# Benefit Insights

RETIREMENT PLAN CONSULTANTS

1080 W. Shaw, Suite 101 ■ Fresno, CA 93711

Providing Third Party Administrative Services Since 1986

A non-technical review of qualified retirement plan legislative and administrative issues

December 2010


## Plan Year-End "To Do" List

The end of the year is fast approaching which signals important assignments for plan administrators. First are the items that must be completed by year-end, such as establishing a new plan or making required minimum distributions. There is also a new in-plan Roth conversion option that requires action before year-end if participants want to take advantage of this special rule.

Second is the gathering of year-end employee census data which will be used for plan contribution and testing purposes. Here are the items that need to be addressed as the year comes to a close.

### Establishment of a New Plan

In order to establish a new plan for 2010, the plan documents must be executed by December 31. If the plan has a salary deferral feature, deferrals cannot begin until the documents have been signed and the plan is established. Thus, a 401(k) plan that intends to start deferrals as of January 1, 2011, should have the documents prepared so they can be signed no later than January 1.

### Required Minimum Distributions

Participants who reach age 70½ must begin taking required minimum distributions (RMDs) from the plan. Participants who are still employed and who do not own more than 5% of the company can defer their RMDs until actual retirement as long as the plan document allows it.

RMDs must be made by December 31, except for the initial RMD which can be delayed until the following April 1. Congress waived the RMD requirement for 2009 due to the struggling economy and 2008 downturn in the stock market, but it's back in effect as of 2010.

### New In-Plan Roth Conversion Option

In recent years, a change in the law has allowed distributions from pre-tax accounts to be rolled over to a Roth IRA or a Roth account in another qualified plan, which are after-tax accounts. These are taxable distributions and are treated like a Roth conversion.

Once in the Roth account, future distributions are tax-free after a qualifying event (age 59½, death or disability) and the account has been in existence for five years.

Congress provided a special incentive for Roth rollovers and conversions during 2010 by allowing the tax to be deferred and paid over two years, 2011 and 2012. This can potentially be a significant savings, since the tax could be paid at a lower rate being spread out over two years.

In September of 2010, Congress extended this benefit further by letting plans provide "in-plan Roth conversions." This allows eligible rollover distributions to simply be transferred to a Roth account under the plan. The plan must provide for Roth deferrals by participants and must allow in-service distributions, although such distributions can be limited to Roth in-plan conversions only.

A Joint Tax Committee report states that it is intended that the IRS provide a remedial amendment period so employers can implement the change for 2010 and amend later (at this writing, no formal guidance has been issued). This would enable interested participants to take advantage of the special deferred taxation rule for Roth rollovers discussed above.

## Reporting Distributions

Distributions that took place during the calendar year, as well as defaulted loans, must be reported on Form 1099-R and be mailed to participants by January 31. Copies of these forms must be filed with the IRS by February 28 in paper form, or March 31 if transmitted electronically.

## Employee Census Data Collection

At the end of each plan year, the employer must prepare a census report so that annual testing can be performed, contributions can be calculated and allocated, a valuation report can be prepared and Form 5500 can be filed with the Department of Labor.

The census consists of the names, compensation, relevant dates (hire, birth, termination) and number of hours worked for **all employees** who were employed during the year, not just those actively participating in the plan.

Compensation typically includes gross compensation reported on Form W-2, unless the plan specifically excludes a certain type of compensation for plan purposes. For partners and self-employed individuals, compensation is net earnings with certain adjustments.

### Owners and Officers

It's important to identify the owners and officers of the company on the census report. This information is needed to help determine highly compensated employees (HCEs) for purposes of the nondiscrimination tests and key employees for the top heavy test. It is also important to indicate which employees are relatives of any owners, since they may be considered owners through stock attributions rules. For example, if Brian works for a corporation that is owned by his father, Brian will also be considered to own the corporation, through stock attribution, for testing purposes.

### Related Businesses

If an owner of a company has ownership in another company, it must be determined if the companies are "related" as a controlled group. Companies could also be related as an "affiliated service" group even if there is no common ownership. Related companies are treated as one company for certain plan purposes, so it's important that relationships with other businesses be shared with the service provider performing required plan testing.

Consider the following example: Zachary owns 100% of a construction company and 90% of a nail salon along with Jennifer, who owns the other 10%. The two companies are considered a controlled group, and any plans sponsored by either employer must consider the employees of both companies for coverage, top heavy and possibly contribution discrimination testing. If Zachary owned less than 80% of the nail salon, a controlled group would not exist.

