a quarterly basis to give:

- Employees (and alternate payees and beneficiaries of deceased employees) the right to divest employer securities "attributable to" employee deferrals, after-tax contributions, or rollover contributions at least quarterly and reinvest an equivalent amount in other investment options; and
- Employees with three or more years of service or their alternate payees or, regardless of years of service, beneficiaries of deceased employees the right to divest employer stock acquired as nonelective contributions and reinvest an equivalent amount in other investment options.⁶⁵

59 Prop. Regs. Sec. 1.414(w)-1(c).

60 Prop. Regs. Sec. 1.414(w)-1(d)(1).

61 Prop. Regs. Sec. 1.414(w)-1(d)(2).

62 T.D. 9340.

63 Rev. Proc. 2007-71, 2007-51 I.R.B. 1184.

64 REG-136701-07.

65 Regs. Secs. 1.401(a)(35)-1(b), (c).

“Applicable defined contribution plan” generally refers to a defined contribution plan that holds publicly traded employer stock. This definition does not include one-participant plans or employee stock ownership plans (ESOPs) that are separate from any other employer plan, but it does include a defined contribution plan that holds nonpublicly traded employer securities if the stock of any of the employers sponsoring the plan or any member of the same controlled group of corporations is publicly traded.⁶⁶

Participants eligible for divestiture of employer stock must be given at least three alternative investment options, each of which must be diversified and have materially different risk and return characteristics. (Investment alternatives outlined under DOL Regs. Sec. 2550.404c.1(b)(3) will meet this requirement.)⁶⁷ Plans may not impose restrictions on divestment of employer securities that are not imposed on other investment options, nor may plans offer benefits that are conditioned on investment in employer stock. However, plans may impose restrictions on employer stock that are necessary to comply with securities laws. Plans may also:

- Impose limits on investment in employer stock;
- Impose limits on trading frequency;
- Freeze further investment in employer stock;
- Impose fees on other investments that are not imposed on employer stock; and
- Permit transfers to stable value funds more frequently than to other funds.⁶⁸

Form 5500 Issues

Online Penalty Calculator for Delinquent Form 5500 Filings

The DOL has posted an online penalty calculator for Form 5500, Annual Return/Report of Employee Benefit Plan, filings under the Delinquent Filer Voluntary Compliance Program (DFVCP). The DFVCP provides eligible late Form 5500

filers the opportunity to avoid DOL-assessed civil penalties by voluntarily correcting the delinquent filing and paying a reduced penalty.

According to an October 10, 2007, press release, the DFVCP calculator “makes it possible to accurately and simply determine the amount of civil penalties owed under the program by plugging in the type of plan, size of plan and number of filings.”⁶⁹ The calculator is available at www.askebsa.dol.gov/dfvcepay/calculator.

Compensation to Be Disclosed on Schedule C

Effective for plan years beginning on or after January 1, 2009, Form 5500, Schedule C, Service Provider Information, will require large pension and welfare plans (i.e., those with 100 or more participants at the beginning of the year) to more fully disclose compensation that is paid (directly or indirectly) by the plan to service providers.⁷⁰

Schedule C requires disclosure for each person who received (directly or indirectly) \$5,000 or more in total reportable compensation during the plan year in connection with services rendered to the plan. Payments are exempt as long as they are made:

1. Directly by the plan sponsor and not reimbursed by the plan;
2. To persons whose only compensation consists of insurance fees and commissions listed in Schedule A, Insurance Information;
3. To employees of the plan whose compensation in relation to the plan is less than \$25,000; or
4. To employees of a plan sponsor or another business entity for which information is reported on Schedule C as long as the employee does not receive separate compensation from the plan.

Persons who receive only eligible indirect compensation may—under an alternative reporting option—simply be identified on Schedule C and excluded from

further disclosure. “Eligible indirect compensation” is defined as fees or expenses that are charged to the plan’s investment funds and reflected in the value of the investment, including finders’ fees, soft dollar revenue, float revenue, and brokerage commissions or transaction-based fees that were not paid directly by the plan or sponsor.

In order for those items to constitute eligible indirect compensation, however, the plan administrator must have received written notice that disclosed the existence and the amount of the compensation, or the formula used to determine the amount, and the identity of the parties paying and receiving the compensation.

Persons who receive compensation other than or in addition to eligible indirect compensation are subject to more detailed disclosure, which requires that the amounts of direct and indirect compensation (excluding the eligible indirect compensation) be separately identified and reported.

