

# Retirement PLAN

## news

## Deadline for depositing deferrals

Almost two years after issuing proposed regulations, the Department of Labor (DOL) has finalized regulations that establish a safe harbor period for the timely deposit of deferrals (and loan repayments) for small plans. The final regulations (effective January 14, 2010) are essentially the same as the proposed regulations with a few minor clarifications.

The general rule is that employee deferrals must become plan assets on the earliest date on which they can reasonably be segregated from the employer's general assets. That rule has not changed — but it has been clarified.

### The new rules

As in the proposed regulations, the final regulations create a safe harbor period for depositing deferrals to a pension or welfare benefit plan with fewer than 100 participants (determined at the beginning of the plan year). To satisfy this safe harbor, contributions must be deposited into the plan no later than the seventh business day following the day on which such amounts would otherwise have been payable to participants in cash.

The final regulations also include a safe harbor for loan repayments that are deposited into the plan by no later than the seventh business day following the day they are received by the employer.

Contributions will be considered deposited when placed in a plan account. The contributed amounts do not have to be allocated to specific participant accounts or investments by the seventh day.

**Example:** Acme Enterprises sponsors a 401(k) plan with 30 participants. The company has one payroll period and uses an outside payroll processing service to pay employee wages and process deductions. Acme receives information from the payroll service within one business day after paychecks have been issued. Acme checks the information for accuracy within three business days and forwards the withheld employee contributions to the plan. An amount equal to the total withheld employee contributions is deposited with the plan trust on the fifth business day following the date employees receive their paychecks.

Under the safe harbor, when participant contributions are deposited in the plan by the seventh business day following a



pay date, the contributions are deemed to be contributed to the plan on the earliest possible date on which such contributions can reasonably be segregated from the general assets of the company.

If an employer complies with the seven-day period, fine. However, if the employer fails to deposit deferrals or loan repayments by the end of the safe harbor period, losses and interest on the late deposits must be calculated from the actual date on which the contributions and/or repayments could reasonably have been segregated from the employer's general assets and not from the end of the safe harbor period. In the former example, penalties for noncompliance would apply starting five business days from when deferrals

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# Safe harbor

## 401(k) notice

Plan participants must be provided with a safe harbor notice not earlier than 90 days and not less than 30 days before the beginning of each plan year the safe harbor is in effect. There are special rules for new plans and new participants.

**New plans.** If a new 401(k) plan is established with safe harbor provisions and the plan design provides immediate eligibility for deferrals and employer contributions (as of the effective date of the plan), a safe harbor notice must be provided anytime between 90 days before the effective date of the plan and the actual effective date of the plan.

**Example:** An employer adopts a safe harbor 401(k) plan effective September 1, 2010. The plan design allows employees immediate eligibility and permits them to make deferrals and receive safe harbor matching contributions as of September 1, 2010. The employer must provide the safe harbor notice between June 3, 2010, and September 1, 2010.

**Newly eligible participants.** The same notice time frame applies to a newly eligible participant in an existing safe harbor 401(k).

**Example:** A safe harbor 401(k) plan has a six-months-of-service eligibility requirement. A new employee hired on March 31, 2010, will be eligible to enter the plan on October 1, 2010. The employer must provide the safe harbor notice no earlier than July 3, 2010, but no later than October 1, 2010.

**Special timing rule.** There is a special rule for coordinating the notice time period for newly eligible participants with the annual safe harbor notice. For safe harbor notice purposes, a new employee is defined as an individual who becomes eligible to participate after the 90th day *before* the beginning of the plan year. Thus, in a calendar-year plan, any employee who becomes eligible to participate between October 2 and December 31 may be provided with a safe harbor notice under the new employee rules (i.e., the notice must be provided no sooner than 90 days before the eligibility date but no later than the date of eligibility).

The annual safe harbor notice (sent between October 3 and December 2 each year by calendar-year plans) covers all ongoing participants. The same notice will cover employees who become newly eligible through the date the notice is provided. Under the special rule, the annual safe harbor notice may be used to satisfy the notice requirements for those who become eligible up to the last day of the plan year.

## Deadline for depositing deferrals

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were withheld from employee paychecks, since that is the normal time frame for Acme Enterprises to deposit contributions to the plan trust.

### Clarifications in the final regs

Here are some highlights of the other clarifications included in the final regulations.

**SIMPLE IRAs and SARSEPs.** SIMPLE IRAs and SARSEPs are also subject to the final regulations because they are cash-or-deferred arrangements. However, SIMPLE IRAs have a 30-calendar-day deadline (instead of a seven-business-day deadline) to make deposits in both ERISA and the IRC.

**Deposit-by-deposit basis.** The safe harbor is available on a deposit-by-deposit basis. Thus, if one payroll misses the safe harbor deadline, all other payrolls during the year may still use the safe harbor.

**Safe harbor is optional.** Using the safe harbor rule is optional, not mandatory. Nor is the safe harbor the only way for employers to meet their obligation to deposit deferrals or loan repayments on the earliest date on which they can reasonably be segregated from the employer's general assets.

**Large plans not included.** The DOL does not believe it has the information it needs to extend the safe harbor (or a variation of it) to large plans at this time. Thus, large plans are still subject to the "as soon as administratively feasible rule" (which may or may not be within the seven-day parameter set by the safe harbor for small plans). The amount of time an employer actually uses to send in deferrals each payday establishes a benchmark that is used to determine if a payment is late.

**Example:** An employer with a large plan regularly deposits deferrals into the plan's trust by the fourth business day after employees would have received their pay as cash. If the employer deposits the deferrals in eight business days instead, interest due to the plan (because of the late payment) would be calculated from the fourth business day.



