

employee benefits update

april/may 2003

**What you need to know
About catch-up contributions**

Qualified Plan Terminations 101

**Sarbanes-Oxley Act
Affects blackout periods**

PLUS!

FREE supplemental report on
how much plan information to disclose to participants
(see response form inside)



Institute of
EMPLOYEE BENEFITS ADVISORS

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Retirement Plan Administrative Service, Ltd.

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1503 Santa Rosa Road, Suite 120
Richmond, VA 23229
(804) 288-8782 / (800) 235-9649 / Fax (804) 288-8786
www.rpasltd.com

Making Catch-Up Contributions Work for You

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) included many provisions to encourage retirement savings. One such provision allows older workers to save more in some retirement plans. Participants age 50 and up — during the plan year — in some qualified retirement plans can make “catch-up contributions” for taxable years beginning after Dec. 31, 2001. Catch-up contributions may be made in the form of elective deferrals.

Because older employees may not have saved enough for their retirements, catch-up contributions give them a chance to defer more money into their retirement plan accounts. They also allow eligible participants the chance to catch up to the retirement savings of their younger counterparts, who may have been able to save more, without adversely affecting the employer’s testing or limits that apply to their retirement plans.

Amendments and Limits

Before an eligible participant can make catch-up contributions, the plan must first adopt an amendment allowing for them. For all calendar-year plans, the amendment must be in place before any eligible participant defers more than the statutory limit (\$12,000 in 2003), or the maximum allowed before the discrimination test is failed, if less.

Only some plans may adopt a catch-up contribution amendment. These include:

- › 401(k) plans,
- › SIMPLE IRAs,
- › Section 403(b) eligible governmental plans, and
- › Section 457 eligible governmental plans.

Different plans have different catch-up contribution limits that are either increased under EGTRRA or indexed each year, or both. For 401(k), 403(b) and 457 eligible governmental plans, the catch-up contribution limit for the 2003 plan year is \$2,000. The catch-up limit then increases by \$1,000 each year until 2006, and is then indexed in \$500



increments. The catch-up contributions limit for SIMPLE IRAs is one half of these amounts.

For an eligible participant’s deferrals to be considered a catch-up contribution, one of the three applicable limits must be exceeded:

1. The statutory limit, such as the \$12,000 employee contribution limit in 2003, or the lesser of \$40,000 or 100% of pay, whichever is less,
2. The nonstatutory limit on employee deferrals, which must be clearly stated in the plan document, or
3. The maximum contribution allowed for highly compensated employees before the discrimination test is failed.

If any of the above limits are exceeded, the plan must treat any deferral contributed by an eligible participant as a catch-up contribution, which cannot exceed the catch-up contribution limit.

Specific Circumstances

Catch-up contributions can be complicated. So let’s look at a few examples of the limits and how they can affect a contribution’s definition.

Statutory total contribution limit. Paula participates in the ABC Co. 401(k) Plan (a calendar-year plan) and turned 50 on May 12, 2002. The plan document doesn't impose a deferral limit. Paula earns \$170,000

What Year Is It Anyway?

Special rules apply when the plan year isn't a calendar year. For plan years not based on the calendar year, the deferral and total contribution limits for any calendar year still apply. But employer-plan limits apply for the noncalendar year plan. For example, Michelle is 53 years old and has just begun deferring into the XYZ Corporation 401(k) Profit Sharing Plan. The plan's year end is Oct. 31. The plan doesn't limit deferrals except to comply with the deferral and total contribution limits. The plan also allows for catch-up contributions. Michelle defers \$1,000 from Nov. 1, 2002 through Dec. 31, 2002. She then defers \$13,000 from Jan. 1, 2003 through Oct. 31, 2003. For the 2002-2003 plan year, Michelle doesn't exceed the total contribution limits. But she exceeds the deferral limit by \$1,000 for 2003. Because the \$1,000 is within the 2003 catch-up contribution limit (\$2,000), the plan treats this amount as a catch-up contribution and disregards it in the discrimination test for the plan year ending Oct. 31, 2003. Give us a call should you need assistance with your fiscal-year plan.

a year and defers the maximum limit (for 2003) of \$12,000. The ABC Co. contributes \$30,000 to Paula as a profit-sharing contribution. For 2003, the individual limit on contributions credited to an account is the lesser of \$40,000 or 100% of compensation. Because Paula has exceeded this limit (\$12,000 in 401(k) deferrals + \$30,000 profit-sharing contribution = \$42,000 annual additions), the plan

will treat \$2,000 of Paula's deferrals as a catch-up contribution, which doesn't count against the other limits.

