employee benefits update

year end 2011

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AUTOMATIC ENROLLMENT

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What you need to know about top-heavy testing

Each plan year, retirement plan administrators must determine whether their plans are "top heavy" based on compensation to "key employees." What are these terms and why do they matter? Let's look at top-heavy testing for defined-contribution plans.

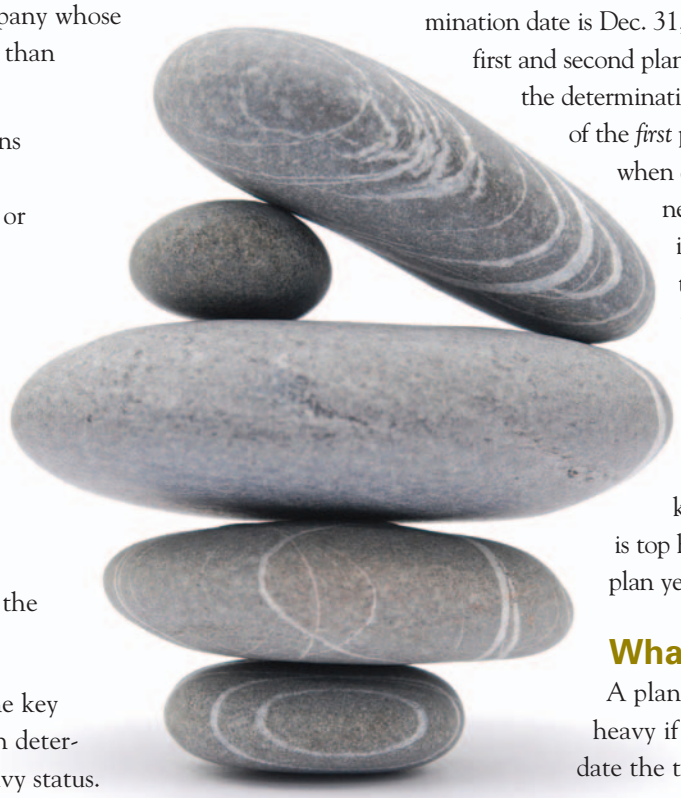
Who is a key employee?

A plan's top-heavy status is determined by performing a calculation that compares the total account value of key employees to the total account value of all employees. To perform top-heavy testing for a plan, you'll need to compile employee census data for the reporting period. From this data you'll identify key employees.

A key employee is:

- An officer of the company whose compensation is more than $160,000 (in 2011),
- An employee who owns more than 5% of the company either alone or through stock attribution (regardless of compensation), or
- An employee who owns more than 1% of the company either alone or through stock attribution and earned more than $150,000 during the determination year.

Correctly identifying the key employees is essential in determining a plan's top-heavy status.



How are plans tested?

Generally, plans perform top-heavy testing at the same time as the plan's year end reporting. Your plan document must outline its top-heavy rules. Make sure to review your plan document before performing the top-heavy test.

Many plan sponsors use software or spreadsheets specifically for top-heavy testing. Generally, the test considers account balances as of a determination date, adds back certain distributed amounts or contributions, and subtracts certain rollovers into the plan and other excluded transactions.

For existing plans, the determination date is the last day of the prior plan year. For example, if you're trying to determine whether an existing calendar-year plan is top heavy for the 2011 plan year, the determination date is Dec. 31, 2010. For both the first and second plan years of a new plan, the determination date is the last day of the *first* plan year. For example, when determining whether a new calendar-year plan is top heavy for 2011, the determination date would be Dec. 31, 2011, for both the 2011 and 2012 plan years. Therefore, for new plans, you may not know whether the plan is top heavy until after the plan year is over.

What is top heavy?

A plan is deemed to be top heavy if on the determination date the total account value of

key employees exceeds 60% of the total account value of all employees in the plan. If the plan is top heavy, the plan administrator must make top-heavy minimum contributions to all nonkey participants employed as of the last day of the plan year.

The top-heavy minimum contribution is the lesser of 3% of the total compensation for the plan year (regardless of the plan's definition of compensation) or the highest key employee contribution percentage during the plan year. Key employee contributions include elective deferrals and any forfeitures allocated to the key employee but don't include catch-up contributions. If there weren't any contributions made for key employees, you don't need to make top-heavy minimum contributions.

What transactions are included?

