

2008: A Year of Change

The landscape of the retirement plan industry is constantly changing. And 2008 promises more of the same. There are plan document changes in store, and the Pension Protection Act of 2006 (PPA) calls for a number of changes to defined contribution retirement plans. This article reviews the current list of 2008 changes. Of course, legislative and/or regulatory actions could create additional changes. Stay tuned.

Restatement of Preapproved Defined Contribution Plans. By April of 2008, the IRS will announce the release of opinion and advisory letters for preapproved defined contribution plan sponsors (i.e., master and prototype plans and volume submitter EGTRRA plans). The IRS will also announce the deadline by which all employers using such plans must amend and restate onto the approved EGTRRA plan documents. (The period is expected to be about two years.)

Final Section 415 Regulations Plan Amendment. The deadline for adopting the final 415 regulations is the end of the first plan year starting on or after July 1, 2007. Calendar-year plans generally must adopt this amendment by December 31, 2008. Included in these regulations are the new post-severance compensation rules.

PPA Changes. These are the major changes affecting defined contribution plans for the 2008 plan year.

Direct Rollover to a Roth IRA. Under PPA, funds from a qualified plan, such as a 401(k), may be directly rolled over to a Roth IRA. Prior to this change, the rollover went to a traditional IRA, which could then be converted to a Roth IRA. We await guidance from the IRS on the taxation and reporting of this new transaction.

Nonspouse Beneficiary. The IRS has changed this from an optional plan provision to one that is required. Thus, all qualified plans will operate under this PPA provision in 2008. The plan document amendment for PPA provisions is not required until 2009.

Bonding Increase. For non-ESOP defined contribution plans with employer securities, the bond is 10% of plan assets up to a maximum of \$1,000,000 (increased from \$500,000).



Automatic Enrollment Plan Testing Change. For any automatic enrollment plan subject to ADP/ACP testing, the time frame for making a refund for a failed ADP/ACP test without a 10% penalty has been extended to the end of the sixth month after the end of the plan year being tested (i.e., June 30 for a calendar-year plan).

Automatic Enrollment 90-day Revocation Period. An automatically enrolled employee in an eligible automatic contribution arrangement may opt out of deferring and request a withdrawal of all deferrals within 90 days of the first payroll from which deferrals were taken. In such a case, the plan is to return all deferrals made during that time frame (adjusted for gains or losses) to the employee, and there is no IRS penalty. We await IRS guidance to clarify operational details.

Qualified Automatic Contribution Arrangement (QACA). This new automatic enrollment plan option is generating a great deal of buzz and may become quite popular.

Qualified Joint and Survivor Annuity (QJSA) Option. New optional survivor annuity provisions must be made available under certain qualified plans. The new rule applies only to plans subject to QJSA rules, such as defined benefit and money purchase pension plans. If the plan's normal QJSA survivor annuity payable to the spouse after the participant's death is less than 75% of the annuity payable while both spouses are alive, the plan must allow the participant to elect an optional survivor annuity with an applicable percentage of 75%. Similarly, if the plan's normal QJSA survivor annuity is greater than or equal to 75% of the annuity payable while both spouses are alive, the plan must allow the participant to elect an optional survivor annuity with an applicable percentage of 50%.

NOTE: We need to begin work on the amendments and restatements of your Retirement Plan.

We will be contacting you in the near future.

Choosing a Retirement Plan to Maximize Benefits for Owners and Key Employees

With the various restrictions and limitations on retirement plan contributions and benefits, small business owners and professionals may wonder whether it is possible to fund adequate retirement benefits for themselves using a tax-qualified plan. In many cases, it is -- if the most appropriate plan design is chosen.

Why has Congress imposed so many restrictions on plans?

Many of the restrictions and limitations added to the federal tax code in the pension area have been aimed at making plans nondiscriminatory -- i.e., making sure that the plan does not discriminate in favor of a firm's highly paid employees. In some cases, the perhaps unintended effect of the restrictions has been to dampen enthusiasm for retirement plans because business owners question whether the benefits they will receive justify the expense of maintaining a plan.

What plans should a business owner who is concerned about funding his or her own retirement consider?

Several possibilities are discussed below.

Age-based Profit-sharing Plan

One type of plan that may be appropriate for many small business owners and professionals is the age-based profit sharing plan. The plan combines the traditional benefits of a profit-sharing plan with the ability to allocate employer contributions to participant accounts using factors that consider both compensation *and* age. In contrast, traditional profit-sharing plans allocate contributions based only on compensation, with each participant receiving a flat percentage of pay.

If employee demographics favor the age-based approach, more of the annual profit-sharing plan contribution is shifted to the accounts of the older owner(s) and key employees participating in the plan. In some instances, the total plan contribution can be lowered while allocations to the owner and the key employees remain at the same levels -- or even increase.

Target Benefit Plan

This type of plan is a cross between a defined benefit pension plan and a money purchase plan. It uses actuarial assumptions -- including assumptions about remaining years to retirement -- in determining the amount to be contributed for each participant. As with an age-based plan, no more than \$46,000 a year (in 2008) can be added to each employee's account, regardless of compensation or age. However, the plan is not as flexible as an age-based plan in that an annual employer contribution is generally required.

Defined Benefit Pension Plan

If the per-employee cap on additions to a plan account is a source of concern, a traditional defined benefit pension plan can often provide more lucrative benefits. With this type of plan, the closer a participant is to retirement age and the larger the promised retirement benefit, the higher the plan contribution, all else being equal.

What else should a business owner consider?

Before deciding to implement any of these plans, the effect of the tax law's top-heavy rules should be analyzed. These rules generally are triggered when key employees hold more than 60% of the account balances or accrued benefits in all plans sponsored by the employer. When a plan is top heavy, every active participant must receive a minimum contribution or benefit (3% of pay for a defined contribution plan). While there have been recent modifications to the top-heavy rules, they continue to be an issue for plan sponsors.

New Retirement Plan Disclosures Not Limited to Retirement Plans

The IRS's 408(b)(2) Regulations that are going into effect that mandate fee disclosures on Retirement Plans aren't just for Retirement Plans. The application of the disclosures apply to ALL ERISA Plans. This means if you have an HRA, you will be required to give the same type of fee disclosures and notices as Retirement Plans.

Remember that the IRS requires that only those fees that are reasonable and necessary can be taken from participants' accounts. The Regulations were designed, not to make sure an employer obtains services at the cheapest rate, but that the fees being charged are reasonable for the services provided.

The most noteworthy disclosures must be made by the following industries: banking, consulting, brokers, insurance, and TPAs. Failure by the industries to provide the disclosures will result in a

15% excise tax on the provider, in addition to a required refund of all of the fees collected. The disclosures must also include (i) a full disclosure of services; (ii) disclosure of potential conflicts of interest; and (iii) any changes that occur in any of the fees.

Although the requirement is that the providers give the information to the employers, it is the employers' obligation to give a corresponding notice to the participants. Failure on the part of the Employer will result in a prohibited transaction and potential disqualification of the Plan.

The effective date of this new regulation will be 90 days after the regulation is finalized.

* Stay tuned for more information as this regulation develops. *

