2011 Highlights Administration

\hi-lit' *n.* **1.** The most important, interesting, or outstanding part, scene, etc. **2.** To give prominence to. **3.** An executive summary or overview.

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These Highlights are intended to be used as an executive summary or overview!

Top Heavy Plans

A qualified retirement plan that primarily benefits "key employees" – a top-heavy plan – can qualify for tax-favored status only if, in addition to the regular qualification requirements, it meets several special requirements. A defined contribution plan is top-heavy if, as of the "determination date", the total of the accounts of all "key employees" exceeds 60% of the total of the accounts of all employees. A top-heavy plan must contain either a three-year vesting provision or a six-year graded vesting provision. Also, under a top-heavy defined contribution plan, the employer's contribution for each non-key participant must not be less than 3% of compensation.

Summary Plan Descriptions

The Summary Plan Description (SPD) describes the provisions of the plan and the rights of the participants under the plan. The SPD is a required document and must be distributed to plan participants within specific time frames. The plan sponsor must distribute the SPD to a new participant within 90 days of entering the plan, or 120 days after the later of the Plan's effective date or adoption date. Courts have held for participants where the participants relied on information in the SPD and were damaged by their reliance, despite contrary provisions in the "official" plan documents. If a qualified plan was amended, a Summary of Material Modifications does not have to be prepared if an updated SPD is distributed within 210 days after the close of the plan year.

Bonding

A bond must be obtained for Plan "fiduciaries." A plan fiduciary is any person or entity who handles the plan's assets including, but not limited to, the Plan Administrator, Trustee and Employer. The minimum bond required is generally the greater of $1,000 (nor more than $500,000) or 10% of the assets of the Plan. Bonding is not required when the employer, whether incorporated or not, that is sponsoring the Plan, is wholly owned by an individual and/or his or her spouse and where such individual and spouse are the only employees. The plan sponsor should contact their insurance professional about obtaining a bond.

Administrator's Tax Number

The Plan Administrator (frequently the plan sponsor or Employer) is required to have an Identification Number. This may be obtained by filing IRS Form SS-4, Application for Employer Identification Number. However, if the employer is the Administrator, you may elect to use its Employer Identification Number instead. Upon written request, S&A will prepare Form SS-4.

Blackout Periods

A defined contribution plan administrator must provide participants and beneficiaries affected by a blackout period with at least 30 days advance notice. The term blackout period means any suspension, restriction or limitation for a period of more than 3 consecutive business days on the ability of participants or beneficiaries as otherwise available under the terms of the plan to direct the investment of assets in their accounts, to obtain loans, or to obtain distributions. Corporate officers and directors may be prevented from trading in employer securities during the blackout period. There are ERISA criminal penalties for willful violation of Title I of ERISA.

Making Timely Contributions

When contributions must be made depends on the type of plan you sponsor and your tax return due date. You must prepare an annual Resolution stating the contribution to your profit sharing plan (including discretionary matching contributions) prior to your year-end.

401(k) matching and profit sharing contributions must be made by your tax return due date (including approved extensions). Generally speaking for smaller plans, 401(k) employee contributions should be deposited to the plan within seven business days.

However, if a **safe harbor** 401(k) plan uses anything other than the entire plan year (e.g., each payroll period) to determine matching, the match for elective deferrals made during a plan year quarter must be deposited no later than the last day of the next quarter. For example, suppose the plan sponsor

determines the matching separately for each payroll period and the plan year is the calendar year. For elective deferrals made during the third quarter of the year (July 1st – September 30th), the matching contributions would have to be deposited by December 31st.

Pension plans (e.g., money purchase, target benefit and defined benefit) have required contributions. In no event can contributions to a pension plan be made after the earlier of the *date you filed your tax return or 8½ months after the end of your plan year.*

Required Minimum Distributions

Certain distributions are required to be made when a more than 5% owner reaches age 70½ or when any other participant reaches the later of age 70½ or retirement. The portion that is required to be distributed cannot be rolled over because it is a required minimum distribution that must be paid to the participant. The required minimum distribution package should include a distribution notice, distribution election form, postponement form, special tax notice, notice of withholding on payments and withholding election. Notify S&A if you would like for us to calculate the distribution and prepare the participant information package.

Timely, Complete and Accurate Data

Many administrative problems are caused by the lack of complete and accurate information ~ both financial and census. S&A needs certain information in order to carry out its duties. Please take the time so that all data supplied by you is accurate and complete. For example, if the employer is a member of a controlled group or an affiliated service group, we need a complete census on ALL employees in ALL entities. S&A has an additional charge if census information is not received in a compatible form of electronic media. Call us to discuss the various ways we can accept data electronically. We MUST receive the data in a timely manner allowing sufficient time to provide service in light of its complexity and magnitude.