Some transactions are included in the top-heavy calculation and some aren't included. For example, included are:

- Distributions processed during the plan year ending on the determination date for any participant who completed service in that plan year,
- In-service distributions (such as distributions when participants reach age 59½ or hardship distributions) for reasons other than death, disability or termination of employment for five years (beginning with the plan year ending on the determination date and going back four years),
- Any receivables for the first plan year only, and
- If you use the accrual accounting method, possibly profit-sharing receivable contributions.

But *not* included are:

- Account balances belonging to participants who terminated employment in a prior year,
- Distributions processed during the plan year for participants who terminated employment in the plan year, or
- Unrelated rollover contributions to the plan.

The calculation also excludes catch-up contributions for the plan year in which they were made. However, these contributions are included in future plan years as part of the participant's account balance.

Safe harbor 401(k) plans not subject to top-heavy testing

There is a way to avoid the top-heavy testing requirements: the safe harbor 401(k) plan. The IRS automatically deems these plans not to be top heavy. Safe harbor plans also eliminate the need for the annual actual deferral percentage (ADP) and actual contribution percentage (ACP) nondiscrimination testing.

However, safe harbor plans are subject to some different contribution, vesting and withdrawal requirements. In addition, you must provide special notices to participants.

If you're interested in converting your qualified retirement plan to a safe harbor plan, speak with your retirement plan administrator to see whether it's a good fit.

Don't get top heavy

Top-heavy determinations aren't simple, so you may want to consult your benefits specialist. If your plan is top heavy and you fail to make the required contributions, your plan could become disqualified and face undesirable tax consequences. Depending on the mistake, you may be able to correct through the self-correction program (SCP) or the voluntary correction program (VCP).

Upcoming compliance deadlines:

12/31 Deadline for making required minimum distributions for 2011

12/31 Deadline for making corrective distribution for 2011 failed actual deferral percentage / actual compensation percentage (ADP/ACP) test with 10% excise tax as well as for making a qualified nonelective contribution (QNEC)

1/17 Deadline for filing the 2009 and 2010 Forms 8955-SSA

1/31 2011 Form 1099s due to participants

Blackout notice: 30 to 60 days before the last day participant may make a change

Correcting errors before they cost you

The Voluntary Fiduciary Correction Program (VFCP) was created by the Department of Labor (DOL) to encourage correction of plan operational errors. The program allows plans to correct 19 specific errors. Once a plan corrects a qualifying error and satisfies the VFCP terms, the DOL will issue a "no action" letter. This essentially means that the DOL accepts the correction and won't impose any further sanctions.

Types of errors

Some of the 19 errors that sponsors can correct under the program include:

- Participant loans that fail to comply with plan provisions for amount, duration or level amortization,
- Purchase or sale of assets from or to parties in interest,
- Sale and leaseback of property to sponsoring employers,
- Purchase or sale of assets from or to nonparties in interest at more or less than fair market value,
- Payment of duplicate, excessive or unnecessary compensation, and
- Improper payment of expenses by the plan.

But such errors make up only a small portion of the corrections that have been made under the VFCP. Since 2000, the DOL has noted that about 90% of all applications have involved delinquent deposits of participant contributions, either deferrals or loan payments.

Generally, plans with 100 or more participants must make these deposits on the earliest date by

which the employer can segregate these assets from its own assets, but no later than the 15th business day of the month following the month in which these funds were withheld from employee compensation.

For retirement and health and welfare plans with fewer than 100 participants, the rules deem contributions to be timely if they're deposited to the plan within seven business days after the payroll date. While this has brought clarity to timeliness of deposits for smaller plans, this safe harbor doesn't apply to larger plans. Because of this, larger plans need to comply with the basic rules and, in all likelihood, will be subject to faster deposit requirements in most situations.

Using the VFCP

You can correct a violation in four steps:

1. Identify violations and determine whether they fall within VFCP-covered transactions,
2. Follow the VFCP process for correcting the specific violations,
3. Calculate and restore any losses or profits with interest, if applicable, and distribute any supplemental benefits to participants, and
4. File an application with the appropriate Employee Benefits Security Administration (EBSA) regional office that includes documentation showing evidence of the corrective action taken.

The DOL encourages plan sponsors to use its model application form, though the form isn't required. Basically, the application consists of a written narrative of the error and the correction that was made plus supporting documentation. You can submit the application only after the correction has been made.

The supporting documentation must provide proof that the plan sponsor corrected the violation. In the case of a late deposit correction, a copy of a canceled check or an investment statement showing the correction was received is generally sufficient. Remember, with a late deposit, correction includes interest on the funds that otherwise would have been earned in the plan. The DOL has an online calculator that is available for your use.