# Successor plan rule

Under the successor plan rule, an employer may not terminate a 401(k) plan and then start a new one for at least 12 months after the original plan is terminated. The 12-month waiting period begins on the date that all elective deferrals have been distributed from the terminated 401(k) plan, not the date of the resolution terminating it.

## Why is there a successor plan rule?

Generally, distributions of elective deferrals may not occur before a participant attains age 59½. Congress did not want employers avoiding this restriction by terminating a plan, making distributions, and then immediately starting another 401(k) plan. Thus, the rule that employers may not establish a successor plan and still receive favorable tax treatment on the distribution of the original plan amounts was adopted.

## What is the successor plan rule?

Generally, a successor plan is defined as any other defined contribution plan established or maintained by the employer that is in existence at any time between the termination date of the original 401(k) plan and 12 months after the distribution of all the original 401(k) plan's assets. If a successor plan is established within that 12-month period, there is no plan termination distributable event to permit the distribution of elective deferrals. As a result, both the original 401(k) plan and its successor may lose their tax-qualified status, resulting in substantial penalties to the plan sponsor and, possibly, the participants.

## Are there exceptions to the successor plan rule?

Yes. A successor plan is defined as a money purchase, profit sharing, or other qualified defined contribution plan. Other plans *may* be established after a 401(k) plan has been terminated without the 12-month wait. These plans include



Employee Stock Ownership Plans (ESOPs), defined benefit plans (including cash balance plans), 403(b) plans, 457(b) plans, SIMPLE IRAs, or Simplified Employee Pension plans (SEPs).

## What is the 2% rule exception?

An additional exception applies if fewer than 2% of the eligible employees in the terminating 401(k) are eligible participants in another plan of the employer during a period that begins 12 months before the termination and ends 12 months after the termination. Under these circumstances, the other employer plan is not considered a successor plan. Eligible employees in the 401(k) plan being terminated are those who were benefiting under the plan as of the termination date.

## How does the successor plan rule work?

**Example 1.** An employer terminates its 401(k) plan on August 19, 2010, and distributes all elective deferrals by December 20, 2010. A new 401(k) plan may not be established until 12 months after the distribution of all elective deferrals. Hence, a new 401(k) plan may not be established before December 20, 2011.

**Example 2.** Assume the same employer establishes a profit sharing plan as of January 1, 2011, instead of waiting until December 20, 2011. This will result in the

loss of favorable tax benefits by both the terminated 401(k) plan and the new profit sharing plan because the new plan was established during the restricted period.

Note that the termination of a qualified plan that has no elective deferrals will not trigger the successor plan rule.

**Example 3.** A profit sharing plan is being terminated and a 401(k) plan is established within 12 months of the distribution of the profit sharing plan's assets. Since the plan being terminated did not permit any elective deferrals, the successor plan rule does not apply.

## Does the successor plan rule apply if plan termination is due to the sale of employer assets or stock?

The timing of the termination of a 401(k) plan is crucial in determining whether the successor plan rule applies to the proposed distributions. If the 401(k) plan is terminated *before* the sale of the assets of the business or the entity becomes part of the buyer's controlled group (because of the acquisition of its stock), there are no successor plan issues. However, if the plan is terminated *after* the acquisition is completed, then the employer who maintains another plan or establishes a new plan will be subject to the successor plan rules.



# RECENT developments

## ▶ 403(b) Form 5500 guidance

In Field Assistance Bulletin (FAB) 2010-01, the Department of Labor (DOL) provides additional guidance to 403(b) plans that will file a full Form 5500 for the first time for 2009. For example, the DOL affirms that the exemption provided by FAB 2009-2 will continue beyond 2009. FAB 2009-2 stated that 403(b) contracts begun prior to 2009 that receive no additional contributions for the 2009 year are exempt from Form 5500 reporting.

## ▶ 403(b) reasonable choice

In the same FAB, the DOL provided clarification on its safe harbor rules for 403(b) plans that are not ERISA plans. In Question 16 — Must a “safe harbor arrangement” under 29 CFR 2510.3-2(f) offer participants a reasonable choice of both 403(b) providers and investment products? — the DOL addresses the issue of whether a

single vendor that offers a variety of investment products will satisfy the “reasonable choice” criteria. The DOL’s response is basically “Yes.” Although the safe harbor generally requires that the arrangement offer a choice of more than one 403(b) contractor and more than one investment choice, the DOL states that an employer may have just one investment contractor to whom it will forward payroll salary reduction contributions, provided participants are permitted to transfer or exchange their interest to the 403(b) account of another provider. In such case, employees must be provided with a disclosure of any limitations and costs associated with such transfers or exchanges before deciding to participate.

An alternate exception is available, but the employer must be able to demonstrate the administrative burdens and costs that require

the employer to limit its choices to one vendor. This exception is available for an annuity vendor or a custodial vendor that offers a broad range of unaffiliated mutual funds.

## ▶ EFAST2 guides

EFAST2 requires that all Form 5500s be filed electronically beginning with the 2009 plan year. To facilitate this transition, the DOL has offered four web seminars. Recordings of these seminars are available on the DOL website at [www.dol.gov/ebsa](http://www.dol.gov/ebsa). In addition, the DOL has recently released six EFAST2 guides to help smooth the learning curve. The guides may be found at [www.efast.dol.gov/fip/forms\\_pubs.html](http://www.efast.dol.gov/fip/forms_pubs.html). Form 5500-EZ is the last form to be placed on EFAST2. At press time, the 2009 Form 5500-EZ had not been issued.

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