



**LAW OFFICES OF
PEEPLS & HILBURN, P.C.**
5580 Peterson Lane, Suite 145
Dallas, Texas 75240



*Richard H. Peeples
Allison M. Kohler*

TEL: (972) 503-9441
FAX: (972) 503-9442

WEB PAGE: www.peepleshilburn.com

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RETIREMENT PLAN NEWSLETTER

PENSION PROTECTION ACT OF 2006

Since 2006 our newsletters have described various provisions of the massive legislation known as the Pension Protection Act (PPA). The PPA rules continue to have substantial impact on the operation of plans, particularly on defined benefit plans - both as to required funding and making distributions.

In virtually all cases there is a range of deductible funding each year, with a minimum and maximum funding amount. This will often allow employers to contribute and deduct certain amounts in advance of the benefits actually being earned (this is referred to as a "cushion amount").

A plan's funded status is determined annually by calculating plan liabilities and comparing that to the value of the plan assets. The plan actuary must formally "certify" the funding status by the 1st day of the fourth month of each plan year (i.e., April 1 for a calendar year plan). If plan liabilities exceed assets, the plan has an asset "shortfall". Where there is an asset shortfall, a contribution must be made to pay off the shortfall, normally over a seven-year period. This shortfall funding amount is in addition to the minimum required funding amount which equals the cost of the benefits earned by participants during the year *and is required even if the plan benefits have been frozen*. Where the value of plan assets is less than 80% of the plan's current liabilities, there will be restrictions on the payment of benefits in forms other than annuities, e.g., lump sums. Further, neither benefit levels nor the value of benefits can be increased. More stringent rules apply if the value of assets is less than 60% of the current liabilities.

As you can see, these funding rules are complicated and the plan's funding status can have dramatic ramifications. Because of this, it is very important to keep in touch with your financial advisor, us and your administrative firm if your financial situation changes.

Even though the various PPA provisions have become effective over the last several years, the IRS did not require qualified plans to adopt "good faith" amendments to comply with PPA until the last day of the 2009 plan year (i.e., December 31, 2009 for a calendar year plan). We have prepared those amendments for all of our clients. **If you have specific questions about your PPA amendment or any of the PPA provisions, feel free to contact us.**

EGTRRA PLAN RESTATEMENT

For the past several years we have kept you apprised about the required restatement of all qualified retirement plans to incorporate the 2001 EGTRRA legislation and various post-EGTRRA laws and regulations. The deadline for restating (and filing, if applicable) all 401(k) and other defined contribution plans is April 30, 2010. However, because of the PPA amendment described above, we encouraged plan sponsors to adopt the EGTRRA restatement before December 31, 2009, and in fact, most of our clients have now adopted this required restatement.

It is now time to shift our focus to defined benefit plans. **Sometime between 2010 and 2012, after the IRS approves our EGTRRA base plan document, all defined benefit plans (including frozen plans) will have to be completely restated for EGTRRA.** As with the defined contribution plans, this restatement will consolidate the "good faith" amendments that have been adopted over the last several years and also add the additional, legal language required by the IRS.

Over the next year, we will be reviewing all defined benefit plans and sending out individual correspondence describing the restatement process and the related fees. *As always, we remain committed to providing high-quality, cost-effective service.*

DISTRIBUTIONS AND INTERIM VALUATIONS

Over the past two years, we have experienced unusual and unsettling financial times. We have seen heightened focus on plan fiduciaries and their investment and other plan management decisions. Both the plan administrator and trustee(s) are fiduciaries. As such, they must operate the plan in the best interests of all participants and beneficiaries.

We continue to believe that a key issue for fiduciaries involves the impact to the plan whenever a participant is to be paid out of the plan, either on account of termination of employment or as an in-service distribution. In plans with pooled investments, the plan assets are generally valued annually. Any distribution from the plan is based on the value of the plan assets as of the latest valuation. Considering all of the facts, it may not be prudent to make distributions based on the prior year's annual valuation (e.g., the prior December 31 value of the participant's account for a calendar year plan). Whenever a participant is eligible to receive a distribution from the plan, the plan fiduciaries should consider whether an interim valuation of the plan is warranted in order to avoid a disproportionate share of the extraordinary investment losses (or gains) being allocated to the remaining participants in the plan.

We recommend that you contact your plan administrative firm and your financial advisor to discuss this option prior to making any substantial distribution from the plan.