The DOL has released “FAQs About the 2009 Form 5500 Schedule C,” which provides additional information about the new Schedule C reporting.⁷¹

Proposed Hybrid Plan Regulations

The IRS has issued proposed regulations relating to new Secs. 411(a)(13) and (b)(5), which were added by PPA to enable cash balance and other hybrid plans to satisfy age discrimination and certain other qualification requirements.⁷² The regulations incorporate the transitional guidance provided in Notice 2007-6,⁷³ adopt new terminology to take into account situations in which more than one benefit formula is used by a plan, and provide additional guidance, taking into account public comments.

The regulations are proposed to be effective for plan years beginning on or after January 1, 2009 (or, if later, the effective date that applies to collectively bargained plans under PPA). However, prior to that time, plans are permitted to rely on the

66 Regs. Sec. 1.401(a)(35)-1(f).

67 Regs. Sec. 1.401(a)(35)-1(d).

68 Regs. Sec. 1.401(a)(35)-1(e).

69 www.dol.gov/opa/media/press/ebsa/ebsa20071509.htm.

70 RIN 1210-AB06, 72 *Fed. Reg.* 64710 (11/16/07).

71 www.dol.gov/ebsa/faqs/faq_scheduleC.html.

72 REG-104946-07.

73 Notice 2007-6, 2007-3 I.R.B. 272.

regulations to demonstrate compliance with Secs. 411(a)(13) and (b)(5) after the statutory effective date.

In addition, on June 17, 2008, the IRS released proposed regulations regarding the application of the Sec. 411(b) accrual requirements (the anti-backloading rules) to defined benefit plans that pay benefits based on the greater of two or more separate benefit formulas.⁷⁴ The proposed regulations establish a special rule permitting separate testing of each formula in 2009 and later plan years. (The IRS issued Rev. Rul. 2008-7⁷⁵ earlier this year to provide relief to certain plans using the “greater of” approach for plan years beginning before January 1, 2009.)

Delinquent Contributions

The DOL is concerned about financial institutions attempting to limit their ERISA obligations by drafting trust agreements to provide that they have no obligation to monitor or collect contributions. As a result, the DOL issued guidance outlining the interrelationship among ERISA §§402–405 and setting forth a step-by-step analysis by which fiduciaries can more clearly identify their duties to collect delinquent contributions.⁷⁶ This guidance clearly states that the duties long imposed under ERISA’s fiduciary framework are not abrogated by those attempts.

Toward that end, all trustees (even directed trustees) are fiduciaries who are obligated to satisfy the prudence and exclusive purpose requirements of ERISA §404(a), and a fiduciary is liable for the breach of a co-fiduciary under ERISA §405(a) if it knows of a breach by that fiduciary but fails to take action to remedy it. The DOL also observed that the obligation to collect delinquent contributions must rest with either a discretionary trustee, a directed trustee subject to the proper direction of a named fiduciary, or an investment manager and that the failure to properly assign the responsibility may cause the fiduciary responsible for the appointment to be liable for plan losses resulting from the failure to collect.

The IRS published the first update to the Employee Plans Compliance Resolution System (EPCRS) in over two years.

Deposit of Elective Deferrals

In seeking to provide employers with a “higher degree of compliance certainty” about the time by which participant contributions must be deposited to pension and welfare plans, the DOL has also issued proposed regulations providing a seven-business-day safe harbor for plans with fewer than 100 participants.⁷⁷

In general, amounts that a participant pays to an employer, or that are withheld from the participant’s wages by the employer, for contribution to an ERISA pension or welfare plan automatically become plan assets “as of the earliest date on which such contributions can reasonably be segregated from the employer’s general assets.”⁷⁸ The existing regulations specify an outside deadline for the deposit, calculated from the date the participant contributions are received by the employer or, in the case of wage withholding, would have been payable to the participant in cash (the participant contribution date). The absolute deadline is:

- The fifteenth business day of the month following the month containing the participant contribution date for pension plans; and
- 90 days from the participant contribution date for welfare plans.

Under the proposed safe harbor, participant contributions to a plan with fewer than 100 participants at the beginning of the plan year would be treated as made in compliance with the general rule (i.e., on the earliest date on which they can reasonably be segregated from the employer’s general assets) if they are deposited no later than the seventh business day after the participant contribution date. As under current rules, the contributions only need to be deposited to an account of the plan and need

not be allocated to specific participants or investments by that date. The proposed regulations clarify that the general rule also applies to loan repayments and that the seven-business-day safe harbor will be available for loan repayments made to plans with fewer than 100 participants.

