OUTLOOK FOR 2010

New Requirements & Options for Retirement Plans

The year 2009 has been tumultuous for retirement plans. The precipitous fall of most retirement account balances from late last year through the first part of this year has been countered by a dramatic rise in the stock market through the third quarter. Many sponsoring employers have struggled to meet their traditional level of matching and discretionary contributions in a difficult economy; yet, surveys show that employees have managed to maintain their level of salary deferrals to their 401(k) accounts. On the other hand, high unemployment rates and a general lack of available credit have increased the number of plan participants willing to tap their retirement savings through taxable distributions and plan loans. It is time for a look at new concepts and procedures coming in 2010.

ELECTRONIC FILING

Beginning with the 2009 plan year filings, the Department of Labor (DOL) will require all retirement and welfare benefit plans (other than one-participant plans) to file their annual Form 5500 electronically using the EFAST2 system. The switch from paper filing to electronic filing will result in significant changes in the filing procedures for both plan sponsors and third-party administrators (TPAs).

Plan sponsors will have three options for electronic filing of data on the Form 5500 and all the required supporting schedules: 1) A private web-based system (e.g., a commercial software forms package), 2) A third-party software application, transmitted to the DOL via internet, or 3) The DOL's web-based system known as IFILE. Most employers will use the first system, with the 5500 prepared by the TPA. Large employers who prepare their own Forms 5500 are the most likely to utilize the third-party software. Meanwhile, the IFILE system will have limited use by small practitioners who file only a few reports.

Regardless of which system is used, each plan sponsor must obtain an electronic signature to file their report with the DOL. The plan sponsor will need to designate an individual to contact the DOL website and enter certain personal information. The individual will then receive an email with a link to a website to receive the credentials (signer ID and PIN code). The credentials are personal to the individual obtaining the credentials. If a plan sponsor has different company officers signing the 5500, each officer will be required to obtain his or her own credentials.

It is important to note that neither TPAs nor financial institutions will be allowed to obtain signer credentials on behalf of their clients. Furthermore, the government limits one set of credentials per email address. When an individual obtains signer credentials, the individual must certify to the government that the credentials will not be shared with anyone, including a TPA or financial institution. Obviously, these restrictions will require coordination between the plan sponsor and the TPA assisting in the preparation of the Form 5500 package for filing.

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403(B) REPORTING

Beginning in 2009, exempt organizations who sponsor 403(b) arrangements will be subject to expanded reporting and audit requirements. This increased compliance is part of the 2007 regulations and will complicate the administration for many sponsors who previously enjoyed broad exemptions under the existing rules.

403(b) plans that satisfy certain requirements will continue to be exempt from reporting under the new regulations. Generally, this limited exemption applies to arrangements that accept only employee salary deferrals, and where the employer takes a "hands-off" approach with respect to plan operation or interaction with the annuity providers. While the exemption is still in place, the new rules that apply to the operation of the plans may make it more difficult to maintain the plans while continuing the hands-off approach. The DOL has published a bulletin on how employers can comply with the new rules and still meet the safe harbor exemption to avoid the Form 5500 requirement.

Plan sponsors who fund any level of employer contribution do not meet the exemption. Any such plan sponsor must file a complete Form 5500 to provide expanded information more like the requirements applicable to 401(k) plans. Up until 2008, all 403(b) plans, regardless of the number of plan participants, were exempt from the general requirement to attach an independent CPA audit of the plan and trust to their Annual Report. While small plans will continue to enjoy a waiver of the audit requirement, beginning in 2009, all plans with more than 100 participants will be required to provide the audit as part of their report.

DEFINED BENEFIT/401(K) COMBINATION PLANS

Beginning in 2010, employers will be able to adopt a single plan to provide both Defined Benefit (DB) and 401(k) benefits to employees. Currently, employers wishing to provide such benefits must adopt separate plan documents, perform dual administration and file two Form 5500 reports. This combined plan was thought to be a great vehicle to provide streamlined benefits at a discounted administrative cost. After reviewing the particulars of the regulations governing these new plans, however, their practical use may be limited.

The new DB/401(k) plan will be available to small employers, defined as those having at least two, but no more than 500 employees. The plan must have a single trust holding all plan assets, but must distinguish the assets belonging to each portion of the plan. The defined benefit plan can be based on either a traditional or cash balance plan formula. The 401(k) portion of the plan must have an automatic contribution provision (employees must defer a minimum 4% of pay) and a required match equal to 50% of the 401(k) contributions, up to 4% of pay. Profit sharing contributions may also be made but must be provided on a uniform basis to all participants.

While these plans may work for certain situations, they also have practical limitations that may continue to favor a two-plan arrangement. There is currently no plan document available for these combined plans, which will force adopting employers to create a "linking agreement" between two plan documents. In addition, it is not clear that these plans can use the same non-discrimination testing methods available to separate plans. This testing issue could greatly hinder their effectiveness in reducing employer costs, especially for employees closer to retirement. Finally, the requirement for an automatic contribution arrangement subjects the employer to increased notification and contribution requirements that may not be necessary and not required in a separate plan arrangement.

ROTH CONVERSIONS

Roth IRA accounts were first created by the Taxpayer Relief Act of 1997. These accounts allow eligible individuals to contribute after-tax dollars to an IRA, rather than the before tax dollars used to fund a traditional IRA. The account will grow tax free, and, assuming the account is not cashed in before five years, the account proceeds, including the growth, will never be taxed. The availability of these accounts has been restricted to taxpayers below certain income levels. The income limitation for taxpayers in 2008 was $100,000.

Beginning in 2010, the income restrictions have been eliminated, which will allow all taxpayers to not only contribute to Roth plans, but also to convert all or part of an existing traditional IRA to a Roth IRA account. A conversion will result in taxation of the traditional IRA account; however, the taxpayer has the option of either paying all the tax in 2010 or spreading the tax impact over the 2011 and 2012 tax years. Once converted, the traditional IRA will be subject to all of the regulations applicable to Roth IRA accounts, and will never be taxed again.

These accounts may provide some unique income tax and estate planning opportunities for wealthier individuals who have substantial IRA accounts and who can absorb the taxable income resulting from the conversion. Roth accounts are not subject to minimum distribution requirements, so the account capital can be preserved after the attainment of age 70-½. Since Roth accounts are never taxed, they have advantages in estate planning and generation-skipping strategies.

CONCLUSION

The year 2010 should be busy for retirement plans. Besides the items mentioned above, all defined contribution plans are in the process of being amended and restated for the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and 403(b) plan sponsors are required to adopt a plan document for the first time. This is an ideal time to re-visit your plan design in light of these many changes.

If you have questions regarding your retirement, or would like more information, please contact Richard Green at 562-435-1191 or **rgreen@windes.com**.