Plan Document and Design

Your plan must have an IRS-approved document in place and one that is up-to-date for recent law changes. Ask yourself questions, including: 1) Has your plan been designed with the assistance of a competent professional so it is customized to help meet the needs of your company? 2) Do you have any workers (including independent contractors or temporary employees) at your company who are not covered under the plan and does your plan document specifically exclude them from participation? 3) Do you know that you do not have an approved document until it contains proper signatures and adoption dates? 4) If you, your family or your company have ownership rights in any other businesses, have you received advice concerning the possible consequences to your plan?

Participant Loans

Participant loans provide a means for participants to access their account balances or benefits without incurring tax liability. A loan is a prohibited transaction under ERISA. A loan may qualify for an exemption if, among other things, it satisfies the following: 1) it is made in accordance with specific provisions that are set forth in the plan and the separate plan loan policy; and, 2) it bears a reasonable rate of interest. A plan sponsor must be very careful to obtain the correct executed Loan Application and Promissory Note. Participant loans are closely scrutinized by IRS and DOL agents during audits. Generally, plan sponsors require participants to make payments through payroll withholding. Notify S&A if you would like for us to prepare signature ready loan documents.

ERISA Section 404(c)

Under ERISA Section 404(c), a plan fiduciary is not liable for investment decisions made by plan participants who direct their own investments, as long as several requirements are met. Meeting all the requirements does not relieve plan fiduciaries of all liability. The following information MUST automatically be given to the participants: participants will be able to direct investments in the plan; the plan intends to comply with 404(c) and the plan fiduciaries may be relieved of liability for losses; the name, address and phone number of the 404(c) plan fiduciary responsible for providing information upon request and for receiving and complying with participant investment instructions. Other information must be provided to participants upon request. Plan fiduciaries are still responsible for: investment selection and monitoring; communicating certain information about the plan investments to participants; and, ensuring that participants have adequate account access to effectively manage their investments.

The plan sponsor must FULLY comply with ERISA 404(c) in order to minimize the fiduciary liability. S&A suggests that you review your 404(c) procedures with your financial professional as part of your regular fiduciary compliance meetings.

Prohibited Transactions

ERISA contains significant rules on prohibited transactions, including transactions between a plan and a "party in interest" and acts of self-dealing. Prohibited transactions are strictly forbidden – even if the results are favorable for the plan. Prohibited

transactions should be well understood by a plan sponsor and reviewed as part of your plan fiduciary meetings.

Investment Policy Statement and Monitoring of Investments

An important job of plan fiduciaries is to lay out the strategy for a winning team of investments. In other words, you may decide to develop a written investment policy – the team's guidelines. The general purpose of an investment policy statement (IPS) is to: 1) create a written document of the guidelines and standards used to select the plan's investment options; and, 2) to provide a basis for the periodic evaluation of investment performance.

Plan fiduciaries need to be aware that they are responsible for the initial selection of plan investments as well as the monitoring of these funds. This is also very important for plans intending to comply with ERISA 404(c). When necessary, fiduciaries must replace investment options that are under-performing the appropriate benchmarks outlined in the investment policy statement. **VERY IMPORTANT! Discuss advisability of IPS with your investment advisors and ERISA attorney.**

S&A recommends that you hold regular investment meetings and keep records. The meetings should be held whenever conditions warrant. However, small cases may be able to justify annual meetings whereby medium and larger cases should have meetings at least quarterly. Work with your investment professional in developing tools to monitor plan selections.

Duties as a Fiduciary

By offering a qualified retirement plan to your employees, you've accepted fiduciary responsibilities for managing the plan and selecting the investments. A fiduciary is anyone who exercises authority or control over the management of a retirement plan or its assets. ERISA rules govern the conduct of a fiduciary, including: 1) acting solely in the interest of plan participants and beneficiaries; 2) holding and dealing with plan assets for the exclusive purpose of providing plan benefits and defraying reasonable expenses of administrating the plan; 3) acting with the care, prudence, skill and diligence that a prudent person acting in like capacity under similar circumstances would act; 4) diversifying the plan's investments unless it's clearly imprudent to do so; 5) acting in accordance with plan documents; and, 6) monitoring the investments.

Fiduciaries can manage their risk by following the rules, seeking expert assistance when needed and following prudent, well-documented procedures. In case errors do occur, though, it's important to have insurance. ERISA permits the purchase of fiduciary liability insurance. There is other insurance that may be used to provide protection against liability, including: directors & officers insurance and errors and omissions insurance. Talk to your insurance and investment professionals.

Timely Government Filing and Response to Participant Request

Fines may be assessed for failure to file the plan's annual report (Form 5500) and other filings as well as failure to respond to a participant request for benefit information. The DOL may assess a civil penalty of up to $1,100 per day for the failure to file the report. The IRS may impose up to $25 per day, up to a maximum of $15,000 for a late Form 5500 filing.

