

# Employee Benefit News

January 29, 2010

---

## 2010's LIBERAL ROTH CONVERSION RULES

---

2010 could be a significant year for retirement tax planning! It will be the first year in which taxpayers will be able to convert funds in regular IRAs to Roth IRAs regardless of the individual's income level. The two major differences between a Roth IRA and a regular IRA are:

1. Distributions from regular IRAs are taxed as ordinary income (other than the portion that is nondeductible contributions), whereas Roth IRA "qualified distributions" are tax-free. A Roth distribution is qualified if it is made after the IRA has been in existence for five years and the distribution is after age 59 ½ or for reasons of death, disability or is a limited amount for the purchase of a first-time home.
2. Roth IRAs are not subject to the rules for required minimum distributions at age 70½.

Half of the income from the conversion will be taxable in 2011 and half will be taxable in 2012, unless the taxpayer elects to have it all taxable in 2010. Of course, the important unknown is what the tax brackets will be in 2011 and 2012, with the current tax brackets set to expire at the end of 2010.

---

## PARTIAL PLAN TERMINATIONS

---

The Internal Revenue Service requires that participants who terminate employment as the result of a "partial plan termination" be 100% vested regardless of their years of vesting service. The determination of whether a partial plan termination has occurred is based on the surrounding facts and circumstances. Although there are no hard and fast rules, most courts and the IRS follow a 20% rule. If there has been some corporate action (such as layoff, plant closing, etc.) which results in more than 20% of participants being terminated during the applicable period, then it is presumed that a partial plan termination has occurred. The general guideline raises two important questions: (1) what employees are included in the numerator and denominator and (2) what is the "applicable period."

The categories of participants who should be included in the numerator and denominator have been the subject of some debate. The IRS' approach (supported by most courts) is to count both vested and non-vested participants in the numerator. The IRS' approach is to use all of the participating employees at the beginning of the applicable period plus the employees who became participants during the applicable period in the denominator.

Another point addressed by the courts is whether both voluntary and involuntary terminations should be included in the numerator. It is clear in the regulations that voluntary terminations do not have to be included. The issue is whether a "voluntary" termination is truly voluntary. An example is whether a participant who was not directly downsized but who terminated because of the impact the downsizing has on his or her job is a voluntary or involuntary termination. The IRS has indicated that a claim by the employer that a termination is voluntary can be supported through items such as personnel files, employee statements, and other corporate records.

The "applicable period" also depends on the circumstances. The applicable period is a plan year or a longer period if there are a series of related terminations.

If the facts indicate that an employer may have had a partial plan termination, the employer can either request a ruling from the IRS or voluntarily 100% vest the terminated participants. In many cases, voluntarily vesting the terminated participants is less expensive than seeking an IRS ruling.





---

## REPORTABLE EVENTS FOR DEFINED BENEFIT PLANS

---

Most defined benefit plans are subject to the rules of the Pension Benefit Guaranty Corporation ("PBGC"). However, a defined benefit plan sponsored by a professional service employer with less than 25 active participants, a church, or a government entity is not covered by the PBGC. Plans that are covered must report certain corporate events and certain retirement plan events to the PBGC. In general, the reporting must occur 30 days after the event. We think it is helpful, from time to time, to review the reportable events. Therefore, we are providing the following list of current reportable events.

1. *Active Participant Reduction* - the number of active participants is reduced to 80% of the number of active participants at the beginning of the plan year or to 75% of the number of active participants at the beginning of the previous plan year. If a plant closing has been reported and the participant reduction is the result of the plant closing, then there does not have to be a separate reporting of participant reduction. Also, to avoid reporting multiple reductions in a year, reporting is waived if there has already been an active participant reduction reported in the past 12 months.
2. *Failure to Make Required Minimum Funding Payments* – required contributions (including quarterly, annual, and payments required as a condition for a funding waiver) are not made. There is an exception for the failure to make quarterly contributions in 2010 for plans with less than 25 participants, if the reason for the failure is not financial. If the unpaid contributions exceed one million dollars, then the failure to make the contributions must be reported within 10 days of the due date.
3. *Inability to Pay Benefits When Due* – if the Plan does not have enough assets to pay full benefits when due or if as of the last day of any quarter of a plan year, the Plan's liquid assets are less than two times the amount of the disbursements for that quarter. Large plans (over 100 participants) are subject to the liquidity shortfall rules. Compliance with the liquidity shortfall rules will avoid the inability to pay benefits.
4. *Distribution to a Substantial Owner* – if the distribution is more than \$10,000 and immediately after the distribution the Plan has unfunded nonforfeitable benefits.
5. *Change in contributing sponsor or controlled group* – if there is a transaction that will result in one or more entities ceasing to be members of the Plan's controlled group.
6. *Liquidation of Contributing Sponsor or Controlled Group Member.*
7. *Extraordinary Dividend or Stock Redemption* – if the amount of a dividend or stock redemption is a large portion of the company's adjusted net income or assets.
8. *Transfer of Benefit Liabilities* – if the Plan transfers 3% or more of the Plan's total benefit liabilities to a company outside the controlled group or to a plan maintained by a company outside the controlled group.
9. *Application for Minimum Funding Waiver.*
10. *Loan Default* – there is a default under a loan agreement by a member of the controlled group if the loan has an outstanding balance of \$10 million or more.
11. *Bankruptcy or Similar Settlement* – if any member of the Plan's controlled group commences a bankruptcy case, an insolvency proceeding, or a settlement with creditors.