## Required Testing

It is important to compile complete and accurate census information as it is used for performing the following tests:

### Average Deferral Percentage/Average Contribution Percentage Tests (ADP/ACP)

These tests must be performed to make sure that non-safe harbor deferral plans do not unfairly discriminate in favor of HCEs. HCEs are generally more than 5% owners of the employer or employees who earned over a specified level in the prior plan year (currently $110,000).

The ADP test compares the average deferral percentages of HCEs with non-HCE percentages while the ACP tests compares matching and/or voluntary contribution rates. A failed test usually requires corrective distribution(s) by March 15, or by June 30 in some plans with automatic contribution arrangements.

The total amount deferred by each employee must be checked to ensure that the annual dollar limit was not exceeded. If it was, then a corrective refund is required by April 15. This also applies to an employee who over-contributed to plans of two different employers during the year.

### Coverage Test

To demonstrate that the plan does not unfairly cover a much larger percentage of HCEs than non-HCEs, the plan must pass one of the coverage tests. The standard test is based on a 70% rate, meaning that if all the HCEs will be covered under the plan (after satisfying the eligibility requirements), then at least 70% of the non-HCEs must be covered. An alternative test can also be used, which compares the projected benefits of these two groups.

### Top Heavy Test

If more than 60% of the adjusted plan assets belong to key employees, then the plan is considered top heavy and must provide certain minimum contributions. A key employee is basically a more than 5% owner, a more than 1% owner earning over $150,000 or an officer earning over a specified limit (currently $160,000). Certain safe-harbor plans are exempt from the top heavy rules.

### Annual Additions Test

In account balance plans, the annual additions limit is the maximum contributions and forfeitures that can be allocated to an individual. For 2010 and 2011 the limit is the lesser of 100% of compensation or $49,000. An additional $5,500 catch-up contribution is allowed in salary deferral plans for those age 50 and older.

## Benefit Statements

All plans must provide benefit statements to participants showing accrued and vested benefits. They must also explain any permitted disparity or other offset arrangement used in determining accrued benefits. In account balance plans the statements must be provided at least once a year, except where participants direct their own investments, in which case they must be provided quarterly.

Defined benefit plans must provide statements once every three years, or upon written request (not more often than annually). Alternatively, defined benefit plans can provide an annual notice informing participants how they can obtain a benefit statement.

## Good Time to Update Beneficiary Forms

The new year is a good time to give participants an opportunity to update their beneficiary forms.

Their circumstances may have changed due to divorce, remarriage, etc., necessitating a change to their prior elections.

## No Cost of Living Increases for 2011

Many plan limits are subject to cost-of-living adjustments. For 2011, there will be no increase in these limits from the 2009/2010 levels because the applicable cost of living index has not been increased. Many of the limits are based on the "plan year." The elective deferral and catch-up limits are always based on the calendar year. See the table for the limits which are applicable to the 2009, 2010 and 2011 plan years.

## Conclusion

The end of the year is the time to take care of unfinished plan business as well as prepare for annual testing and reporting. Complete employee data must be collected in order to perform the numerous administrative tasks required of a qualified plan. Proper planning along with accurate information are the most effective tools for the smooth operation of a retirement plan.

| Limit | 2009-2011 |
|---|---|
| Maximum compensation limit | $245,000 |
| Defined contribution plan maximum contribution | $49,000 |
| Defined benefit plan maximum benefit | $195,000 |
| 401(k), 403(b) and 457 plan maximum elective deferrals | $16,500 |
| Catch-up contributions* | $5,500 |
| SIMPLE plan maximum elective deferrals | $11,500 |
| Catch-up contributions* | $2,500 |
| IRA maximum contributions | $5,000 |
| Catch-up contributions* | $1,000 |
| Highly compensated employee threshold | $110,000 |
| Key employee (officer) threshold | $160,000 |
| Social security taxable wage base | $106,800 |

*Available to participants who are or will be age 50 or older by the end of the calendar year.



RETIREMENT PLAN
CONSULTANTS

■ 401(k) Plans
■ Profit Sharing / New Comparability Plans
■ Defined Benefit Plans
■ 403(b) Plans
■ 125 Plan Consulting

Please contact us at (559) 437-7070 or Fax (559) 437-7071