The proposal is not clear on how the number of participants will be determined, although presumably it will be by reference to the Form 5500. Likewise, the proposal is not clear on whether the number will be limited to active or will also include separated participants.

Although the regulations are not yet effective, employers are entitled to rely on them.

IRS Guidance on PPA Distribution Changes

The IRS issued Notice 2008-30⁷⁹ to provide guidance on various PPA and other changes affecting qualified plan distributions.

Rollovers to Roth IRAs from Additional Eligible Retirement Plans

Effective January 1, 2008, distributions from qualified retirement plans, annuity plans, and governmental plans can be rolled over to a Roth IRA.⁸⁰ With regard to the newly eligible retirement plans, the IRS clarified the following:

Direct or indirect rollover permitted: A rollover to a Roth IRA can be accomplished either by a direct rollover or by a plan distribution that is followed by a rollover within 60 days.

Taxable income: For a rollover to a Roth IRA, the individual must include in gross income the amount that would be includible if the rollover did not occur.

74 REG-100464-08.

75 Rev. Rul. 2008-7, 2008-7 I.R.B. 419.

76 Field Assistance Bulletin No. 2008-01 (2/1/08).

77 RIN 1210-AB02, 73 Fed. Reg. 11072 (2/29/08).

78 DOL Regs. Sec. 2510.3-102(a).

79 Notice 2008-30, 2008-12 I.R.B. 638.

80 Sec. 408A(e), as amended by PPA §824.

Qualified plans with QACAs will be treated as satisfying the ADP and ACP nondiscrimination tests.

Early distribution tax does not apply:

Even though amounts are included in gross income, the 10% early distribution tax under Sec. 72(t) does not apply to the rollover. It will apply, however, if the taxable amount rolled into the Roth IRA is distributed within five years.

\$100,000 adjusted gross income limit:

For 2008 and 2009, a taxpayer cannot roll over a distribution from an eligible retirement plan (other than a Roth IRA) to a Roth IRA if the taxpayer has modified adjusted gross income over \$100,000 or is married and files a separate return. The taxpayer could, however, elect a rollover to a traditional IRA and, when permitted in 2010, convert the traditional IRA to a Roth IRA.

Direct rollover election required: A qualified plan must permit any distributee to elect a direct rollover to a Roth IRA (subject to existing exceptions for small amounts and multiple distributions).

Administrator not responsible for determining eligibility: The plan administrator is not responsible for determining whether the distributee is eligible to make a rollover to a Roth IRA. If the distributee is mistaken and turns out to be ineligible to make a rollover, it can be corrected by transferring it to a traditional IRA or other appropriate eligible retirement plan before the due date of the individual's income tax return.

Withholding not required in direct rollover: Direct rollovers to Roth IRAs, like other direct rollovers, are not subject to the 20% mandatory tax withholding requirements, even though the rollover results in taxable income to the distributee. Voluntary withholding is permissible.

New Qualified Optional Survivor Annuity

Effective for plan years beginning after December 31, 2007, qualified retirement

plans that are subject to the qualified joint and survivor annuity (QJSA) requirements of Sec. 401(a)(11) are required to offer a qualified optional survivor annuity (QOSA).⁸¹

A QOSA is a joint and survivor annuity that has a survivor percentage equal to 75% where the plan's QJSA has a survivor percentage less than that, or equal to 50% where the plan's QJSA has a survivor percentage of at least 75%, and that is the actuarial equivalent of the single life annuity payable at the same time. Notice 2008-30 clarifies that:

Existing optional joint and survivor annuity may be sufficient: A plan that already provides a compliant optional joint and spouse survivor annuity, with the survivor percentage required for the QOSA, and that is at least actuarially equivalent to the single life annuity payable under the plan will satisfy the requirement. In this case, the plan need not be amended (nor its administrative procedures modified) to designate the optional form as a QOSA.

The QOSA need not be actuarially equivalent to the QJSA: The QOSA must be at least actuarially equivalent to the single life annuity payable at the same time and need not be actuarially equivalent to a more valuable QJSA.

Spousal consent may or may not be required: Where the QOSA is actuarially equivalent to the QJSA, no spousal consent is required for the participant to elect it; however, where the QJSA is more valuable, spousal consent is required.

Existing written explanation requirements apply: The QOSA is an optional form of benefit, and the written explanation requirements of Regs. Sec. 1.417(a)(3)-1 apply. The written explanation need not identify the QOSA by that name.