It's also important to note that the statute of limitations doesn't begin until the Form 5500 and related schedules, including Schedule P, are accurately completed and filed. The Internal Revenue Code contains a statute of limitations that only permits the IRS to challenge matters covered in the Form 5500 for three years from the date of filing, provided that the form and related schedules were completed properly and in good faith.

A participant has the right to request copies of certain non confidential plan documents. Unless a response is provided to the participant within 30 days, the plan administrator named in the plan document (usually either the employer or a plan committee) may be subject to a civil penalty of up to $110 per day. S&A, as part of its Administrative Services, may prepare a signature ready Form 5500. It is the plan sponsor's responsibility to execute and forward the Form 5500 and other filings.

Audits ~ for Both Small & Large Plans

Retirement plans with more than 100 participants have to have an independent audit by a CPA. New regulations require small retirement plans to meet certain conditions in order to be exempt from the audit requirement. Otherwise, the annual accountant's report will need to be included with the plan's Form 5500.

To be exempt from the small retirement plan audit requirement: 1) a small retirement plan must hold at least 95% of the plan's assets in "qualifying plan assets" OR the assets must be covered by a bond, and, 2) the summary annual report will have to contain new information. Qualifying plan assets include employer securities, participant loans, assets with a regulated financial institution, mutual funds and investment/annuity contracts by an insurance company. If your plan contains non-qualifying plan assets (e.g., real estate, collectibles or tangibles), please contact your investment representatives. If you require an audit, please contact your CPA.

Employee Enrollment Meetings and Beneficiary Designations

If your plan intends to comply with ERISA Section 404(c), the plan fiduciaries must provide participants with sufficient information to make informed investment decisions. Otherwise, in order to maintain a high level of enthusiasm among eligible employees, the plan sponsor should conduct periodic enrollment meetings.

Generally, plans provide that, if a participant dies, the participant's benefits are payable to a beneficiary. Typically, plans must provide that 100% of the death benefit is payable to the surviving spouse. If the participant wishes to designate a beneficiary who is not a spouse, he or she must get the spouse's consent in writing. Beneficiary designation forms are given to participants when they enroll in the plan and at your enrollment meetings. Participants should be encouraged to fill out the forms and keep them up to date as their family circumstances change. The plan sponsor should keep the current beneficiary designations on file. Contact S&A for the correct Beneficiary Designation for your plan.

Participant Distributions

Participant distributions generally will occur upon a participant's termination, retirement, disability or death. Distributions may also occur because of the termination of the plan, hardship distributions or certain nondiscrimination testing. The plan sponsor has distribution package, document provision and tax deposit responsibilities. Your plan's provisions and participant's balance or benefit will dictate what distribution package is required. You must not only follow IRS and DOL regulations, but your plan document. For example, do not overlook your distribution obligations if your plan requires that you cash out participants with balances of less than $5,000. The plan sponsor is also obligated to withhold appropriate taxes and make timely tax deposits. S&A will provide assistance under our Additional Services.

The Department of Labor (DOL) requires a plan to automatically roll over a participant's account that exceeds $1,000 but does not exceed $5,000, and is distributable to an IRA, unless the participant affirmatively directs otherwise.

As a plan sponsor, an employer must satisfy six conditions to qualify for the automatic rollover safe harbor. The DOL states that to ensure an IRA provider chosen by the employer satisfies these requirements as well, an employer as a plan fiduciary must enter into a written agreement with the IRA provider. This agreement must be enforceable by the participant and specifically addresses the investment of rolled-over funds and the IRA fees and expenses. To the extent the agreement meets the safe harbor conditions, the plan fiduciary can rely on the IRA provider's commitments in the agreement and is not required to monitor the IRA provider's performance after funds are properly rolled over. Fees and expenses must be comparable to what the IRA provider charges for IRAs other than automatic rollover IRAs. Call S&A for more information.

Cross-Tested or New Comparability Plans

New comparability plans are also called "cross-tested plans" and involve converting the employer's yearly contribution to each plan participant into an equivalent benefit, payable at the plan's normal retirement age and continuing over the participant's life-time. Because a participant's age as well as his compensation are taken into account, the resulting *allocations are weighted in favor of the older, more highly compensated plan participants.*

This allocation formula requires special nondiscrimination testing. S&A prepares an annual test as part of our Compliance Services. However, the plan sponsor should notify us if they have had a change in their employee demographics. We may suggest an interim test.