The DOL encourages plan sponsors to use its model application form, though the form isn't required.

Plan sponsors must also complete a checklist. This checklist ensures that the plan sponsor has answered all pertinent questions. While the model application form isn't required under the VFCP, the checklist is. Adhering to the checklist is necessary to receive a no action letter.

Follow the procedures

Simply making a correction isn't enough. To avoid further sanctions, be sure to follow the VFCP procedures. For additional information regarding the VFCP, contact your benefits specialist or the appropriate EBSA office. More information can be found on the EBSA website, www.dol.gov/ebsa/compliance_assistance.html.

The quickest way to boost retirement plan participation

Statistics show that automatic enrollment dramatically improves participation. Why? Because even though employees can opt out if they choose, they rarely do. If you haven't implemented automatic enrollment yet, 2012 may be the year to do so.

Types of arrangements

There are two types of automatic enrollment arrangements that employers can set up:

1. Eligible automatic contribution arrangements (EACAs). In an EACA, the employer can match the employee's contribution, make a nonelective contribution that is a percentage of each employee's compensation, or not make any employer contribution. The employer can change contribution amounts each year and attach a graded vesting schedule of up to six years on employer contributions.

EACAs are subject to annual nondiscrimination testing. Generally, automatic enrollment increases participation, which makes it more likely that the plan will pass the testing.

2. Qualified automatic contribution arrangements (QACAs). These are more restrictive on the employer, but QACAs automatically pass nondiscrimination testing. The employer must either make a nonelective contribution to all participants in the amount of 3% of compensation, or make a matching contribution of 100% of salary deferrals up to 1% of compensation and a 50% match for salary deferrals above 1% but no more than 6% of compensation (that is, the next 5%).

Initially, the employee is automatically set up to contribute at least 3% of compensation. These contributions automatically increase so that the total employee contribution is at least 6% by the

fifth year. Automatic contributions cannot exceed 10% in any year.

Employees can change their contributions or choose not to contribute without impacting the plan's nondiscrimination testing. It doesn't matter if employees opt out or change their contribution percentage from the assigned amount. Unlike EACA employer contributions, QACA employer contributions must fully vest when an employee completes two years of service.

Setting up automatic enrollment

First, you'll need to amend your plan document to allow for automatic enrollment. For both EACAs and QACAs, the plan fiduciary must set up default investments because automatically enrolled participants don't go through the previously "normal" procedure of completing an enrollment form and setting up investment selections.

Before the plan can deposit the first contribution, you must provide employees with an automatic enrollment notice describing the plan's automatic enrollment process and participant rights. The notice must specify the deferral percentage, the participant's right to change the automatic percentage, his or her right to opt out and the default investment information. After the first notice you'll need to send out this notice annually.

It's a win-win

Employees are often surprised at how little impact the automatic deferrals have on their take-home pay. Setting up automatic enrollment benefits both the plan and the employees — everybody wins.

Be on time with your electronic federal tax deposits

As of Jan. 1, 2011, the IRS no longer accepts federal tax deposit coupons and it requires taxpayers to submit the deposits electronically. This affects many qualified retirement plans. For example, a qualified plan distribution that's eligible for rollover must have 20% withheld for federal income taxes if a cash distribution is selected.

If you haven't already enrolled in the electronic federal tax payment system, go to eftps.com. There's no cost to use this service. Once enrolled, the IRS will mail your PIN within seven business days. It's important to enroll so you can avoid late-deposit penalties.

You must deposit withholding payments in a timely manner. IRS Form 945 sets monthly or semiweekly deposit schedules; to determine which applies to you, review your total tax for the second preceding calendar year. (For example, 2010 determines 2012 deposit schedule status.) Generally, if the total tax is $50,000 or less, the plan can follow the monthly schedule. If the total tax is more than $50,000, the plan must follow the semiweekly schedule.

But if the tax liability reaches $100,000 or more in one day, the plan must follow the semiweekly schedule beginning on the following day (if it's not already following that schedule) and the deposit is due the next business day. The plan must continue using the semiweekly schedule for the remainder of the current calendar year and the following year.

For a plan on the monthly schedule, you must deposit the withholding by the 15th of the month following the distribution. For the semiweekly schedule, you must make the deposit within three business days of the semiweekly period. Semiweekly periods are Wednesday to Friday (deposit due the following Wednesday) and Saturday to Tuesday (deposit due on Friday).

You must report withholding from qualified plans annually on Form 945. If the total tax liability for the year falls below $1,000, the deposit rules don't apply; you can pay the tax when you file Form 945.

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