DOCUMENTATION OF FAMILY ON PAYROLL

In many small businesses family members provide personal services to the business. Like other employees, they can be compensated for their services and contributions to the business' retirement plans can be made on their behalf. That compensation and any plan contributions are legitimate deductions for the business, *but only so long as the services are ordinary and necessary to the business and the total compensation is reasonable for the personal services provided.*

It is important to document that the rate of compensation for any family member on the payroll is comparable to the rates paid to other employees performing similar functions. We also believe it is important to maintain a personnel file for any family members/employees and keep track of the hours they spend performing services related to the business by maintaining an accurate time log. **If you have questions about this, we recommend that you contact your tax and/or financial advisor.**

PARTIAL TERMINATION OF PLAN

Many of our clients have now had some experience with the "partial termination" rules applicable to qualified retirement plans. *IRS guidance provides that a partial termination is presumed to occur whenever 20% or more of the active participants in the plan terminate employment during a plan year.* These rules are important because if a partial termination occurs, according to the IRS guidance, *all* participants who terminate during the plan year will become 100% vested in their account balance/accrued benefits.

The partial termination rules are only concerned with "employer-initiated" terminations. An "employer-initiated" termination is defined to include generally any termination other than on account of death, disability or retirement on or after the plan's normal retirement age. However, the employer may provide evidence that a termination was purely voluntary and thus not "employer-initiated". Because of this, we recommend that you obtain a written letter of resignation whenever possible, or in the absence of such written notice, that you document the participant's personnel file with detailed information regarding the reason for the termination.

Not every situation in which at least 20% of the participants terminate employment will trigger a partial termination – it is a facts and circumstances test. Factors such as turnover for the employer during prior years and the extent to which terminated employees were replaced, whether the new employees performed the same functions, had the same job classification and received comparable compensation, are all relevant factors to consider when determining whether a partial termination has occurred.

Because it is a fact-specific analysis, your plan administrative firm may ask you to provide additional information on any terminations reported on your census. **If you have questions about these rules, please feel free to contact us.**

REHIRED EMPLOYEES

Rehired employees continue to provide challenges for our clients and their plans. In virtually all plans, if you rehire an employee who previously worked for your business (or a predecessor or related business, such as a prior sole proprietorship), her prior employment is counted in determining her eligibility for the plan. *This applies even if the prior employment occurred before the plan existed.* This also applies even if the employee is only rehired on a "fill-in", temporary or part-time basis. Normally, a rehired employee who had previously met the eligibility requirements is eligible *immediately* as of her date of re-employment and would enter the plan on that date. She does not have to wait until the next regular entry date.

If a rehired employee is eligible and you have a 401(k) plan, you must give her the Salary Reduction Agreement form on her date of rehire (safe harbor plans must also provide the Safe Harbor Notice for the current year on the same date). You will also need to give her a copy of the current Summary Plan Description. *If you fail to do so, you will be required to make corrective contributions for the rehired employee in accordance with the IRS program known as Employee Plans Compliance Resolution System (EPCRS). These contributions will be immediately 100% vested.*

For any rehired employees, we recommend that you contact your plan administrative firm or us immediately upon rehire to determine exactly when they will be eligible to participate.

SAFE HARBOR NOTICE FOR 401(k) PLANS

The Safe Harbor Notice is the key document in the annual operation of a safe harbor 401(k) plan. The notice describes in simple terms the major provisions of the plan. Generally, your plan administrative firm will assist you in providing this notice.

If you do not timely distribute the annual Safe Harbor Notice to all participants, *including each newly eligible employee and rehired employees*, and allow salary deferrals to be made, you have caused, at the very least, an operational error which must be corrected. The IRS program known as the Employee Plans Compliance Resolution System (EPCRS) sets out an appropriate correction method and involves making corrective contributions for the affected employee(s). This will result in increased funding costs and administrative and legal expenses to you. **If you have questions about which employees are eligible to participate in the plan, we recommend you contact your financial advisor, plan administrative firm or us for assistance.**

ROTH 401(k) PROVISIONS

If you sponsor a 401(k) plan with the Roth (after-tax) feature, then a participant is able to *prospectively* designate that all or a portion of her salary deferrals will be made to a Roth 401(k) Account. These deferrals are called "designated Roth contributions" or "DRCs". Any portion of salary deferrals that the participant does not designate as DRCs will be traditional pre-tax deferrals.

Distribution Rules: Because the tax consequences of a distribution from a participant's Roth 401(k) Account are different from those of the participant's other plan accounts, the IRS has adopted special rules applicable to distributions from Roth 401(k) Accounts. These rules establish whether a Roth distribution is "qualified", meaning the investment earnings are *tax-free*, or "non-qualifying", meaning the investment earnings are subject to tax. These rules also establish certain

procedures that must be followed whenever a participant's distribution involves rolling over her Roth 401(k) Account to an individual Roth IRA or to a Roth 401(k) Account in another 401(k) plan.

Form W-2 Reporting: DRCs must be separately reported on a participant's Form W-2. The IRS has instructed preparers to report DRCs in box 12 with code AA (pre-tax deferrals are reported with code D). In addition, because DRCs are made with after-tax dollars, they should also be included in the amount of taxable compensation reported in box 1 of the Form W-2. If incorrect information is reported on a Form W-2, the employer is subject to fines, which can be substantial, particularly since this might be considered to be tax fraud.

