THE BENEFITS CONSULTING GROUP

53 W. Jackson Blvd., Suite 1250
Chicago, IL 60604
(312) 427-9140
www.benefitsconsulting.net

NEWSLETTER Summer 2006, Volume 2 Issue 2

Inside this issue

Timely 401(k) Deposits

by James Aniol

In February 2006, the Department of Labor (DOL) revised the instructions to IRS Form 5500 to require that plan auditors review the deposit of 401(k) elective deferral contributions and to confirm that the plan sponsor has deposited these contributions in a timely manner. The DOL is using plan auditors to enforce this regulatory requirement, placing greater pressure on plan sponsors to comply with the deposit requirement as well as to correct any late deposits. The requirement began with the 2003 plan year. Only large plans, those with more than 100 participants are required to have their plans audited, but small plans that are not subject to the audit requirement need to comply with the deposit deadlines as well.

The time period described by the DOL regulations requires that a plan sponsor deposit 401(k) deferral, after-tax contributions and loan repayments (employee contributions) that have been taken from their employees' paychecks on the earliest date the employer can reasonably segregate these amounts from its general assets, but in no event later than the 15th business day of the month following the month in which the employer withheld the contributions from the employee's paycheck.

In separate DOL investigations completed in 2005, the DOL took the

continued on next page

EXTRA!!! EXTRA!!!

PENSION REFORM PASSES

The Pension Protection Act of 2006 passed Congress on August 3.

This represents the most comprehensive pension reform legislation in decades (907 pages). The bill now goes to President Bush for signature and is expected to be signed soon. We will be including more in-depth analysis of provisions of the bill in future articles as we review the details. Stay tuned.

Timely 401(k) Deposits (continued from page 1)

position that plan sponsors had the ability to remit employee contributions to the plan within 7 (small plans) to 14 (large plans) days of the payroll date. The IRS lists late deposits as the first of the top ten 401(k) compliance issues on their website http://www.irs.gov/retirement/article/0,,id=135260,00,html and has indicated the employee contributions can be segregated within a day or two of the date the employee's paycheck is issued. In many cases, amounts can be segregated on the same day. Clearly there is no current support for the 15-day limit. The DOL has taken the position that remittances made to the plan later than these time frames failed to comply with DOL regulations and that these untimely deposits of employee contributions to the plan and the retention thereof violated Employee Retirement Income Security Act (ERISA) guidelines.

ERISA requires the DOL to assess a civil penalty against a fiduciary that causes the late deposit of 401(k) elective deferral contributions. The penalty under ERISA is equal to 20% of the "applicable recovery amount", meaning the late deposit plus earnings.

If contributions are deposited late, the employer should take the following corrective action:

- Determine the amount of the earnings due on the late deposits using the DOL calculator found at http://askebsa.dol.gov/VFCPCalculator/WebCalculator.aspx
- Correct the late deposit of participant contributions by filing under the Voluntary Correction Program (VCP) and comply with the requirements of Prohibited Transaction Exemption 2002-51;
- Pay the excise tax; and
- Footnote Schedule H or I of IRS Form 5500 to indicate to the DOL that the correction has taken place.

If an employer corrects the late deposit of employee contributions by filing under the VCP, the employer does not have to pay the 20% excise tax. The employer must correct the late deposit and pay the excise tax using Form 5330. Because the amount of the excise tax is small, many employers correct the situation using the steps detailed above, but do not file under VCP. Filing under the VCP and paying the excise tax may give the employer protection against future DOL and IRS actions.

If late deposits are uncovered in a plan audit, substantial monetary sanctions and penalty taxes may be imposed by the IRS and the DOL even if the failures are unintentional administrative errors. The IRS has emphasized that sanctions will be imposed for failure to follow the terms of the governing plan document, even if the plan's operation otherwise complies with the qualification requirements of the IRC. The DOL may seek to apply this correction for all earlier years open under the statute of limitations, which would be a maximum of six years.

RECOMMENDATION

To avoid the appearance of any impropriety we recommend that employee contributions be deposited to the trust at the same time that payroll tax deposits are made.

Roth 401(k) Revisited

by Larry Shippee

Since Roth 401(k) contributions were introduced this year, they have been described by some as the most important new benefits since 401(k) itself. Others have dismissed the Roth as confusing and unnecessary. One thing is for certain, there are still many unanswered questions about how these plans are to be operated.

Roth type contributions to a 401(k) plan first became available in 2006. See "Get Ready for the Roth 401(k)" at www.benefitsconsulting.net for an overview. Final regulations were issued December 30, 2005 answering some of the questions. On January 26, 2006 the IRS released proposed regulations that provided further guidance.

Here's where we are now on some of the relevant issues.

A plan must offer normal 401(k) contributions before it can add a Roth option. Thus, you can't have a Roth only 401(k) plan.

The final regs clarify that catch up contributions can be designated as Roth contributions.

Roth contributions in a 401(k) plan are subject to the minimum distribution rules (starting at age 70 ½). Roth IRA's are not.

Roth 401(k) accounts can be rolled over to another 401(k) plan that allows Roth contributions or to a Roth IRA. A Roth IRA cannot, however, be rolled to a Roth 401(k).

Roth 401(k) accounts become "qualified" and therefore can be distributed tax-free if the account is 5 years old and the participant is at least age 59 ½. The 5-year clock starts at the beginning of the first taxable year a Roth 401(k) contribution is made.

Here are some of the problems with Roth accounts.

If the funds are distributed prior to the time the account meets the "qualification" requirement (5 years and 59 ½), the earnings are taxable. The contributions are not taxable. This means a basis must be maintained. As accounts transfer from plan to plan or from plan to IRA, maintaining this information may be difficult. The regulations indicate who is responsible for maintaining the information in these circumstances.

If a distribution includes both taxable and nontaxable amounts, the situation can get complicated. This is especially true if there is a partial distribution. How much is taxable and how much isn't. This is one area where more guidance from the IRS is needed.

<u>RECOMMENDATION</u>
While Roth accounts can be added now, it may be advisable to wait until some of the answers are clear and better recordkeeping capabilities exist.

"Roth 401(k) accounts become "qualified" and therefore can be distributed tax-free if the account is 5 years old and the participant is at least age 59 ½"

[Summer 2006, Issue 2]

PBGC Premiums Increase

by Lori Mayer

If you are a plan sponsor of a Defined Benefit plan subject to the Pension Benefit Guaranty Corporation (PBGC) requirements, expect to see an increase in your premium payment. The PBGC is the government created corporation that guarantees pensions against plan insolvency. When the large Fortune 500's plans go belly-up, they turn to the PBGC to pay benefits. The PBGC then turns to premium payers which include the smaller fully funded plans. The Deficit Reduction Act of 2005, signed into law on February 8, 2006, increased the flat-rate premium from $19 to $30 per participant. This rate increase is effective for plan years starting in 2006.

Also, look for changes in future years. Starting in 2007, the flat-rate premium of $30 will be automatically adjusted each year based on the national average wage index that is currently used for the Social Security indexing.

.

The Benefits Consulting Group, Inc.

53 W. Jackson Blvd., Suite 1250
Chicago, IL 60604
(312) 427-9140

www.benefitsconsulting.net

PRSRT STD
U.S. POSTAGE
PAID
LOMBARD, IL
PERMIT NO. 302