employee benefits update

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It’s a privilege

UNDERSTAND THE ERISA FIDUCIARY EXCEPTION TO THE ATTORNEY-CLIENT PRIVILEGE

Many qualified retirement plans will employ an attorney at some point to give advice regarding the plan or create various plan documents. Plan sponsors will communicate with attorneys as to plan requirements and potential legal issues. These communications may be subject to the attorney-client privilege, but then again, they may not. ERISA plan fiduciaries must understand how attorney-client privilege works for them and its exceptions.

The privilege

The attorney-client privilege is one of the strongest privileges permitted under United States law. Generally, it makes matters discussed between the attorney and client confidential, and the attorney cannot divulge information discussed with the client without the client’s consent. The aim is to allow clients to communicate freely with their attorney.

However, the attorney-client privilege isn’t without exception — there are times it doesn’t apply or when a client unknowingly waives the privilege. And when the communication involves retirement plans and ERISA fiduciaries, certain discussions qualify for the privilege while others don’t. It depends on whom the attorney is representing at the time of the conversation with the fiduciary — it could be the fiduciary or plan participants and beneficiaries, depending on the topic.

The fiduciary exception

The fiduciary exception to the attorney-client privilege affects those who act only in a fiduciary capacity. Under ERISA, a fiduciary is a person who:

- Exercises any discretionary authority or control over the plan’s management or the disposition of its assets,
- Renders investment advice with respect to plan funds or property for a fee or other compensation or has any authority or responsibility to render such advice, or
- Has discretionary authority or responsibility in the plan’s administration.

Fiduciary responsibilities include:

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them,
- Carrying out their duties prudently,
- Following the plan documents (unless inconsistent with ERISA),
- Diversifying plan investments, and
- Paying only reasonable plan expenses.

The fiduciary exception allows certain discussions between the plan fiduciary and an attorney to be disclosed to plan participants and beneficiaries.

The topic of conversation

It can be complicated to determine if a communication falls under the fiduciary exception. The Fourth Circuit Court found that attorneys communicate with ERISA fiduciaries in one of two ways:

1. Advising a fiduciary on fiduciary matters. Fiduciary matters generally fall under the exception, and thus can be disclosed to participants and beneficiaries. For example, if the ERISA plan fiduciary (employer) and legal counsel discuss a matter of plan administration, the fiduciary may not claim the privilege against the participants because the participants are actually the attorney's clients in this scenario.

2. Advising a fiduciary on nonfiduciary matters. Settlor functions, such as choosing the type of plan or options in the plan, are nonfiduciary matters that fall under the attorney-client privilege. For example, the attorney-client privilege applies when a fiduciary consults with an attorney regarding business matters, such as plan design or termination. Discussions of this nature involve business decisions and aren't related to plan management or administration, so the fiduciary is the client and retains the privilege.

An example

Keep in mind that a fiduciary's status can change during a single discussion. For example, suppose a discussion starts by talking about a plan's investment performance and then changes to plan termination issues. The first half of the discussion falls under the fiduciary exception because investment performance is a fiduciary action pertaining to the plan, but is really for the benefit of the participants. Thus the exception applies and the privilege doesn't apply.

However, the second half of the conversation about plan termination issues falls under plan design and is protected under the attorney-client privilege. The exception won't apply if the fiduciary was seeking advice for his or her protection in anticipation of litigation.

Steps to take to avoid litigation

Plan fiduciaries must understand that their communications with their attorney about the administration of their retirement plan may not be confidential. To avoid possible litigation, plan fiduciaries should consider designating a specific attorney as their ERISA legal counsel.

By segregating the attorney communications you have on fiduciary matters, you can control the communications that could fall under the attorney-client privilege exception. The less your ERISA attorney is involved with your internal business operations, the more control you have over the information flow and the stronger your attorney-client privilege becomes.

Because the application of the attorney-client privilege exception varies in each jurisdiction, discuss any concerns with your legal counsel. It's best to separate your business advisor from your legal advisor.

Know the difference

The attorney-client privilege, along with the fiduciary exception as it applies to ERISA retirement plans, is a complex matter. Review with your legal counsel to learn more about when the privilege does and doesn't apply.

Upcoming compliance deadlines:

2/28 Deadline for filing written 2011 Form 1099 with IRS (electronic filing deadline is April 2)

3/15 Deadline for actual deferral percentage / actual contribution percentage (ADP/ACP) corrective distributions without 10% excise tax on employer

3/15 Deadline for filing 2011 corporate tax return and making contributions eligible for deductibility without extension

4/17* Deadline for corrective distribution of 2011 402(g) excess deferral failures

4/17* Deadline for filing 2011 individual and/or partnership tax returns and making contributions eligible for deductibility

** The IRS announced that the normal April 15 deadline would be extended to April 17 this year, to allow for observance of a District of Columbia holiday.*

Is that domestic relations order qualified?