There is no requirement to provide QPSA based on the QOSA: There is no requirement that an alternative to the qualified preretirement survivor annuity (QPSA) be offered based on the QOSA.

2009 PPA deadline applies for amendments but there is no Sec. 411(d)(6) relief:

Amendments implementing the QOSA need not be adopted until the end of the PPA amendment period (generally, the last day of the plan year beginning on or after January 1, 2009) and will be retroactively effective as of the PPA effective date as long as the plan is operated in accordance during the interim period. However, the anti-cutback provision of Sec. 411(d)(6) still applies, so the elimination of a distribution form or subsidy in connection with the implementation of a QOSA would need to satisfy Sec. 411(d)(6) and could not be adopted retroactively.

Determination of Present Value for Sec. 417(e)

Effective for plan years beginning on or after January 1, 2008, the determination of present value under Sec. 417(e) is modified as a result of changes in the definition of "applicable interest rate" and "applicable mortality table" and related changes.⁸²

Under existing regulations, a QJSA for a married participant must be at least as valuable as any other optional form of benefit under the plan; however, the regulations indicate that a plan will not fail this requirement simply because the amount payable under a form of benefit subject to the present value requirement of Sec. 417(e) is calculated using the applicable interest rate and applicable mortality table.⁸³

Notice 2008-30 clarifies that:

A formula using the more favorable of pre- and post-PPA present value will comply: The requirement that a plan's QJSA be "at least as valuable" as any other form of benefit will not be violated if the amount payable under a form of benefit subject to Sec. 417(e) is calculated as the "more favorable of" that determined using pre-PPA interest and mortality assumptions and that determined using post-PPA interest and

81 Sec. 417(a)(1)(A), as amended by PPA §1004.

82 Sec. 417(e)(3), as amended by PPA §302.

83 Regs. Sec. 1.401(a)-20, Q&A-16.

mortality assumptions. This special treatment expires at the end of the amendment period specified under PPA §1107(b)(2)(A) (generally the last day of the 2009 plan year or, if earlier, the date the amendment is adopted).

A second plan amendment may qualify for PPA amendment period: Although PPA §1107 provides a general deadline of the last day of the 2009 plan year for the adoption of amendments to comply with PPA, the deadline expires on the date the amendment is adopted, if earlier. Subsequent amendments for the particular PPA provision are not treated as adopted under PPA §1107 (and are subject to the deadlines otherwise applicable to the adoption amendments and the limitations of Sec. 411(d)(6)).

An amendment that provides for using the more favorable of the pre-PPA and post-PPA interest and mortality assumptions would constitute a PPA amendment for this purpose, thereby ending the PPA amendment period for that change. To avoid problems, the IRS established the rule that, in order to determine whether an amendment that implements the PPA applicable interest rate and applicable mortality table is the first amendment, amendments adopted on or before June 30, 2008, will be disregarded.

Therefore, if the plan is amended to provide the “greater of” formula on or before June 30, 2008, and is later amended to provide only the PPA formula, the latter amendment will qualify for the PPA amendment period and related Sec. 411(d)(6) relief provided under PPA §1107. The same relief applies to plan amendments that replace a plan reference to a pre-PPA interest or mortality assumptions with the PPA interest or mortality assumption, regardless of whether PPA requires such an amendment.

Gap Period Earnings

Effective for excess deferrals attributable to tax years beginning on or after January 1, 2007, gap earnings must be included when excess deferrals are distributed under Sec. 402(g).⁸⁴ (Unlike the changes described above, this is a regulatory rather than a PPA

change.) Excess deferrals must be credited with allocable gains or losses for the gap period to the extent they would be so credited if the total account were distributed. The gap earnings requirement applies to excess deferrals that are either pretax or designated Roth contributions. According to Notice 2008-30:

Cycle B and C plans must include gap earnings provisions: Plans submitted in remedial amendment Cycle B (February 1, 2007–January 31, 2008) or Cycle C (February 1, 2008–January 31, 2009) are required to provide for the distribution of gap earnings. A sponsor of a plan submitted prior to March 24, 2008, that does not provide for gap earnings will be asked to amend the plan to so provide.

Interim amendment not required: An interim amendment to provide for gap earnings is not required to be adopted until the last day of the first plan year beginning on or after January 1, 2009; however, the plan must be in operational compliance and distribute gap earnings with excess deferrals effective for excess deferrals attributable to tax years beginning on or after January 1, 2007.

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⁸⁴ Regs. Sec. 1.402(g)-1(e)(5).