Deferral limit. Mary is 52 years old and participates in the DEF Co. Retirement Plan (a calendar-year plan). The plan document limits elective deferrals of \$12,000, which is the statutory limit for 2003. For the 2003 plan year, Mary defers \$12,750, exceeding the limit by \$750. Thus, the plan treats \$750 as a catch-up contribution.

Nonstatutory limit. Mike is 51 and participates in the GHI Co. Retirement Savings Plan. The plan document limits elective deferrals to 15% of compensation. Mike earns \$45,000 annually and defers \$7,750 in the retirement plan. Mike hasn't exceeded the annual additions limit (the lesser of \$40,000 or 100% of compensation), and he hasn't exceeded the deferral limit (the lesser of \$12,000 or 100% of compensation). Because the plan document limits elective deferrals to 15% of compensation ($\$45,000 \times 15\% = \$6,750$), \$1,000 will be treated as a catch-up contribution.

Effects on Testing

Catch-up contributions don't adversely affect the employer's testing or plan limits. Catch-up contributions are *not* counted in the 401(k) discrimination test if:

- ▶ An eligible participant's deferrals exceed the deferral limit or the nonstatutory plan limit, or
- ▶ His or her annual additions exceed the individual statutory limit of \$40,000 or 100% of pay.



Top-heavy testing doesn't include catch-up contributions in the year they are made when calculating the contribution percentage. Top-heavy testing only accounts for catch-up contributions from previous years when used to calculate whether the plan is top-heavy. Also, the new catch-up contribution rules require no separate record keeping.

More Catch-Up Contribution Rules

Employers decide whether to match catch-up contributions. A plan sponsor that matches catch-up contributions must so state in the plan document and must count them in the 401(k) discrimination test. If the employer classifies the elective deferrals as catch-up contributions to satisfy the discrimination test, then related nonvested matches may be forfeited.

The plan sponsor isn't required to offer eligible participants the opportunity to make catch-up contributions. But if one employer plan allows for catch-up contributions, then all plans of that controlled group must also allow for catch-up contributions. This rule is known as "universal availability." As a caution, a plan may *not* provide a lower deferral limit that applies only to catch-up eligible employees.

Catch Up With Your Plan Advisor

The rules pertaining to fiscal year plans and catch-up contributions can be complex. Contact a representative from our company for a detailed explanation on how these rules affect your plan. ↗

Qualified Plan Terminations 101

A retirement plan must be permanent to achieve favorable tax status as a "qualified plan." But this doesn't mean that plans can never be terminated. All plans can be voluntarily terminated. Here are the details of this process.

Complete vs. Partial Termination

A complete termination affects all plan participants. A partial termination affects only the participants no longer covered by the plan. Legitimate business reasons cause most complete terminations. This may include a business restructure (such as a merger, change in stock ownership or bankruptcy reorganization), changes in laws affecting qualified plans, substitution of another plan or financial hardship.

A partial termination occurs when an event or series of events — including plan amendments — adversely affects plan members' vested rights. For example, a plan sponsor can adopt an amendment to stop or decrease benefit accruals for some participants but not for others. Layoffs can also

cause partial termination. This type of termination can apply to any type of plan and affects only participants who are no longer covered by the plan. Often, plan sponsors don't consider the consequences to the qualified plan when layoffs take place.

Setting the Termination Date

Voluntary terminations begin when a plan sponsor decides to terminate a plan. First, the sponsor establishes a tentative termination date



and reviews the plan for any potential qualification defects before setting a permanent termination date.

The Pension Benefit Guaranty Corporation (PBGC) covers most defined benefit pension plans. When such plans terminate, they must submit their

plans for review to the PBGC. A termination can't take effect until 60 days after the sponsor distributes a notice of intent to terminate.

Normally, the plan administrator specifies the date the termination takes effect in the amendment stopping the benefit accruals.

In setting this date, the administrator

must allow sufficient time to prepare the notice and to distribute it at least 60 and no earlier than 90 days before the proposed termination date.

The plan sponsor needs to adopt a formal resolution establishing a termination date. All types of pension plans must provide participants a notice that benefits will be frozen at least 45 days in advance of the freezing of benefit accruals. Profit-sharing plans, stock-bonus plans and 401(k) plans don't require advance notice. But with 401(k) plans, the employer must notify the employees that the plan and future deferrals have been terminated.

IRS Determination Letter

Most plan sponsors apply for an IRS determination letter as to the qualified status of the plan termination. Although a request for a determination letter from the IRS isn't required, it is recommended. Failure to apply increases your chances for a plan audit. If you file Form 5310, do it as soon as possible. Most plan sponsors defer distribution benefits to participants until the determination letter issues, though such a delay isn't required.