Every plan administrator likely will have to handle a domestic relations order at some time. These orders require plan administrators to distribute funds owed to a plan participant to another person.

The plan administrator must notify the participant and alternate payee after receiving a domestic relations order. Until the plan administrator determines that the order is a qualified domestic relations order (QDRO), it must freeze funds in the plan, such as any installment payments, withdrawal or loans. Only the portion of a participant's balance that isn't subject to the court order can be paid out.

To qualify as a QDRO, the order must contain:

- The name and last known address of the participant and each alternate payee,
- The name of each plan to which the order pertains,
- The dollar amount or percentage (or the method of determining the amount or percentage) of the benefit to be paid to the alternate payee, and
- The number of payments or time period that applies.

Generally, a plan administrator must determine whether a domestic relations order is qualified within a reasonable amount of time after receiving the order. What a "reasonable" period is will depend on the specific circumstances. Plans must adopt reasonable procedures for determining the qualified status of domestic relations orders, and compliance with these procedures should ensure that determinations of the qualified status of an order take place within a reasonable period of time.

After the domestic relations order is considered "qualified," the plan administrator will send a notice to the participant and the alternate payee in writing. The notice must also include copies of the plan's claim and appeal procedures.

If the alternate payee is the participant's spouse or former spouse, the alternate payee is considered the distributee for tax purposes. If the alternate payee is any other individual, the participant becomes the distributee for tax purposes. QDRO distributions made from a qualified plan prior to age 59½, unlike non-QDRO distributions, aren't subject to a 10% penalty under IRS regulations.

They're back …

THE REQUIRED MINIMUM DISTRIBUTION DEADLINE IS NEARING

While some were hoping for an IRS reprieve similar to that in 2009, retirement plan participants must take required minimum distributions (RMDs) for the 2011 tax year. RMDs are minimum amounts that certain participants must take each year. When to start these distributions and how much to distribute can be tricky.

Calculating the due date

In defined contribution plans, participants must take RMDs by April 1 of the first year following the later of the date the participant reaches 70½ or the date the participant retires from the company maintaining the retirement plan. For each year after the year a participant turns 70½, the RMD is due by Dec. 31.

If the participant is a 5% owner of the employer maintaining the retirement plan, he or she must take the RMD by April 1 of the first year following the calendar year in which the participant reaches age 70½, even if he or she hasn't retired.

Calculating the amount

Calculating RMDs for 401(k) and profit sharing plans is relatively straightforward. First, you'll need the participant's account balance at the end of the calendar year prior to the year in which you'll make the RMD. For 2012 distributions, use the 2011 year end account balance.

Then, determine the applicable distribution period using the IRS lifetime expectancy table that applies to the participant's specific situation:

Single life expectancy table. Use this table for beneficiaries after a participant's death.

Joint life and last survivor expectancy table. This table is for married participants who have a spouse more than 10 years younger than the participant, with the spouse being the participant's only beneficiary.

Uniform lifetime table. Use this table for all other participants.

Use the appropriate table to calculate the applicable distribution period. If applicable, use the participant's and the beneficiary's ages for the year the calculation is being made. For example, if the participant was born in 1939, the participant's age for 2012 is 73.

Determine the applicable distribution period using the IRS lifetime expectancy table that applies to the participant's specific situation.

Unless the participant has a spouse who is more than 10 years younger and is the sole beneficiary of the account, the distribution period is 24.7, which can be located on the uniform lifetime table. Finally, the RMD amount can be calculated by taking the account balance and dividing it by the distribution period. So, if the account has a balance of $1 million, the $1 million is divided by 24.7 for an RMD of $40,485.83.

If a participant dies on or after RMDs begin, calculate the RMD by dividing the participant's account balance at the end of the calendar year prior to the year you're making the RMD by the appropriate number from the single life expectancy table.

Make the distribution

It can be costly if participants fail to take their RMDs by the due date. The IRS may assess a 50% excise tax on any amount that isn't distributed. When calculating and distributing RMDs for your participants, consult with your plan administrator or tax advisor to make sure they're accurate and distributed on time.

Dealing with terminated employees' plan balances

When a participant terminates employment with a company and leaves a vested account balance in the plan, several options are available. The terms of your plan document will control the participant's decision.

Force-outs

Generally, when a participant's vested account balance is $5,000 or less, the plan can require the participant to take a distribution. The payout may be in the form of a cash distribution or by rolling the balance into an IRA or a new employer's plan. If the participant's balance is less than $1,000, you can cash out the balance and withhold the appropriate taxes.