401(k) SALARY DEFERRAL (AND OTHER) LIMITS

The IRS establishes annual limits on amounts that can be contributed to retirement plans. Because the government cost of living index declined during 2008-2009, most of these limits did not increase for 2010. For 2009, the dollar limits for making salary deferrals to 401(k) plans (called the 402(g) limit), including "catch-up" contributions, are \$16,500 and \$5,500, respectively. *These limits apply to a participant's combined pre-tax deferrals and DRCs, if applicable.* "Catch-up" contributions are additional deferrals that participants who are age 50 or older at *any time* during the year can make to a 401(k) plan.

The 2010 dollar limits as published by the IRS are below. These limits are indexed for inflation after 2010.

402(g) limit	\$16,500
Catch-up limit	\$5,500
Annual compensation limit	\$245,000
Defined contribution plan dollar limit	\$49,000
Defined benefit plan dollar limit	\$195,000

DEPOSITING 401(k) DEFERRALS

The assets of your 401(k) plan include participants' salary deferrals (including DRCs, if applicable). Department of Labor (DOL) regulations state that *such deferrals must be separated from the assets of the employer (i.e., transmitted to the plan trust account) as of the earliest date on which it is reasonably possible to do so.*

As discussed in last year's newsletter, the DOL issued guidance in 2008 establishing a safe harbor to meet the "earliest date" standard. Consistent with our prior recommendations, the DOL considers participant salary deferrals to be timely separated if transmitted to an account of the plan no later than 7 business days after the pay date. This safe harbor also applies to loan payments (see next article) withheld from a participant's pay. It is important to remember that this DOL guidance

establishes a "safe harbor" for timeliness; it does not override the general rule. Thus, while we recommend you meet the 7 business day standard whenever possible, just because an amount is deposited outside of the safe harbor time period does not necessarily make the deposit late. As is always the case with the DOL, it is a facts and circumstances determination.

Please be aware that the DOL continues to take a proactive role in policing the late deposit of salary deferral (and loan payment) amounts. Thus, you may receive a letter from the DOL regarding salary deferral amounts that have been reported as late on the plan's Form 5500. Generally, the DOL letter will invite you to participate in a voluntary correction program. However, in some cases, plan sponsors are being notified that their plan has been selected for an audit. **If you are contacted by the DOL, we recommend that you contact your plan administrative firm or us immediately.**

PLAN LOANS TO PARTICIPANTS

Some plans allow loans to be made to participants. The Internal Revenue Code and IRS regulations place many precise rules and restrictions on the making and repayment of loans. If any of the loan restrictions are violated, the entire loan could be treated as a taxable distribution to the borrower participant. ***Because of the complexities and serious consequences of improper loans, you must contact your plan administrative firm to prepare the documentation for any loans from the plan.***

Repayment of a participant loan must begin *within 90 days of the date it is made*, according to the repayment schedule. The trustee(s) of the plan is responsible for collecting the payments on a timely basis. If payments are not made according to the loan terms, the entire outstanding balance of the loan, plus accrued interest, will be in default and considered to be a taxable distribution to the borrower. ***This means that it will be reported as current taxable income subject to tax at the participant's current tax rate and an additional 10% penalty tax may also be assessed.*** In addition, the loan may still have to be repaid. The only way to avoid these adverse tax consequences once a loan is in default is for the plan sponsor to file a costly and timely application with the IRS under its voluntary correction program which is part of the Employee Plans Compliance Resolution System.

NON-TRADITIONAL INVESTMENTS

Several legal issues can arise where "non-traditional" investments are made by qualified plans. Basically, this includes any investment that is not in publicly traded stocks, bonds, mutual funds or qualified group pooled trusts. Examples include real estate investments, partnership interests, non-publicly traded stocks or loans.

With respect to the investment decision, we have identified three broad *legal* issues that often require analysis - fiduciary duties, prohibited transaction rules and plan asset regulations. In addition, non-traditional investments raise administrative issues concerning valuation and reporting of the non-traditional asset and the required coverage amount under the plan's ERISA bond.

If you are considering investing plan assets in a "non-traditional" investment, please contact your financial advisor or us for a general review of the legal issues. *In certain circumstances, we may also advise a more thorough analysis of your specific facts and circumstances.*

CHANGES IN YOUR BUSINESS OPERATION AND/OR CONTACT INFORMATION

Any change in your business structure (incorporation, new partner, split in partnership, etc.) or establishment or purchase of an interest in another business may impact your qualified retirement plan. **Please let us know about any purchase of a business interest or change in your business structure as soon as possible. Also, please notify us of any changes regarding your office, mailing or email address, your telephone or fax number (including area code), or your plan advisors so that we may keep our records up to date.**

This newsletter contains general information and should not be used to resolve legal questions regarding specific fact situations.