When distributing assets to participants, follow distribution procedures — including notification, withholding and reporting rules. Treat participants



as if they terminated employment when the plan terminated. Whether you completely or partially terminate your plan, it must provide for 100% vesting of accrued benefits or amounts credited to the employee's account on the termination or discontinuance-of-contributions date.

Other Termination Concerns

Participants are entitled to receive all benefits earned up to the termination date, including the right to receive them in a specific form, such as a lump-sum distribution. Generally, benefits accrue until the termination takes effect.

You must carry out normal plan operations during the termination proceedings. Continue, in accordance with plan provisions and applicable laws, to put participants into pay status, collect plan contributions and invest plan assets. In managing the plan, keep in mind that you will distribute the assets shortly.

Also, continue to file a Form 5500 until you have distributed the plan's entire assets. File a final Form 5500 in the year that all the assets are distributed. Monitor the timing of the final Form 5500 filing as the plan's final year ends as of the date all assets are distributed. For example, a calendar year plan that would normally file seven months after the year end (Dec. 31) would instead file seven months from the date the final assets are distributed.

Details Are Essential

Terminating a plan requires attention to details. If you need help with your partial or complete plan termination, call us. We would be happy to make sure it runs smoothly. ☺

Most plan sponsors defer distribution benefits to participants until the determination letter issues, though such a delay isn't required.

New DOL Notice Requirements for Blackout Periods

The Sarbanes-Oxley Act of 2002 affects pensions in several ways. The most significant is the notice requirement for blackout periods, which took effect Jan. 26, 2003.

What Is a Blackout Period?

A blackout period is defined as any suspension for more than three consecutive business days of participants' or beneficiaries' ability "as otherwise available under the terms of the plan" to direct or diversify their investments or to obtain loans or distributions.

But the meaning of the term "otherwise available under the terms of the plan" is unclear. The legislative intent was to avoid notice requirements for plans valued quarterly. Or does it mean the plan document must specify investment direction and other rights under the plan that is valued quarterly?

Not considered blackouts are suspensions, limitations or restrictions resulting from qualified domestic relations orders (QDROs) or because of various securities laws. The act specifically exempts these situations from the notice requirements.

Sponsors may modify the 30-day advance notice requirement because of unforeseen circumstances or if the notice requirement would violate a fiduciary responsibility. Then you must give notice as soon as possible — even if it occurs after the blackout begins. Under these exceptions, keep careful written records regarding the circumstances.

New Requirements

This rule requires the administrator of a defined contribution plan to notify both participants and beneficiaries affected by a blackout at least 30 days before it begins. The notice must include:

- › Reasons for the blackout period,
- › Investments or other rights affected,
- › Expected length of the blackout period,

- › A statement instructing participants and beneficiaries to review their investment choices in light of the impending blackout, and
- › Any other matters the DOL may require in the future.

Convey the notice either in writing or electronically, but electronic notices must be "reasonably accessible" to participants and beneficiaries.

Penalties

Failure to follow the guidelines can result in substantial fines. The DOL may assess penalties of up to \$100 per day per occurrence. For example, assume you have a plan with 50 participants and you provide the notice 20 days before the blackout; the DOL could potentially assess up to \$50,000 (\$100 x 50 participants x 10 days late) in fines.

The legislation also increases criminal penalties for willful violation of ERISA rules, including this new blackout notice requirement. Penalties increased to ten years and/or \$100,000 (\$500,000 for a nonindividual).



Avoid Trouble

Plan administrators anticipating any situation that may constitute a blackout are wise to consult their advisors as to the potential blackout period and the steps to take to avoid substantial fines. If you have any concerns, our specialists would be happy to help. 🙋

See other side for your FREE report on how much plan information to disclose to participants . . .



Burl V. Bachman,
ASA, EA, MSPA, President

Barbara H. Smith,
Vice President

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PLEASE FAX OR MAIL BACK TO:



Burl V. Bachman, ASA, EA, MSPA, President
Barbara H. Smith, Vice President
Retirement Plan Administrative Service, Ltd.
1503 Santa Rosa Road, Suite 120, Richmond, VA 23229
(800) 235-9649 / Fax (804) 288-8786 / www.rpasltd.com



Is worrying about how much plan information to disclose to participants giving you a headache?

Varying legal interpretations of the broad fiduciary duties under ERISA have led to confusion about disclosure requirements. Until regulatory or legislative clarity is reached, sifting through complicated issues and taking the steps needed to comply with the rules will be critical. *To learn more about fiduciary disclosure requirements — or ways to administer your benefits plan more effectively — complete this form and fax or mail it back, or CALL US today!*

EXPRESS RESPONSE FORM

- Yes!** Please send me a copy of your informative report, “Double Duty: Fiduciaries and Disclosure.”
- Yes!** Please contact me about how your benefits plan advisory services can help me more effectively administer my benefits plan.

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