The PBGC has issued proposed regulations which add two new additional reportable events:

1. *Funding Status* - if the adjusted funding target attainment percentage is less than 60% or presumed to be less than 60%.
2. *Transfer to Retiree Health Account* – if \$10 million or more of excess assets are transferred to fund retiree health benefits.

Under the current rules, there are automatic waivers and extensions of time for most reportable events. However, the proposed regulations eliminate most of the waivers and extensions and increase the information that must be included with the filing. The purpose of reporting such events is to provide an early alert to the PBGC that plans could be in financial distress. The proposed regulations are designed to ensure that the PBGC receives complete information in a timely manner. The proposed regulations will become effective when they are finalized.



---

## EFAST 5500 FILING PROCEDURES

---

All Form 5500 filings with plan years beginning January 1, 2009 and later must be electronically filed and signed (known as "EFAST 2"). Even though the Department of Labor ("DOL") has moved to a paperless filing system, plan administrators must continue to keep a copy of the Form 5500, its schedules, and all attachments, with all required signatures in their files.

The first step to prepare for EFAST2 is for the individual who will sign the 5500 to register at the DOL website. More than one person may obtain signing credentials. Once the registration is complete, the signer can continue to use the User ID and PIN in future years. To date, the DOL does not allow someone other than the signer to apply for the User ID and PIN. Therefore, unfortunately, we cannot complete the registration process for you.

Here is a description of the registration steps:

1. Go to <http://www.efast.dol.gov> and click on the registration link.
2. Read and sign the privacy statement.
3. Complete profile information such as name, address, and user type. Your user type is "filing signer." (Other user types are described below.)
4. Enter challenge information.
5. Respond to confirmation email.
6. Respond to challenge question.
7. Accept PIN Agreement.
8. Accept signature agreement.
9. A User ID and PIN will be provided.
10. Create a password.

User types include the following:

Filing Author – person who creates and edits the filing.

Filing Signer – person who signs the return.

Schedule Author – person who creates and edits schedules; cannot create or transmit 5500.

Transmitter – company that transmits the filing using third party software.

If McCready and Keene prepares your 5500, we will handle the Filing Author, Schedule Author, and Transmitter duties.

Some comments on attachments:

You will want to gather all data for the filing before attempting to file. In addition, if an audit is required, it should be completed prior to filing. Schedules MB and SB must be printed, signed by an Actuary, scanned into a PDF format, and attached to an electronic filing. All other attachments must be in TXT or PDF format.

Schedule SSA will no longer be filed with Form 5500. It is now called Form 8955-SSA and will be submitted directly to the IRS.

Reminders:

The full 5500 for defined benefit plans must be posted on the employer's intranet beginning with the 2009 form. (For the 2008 form, only the Schedule SB was required to be posted.) 403(b) plans, other than government or church plans, must file a full 5500 (including schedules and attachments) beginning with the 2009 form.



---

## LOANS AND REG Z

---

Current rules require that retirement plans provide a truth-in-lending disclosure to loan applicants if the plan made more than 25 loans in the current or prior calendar years. The truth-in-lending disclosure includes the amount financed, the finance charge, interest rates, timing of payments, and the total amount to be paid.

Effective July 1, 2010, Federal Reserve Regulation Z has been amended to exempt loans from qualified plans, 403(b) plans, and 457(b) governmental plans from the truth-in-lending disclosure if three conditions are satisfied:

1. The loan is made to a participant.
2. The loan is from fully vested funds in the participant's account.
3. The loan is made in compliance with Internal Revenue Code requirements.

The Federal Reserve has acknowledged that a loan from a retirement plan is substantially different from commercial loans because there are no creditor imposed finance charges. At last, there is a little relief for retirement plans!

---

## DOL FINALIZES RULES ON DEPOSIT OF EMPLOYEE CONTRIBUTIONS

---

The general rule is that all employers must deposit employee contributions, including loan payments, to retirement plans as soon as the money can be segregated from the employer's assets, and in no event later than the 15th business day of the following month. Final regulations issued this month provide that small plans (fewer than 100 participants) may elect to use an optional safe harbor for determining whether deposits were made timely. The optional safe harbor requires the deposit of employee contributions by the seventh business day following the day the employee was entitled to receive the money. If a small plan does not elect to use the optional safe harbor, then the general rule will apply.

---

If you have questions or would like additional information about the items presented in this newsletter, call your McCready and Keene consultant.

*Employee Benefit News is not intended as legal advice. Readers should seek legal advice before acting on any of these subjects.*