You must give the participant at least 30 days' notice of the right to request a distribution. If the participant doesn't respond to the advance notice, the plan sponsor must establish a rollover IRA for former participants with balances between $1,000 and $5,000.

Balance of more than $5,000

You can't require terminated employees to take a distribution from account balances larger than $5,000. But, when determining the $5,000 limit, you can disregard any portion of a participant's account that was rolled into the plan from an IRA. And you can provide participants with the same distribution notices and forms.

If the vested account is more than $5,000, participants can leave the money in the plan and the account will continue to grow tax-free. Participants don't have to pay taxes on the money. Plans generally charge a fee for keeping a terminated employee's account balance open, and may restrict a participants' ability to transfer money among the plan's investment options. Your distribution notice should indicate that plan fees and investing flexibility may

differ if the participant chooses to roll the account into an IRA or another employer's plan.

Plans generally allow terminated employees to take a lump sum distribution, but the participant will owe at least 20% automatic withholding tax on the distribution. Generally, participants should consider this option only if there is a financial emergency.

Employers' options

Deciding what to do with terminated employees' account balances can be complex. When drafting or revising your plan document, consider the following:

Plan provider costs. Plan providers can base fees on total plan assets, the number of participants, the average account balance or a combination of these. If fees decrease as plan assets increase, design the plan to minimize distributions to terminated participants. But if fees increase as average account balances decrease, and many of the terminated participants have smaller account balances, then consider designing the plan to expedite distributions as soon as possible.

Participant disclosure requirements. Government regulations, such as ERISA and Sarbanes-Oxley, require plan sponsors to annually provide several disclosures to participants — including former employees with account balances. These disclosures include participant statements, changes in providers or investments offered, the summary plan description (SPD), the summary annual report, blackout notices, and notice of submission to the IRS. By drafting your plan document to allow for immediate distributions, you can minimize the burden of providing these disclosures to former employees with account balances.

IRS disclosure requirement. Plans that retain former employees' account balances must annually file Form 8955-SSA directly with the IRS. The form lists the name, Social Security number and vested account balance for terminated employees.

The IRS gives the information to the Social Security Administration so it can notify Social Security recipients that they may also be entitled to additional benefits from a former employer's retirement plan. In addition to reporting participants when they terminate, plans must report when terminated participants receive a distribution.

Timing the distribution. When drafting or reviewing your plan document to meet your specific needs, consider timing forced distributions to coordinate with the record keeper's processing deadlines. For example, many plans provide that participants are eligible to take distributions as soon as possible following termination of employment, but some record keepers are set up to process the distributions only quarterly, semiannually or annually.

Getting it right

Be sure to check your plan document for the rules pertinent to your plan. Getting the payout right can avoid extra costs for the plan.

2012 vs. 2011 retirement plan limits

TYPE OF LIMITATION	2011	2012
Elective deferrals for 401(k), 403(b), 457(b)(2), 457(c)(1) plans	$ 16,500	$ 17,000
Annual benefit for defined benefit plans	$195,000	$200,000
Contributions to defined contribution plans	$ 49,000	$ 50,000
Contributions to SIMPLEs	$ 11,500	$ 11,500
Contributions to IRAs	$ 5,000	$ 5,000
Catch-up contributions to 401(k), 403(b), 457(b)(2), 457(c)(1) plans	$ 5,500	$ 5,500
Catch-up contributions to SIMPLEs	$ 2,500	$ 2,500
Catch-up contributions to IRAs	$ 1,000	$ 1,000
Compensation for benefit purposes for qualified plans and SEPs	$245,000	$250,000
Compensation for SEP coverage	$ 550	$ 550
Highly compensated employee threshold	$110,000	$115,000
Social Security taxable wage base	$106,800	$110,100

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    - ESOPs and ownership succession planning and implementation
    - Assisting fiduciaries to reduce liability and comply with legal requirements
    - Transitioning benefit plans in mergers and acquisitions
- Tax and Business Planning/Corporate and Business Representation
- Business Mergers and Acquisitions
- Tax and Regulatory Dispute Resolution
- Trusts, Estate Planning and Probate
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- Entity Formation and Counseling, including non-profits and private foundations

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M&J is committed to continuing its tradition of delivering personalized legal services by working together to provide effective solutions for its clients.

W. Terence Jones has over 30 years experience in benefits and corporate matters. He received his B. A. from Yale University and received his law degree cum laude and a Master in Laws (in Taxation) from Boston University School of Law. He may be reached at **tjones@maselanjones.com** or 617-310-6565.