401(k) Special ADP and ACP Testing

The amount of contributions under a 401(k) plan must not discriminate in favor of highly compensated employees. The amount of employee deferral contributions under a 401(k) plan is not considered discriminatory if the plan satisfies the *actual deferral percentage* (ADP) test. Similarly, any employer matching contribution is not discriminatory in amount if the plan meets the *actual contribution percentage* (ACP) test. A 401(k) plan can avoid ADP and ACP testing if the 401(k) plan qualifies as a SIMPLE or safe harbor 401(k) plan (see below).

If the ADP or ACP test for a plan year is not satisfied, the plan in its entirety ~ may no longer be qualified. The regulations, however, provide several mechanisms for correcting an ADP or ACP test that does not meet the requirements of the law. The tax treatment of a corrective distribution depends on when the distribution is made. If the 401(k) plan does not make the correction within 2 ½ months after the end of the plan year for which they were made, the employer is subject to a 10% penalty tax of any excess contributions. If the corrections are not made before the end of the plan year following the plan year for which the excess contributions were made, the 401(k) plan will fail to qualify (e.g., no tax deductions for employer or participants) for the plan year for which the excess contributions were made and for all subsequent plan years during which the excess contributions remain in the plan.

Hardship Withdrawal

Many plans (including most 401(k)s) contain a hardship withdrawal provision. If a participant requests a hardship withdrawal, a distribution package should be provided to the participant that contains a notice of hardship withdrawal, an application for the withdrawal, a special tax notice, a notice of withholding on payments and a withholding election. The plan sponsor

must prohibit the participant from making additional elective contributions for 6 months. Upon written request, S&A will prepare a hardship package.

Safe Harbor 401(k) Plans

A safe harbor 401(k) plan is a 401(k) plan under which an employer will no longer be required to perform nondiscrimination testing of elective contributions or matching contributions. To land within the safe harbor, a 401(k) plan must meet certain employer contribution requirements and, like a SIMPLE 401(k) plan, must provide for 100% immediate vesting of these contributions.

Each eligible employee MUST BE given written notice of rights and obligations under the safe harbor 401(k) plan within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible). Giving such notice at least 30 days (and no more than 90 days) before the beginning of each plan year (for employees entering the plan on a day other than the first day of the plan year, during the 90-day period ending on the date of entry) is deemed to satisfy the timing requirement.

Under a safe harbor 401(k) plan, an employer can elect to provide either of the following contributions: 1) a dollar-for-dollar match on elective contributions up to 3% of compensation and a 50 cents-on-the-dollar match on elective contributions between 3% and 5% of compensation; or 2) a 3% of compensation nonelective (profit sharing) contribution.

S&A has samples of the different required notices. A plan sponsor must distribute these notices to its employees within the time frame prescribed by law.

Qualified Default Investment Alternative ("QDIA")

The Pension Protection Act of 2006 provides a safe harbor for plan fiduciaries investing participant assets in certain types of default investment alternatives in the absence of participant investment direction. Investments that would qualify as QDIAs would be: life-cycle or targeted-retirement-date funds; balanced funds; or professionally managed accounts. Additionally, each participant must have been provided the opportunity to direct the investment of assets in their account but did not do so and be furnished a written notice. There are additional requirements. For some lawsuit protection, compliance with all of the requirements is essential.

Each eligible employee MUST BE given written notice of rights and obligations under the QDIA rules within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible). Giving such notice at least 30 days before the beginning of each plan year (for employees entering the plan on a day other than the first day of the plan year, 30-days prior to their date of entry) is deemed to satisfy the timing requirement.

Automatic 401(k) Enrollment

In the typical 401(k) plan, employees decide whether to invest and, if they choose to, how much and where to put the money. Employers who "automatically enroll" workers in a 401(k) plan, if they abide with the requirements, will have some protection from lawsuits if the investment options chosen are "reasonable." Automatic enrollment can be extremely effective in boosting 401(k) participation, especially among young and lower-income workers. Notice requirements are similar to the Safe Harbor and QDIA features. Automatic enrollment includes many complex factors. If you would like to explore the advantages of automatic enrollment, please contact our office.

NEW ~ 408(b)(2) Fee Disclosure

New regulations amend a prohibited transaction rule under ERISA and the IRC. That rule says that it is a prohibited transaction for a plan to enter into an arrangement with a specific provider unless the "arrangement" is reasonable and the compensation being received by the service provider is reasonable. The new regulation adds disclosure requirements for determining whether a service provider arrangement is reasonable. The new rules are extensive and complex, therefore, plan sponsors would be wise to check immediately with their service providers as more information becomes available.

The information provided in this bulletin is based upon complex requirements of the Internal Revenue Code and Treasury Regulations. This information is intended to be used as an executive summary or overview. Call Simpkins & Associates, your legal, accounting or investment professional for additional information. Although care has been taken to present the material accurately, S&A disclaims any implied or actual warranties as to the accuracy of any material herein or completeness and any liability with respect thereto.