june/july 2009

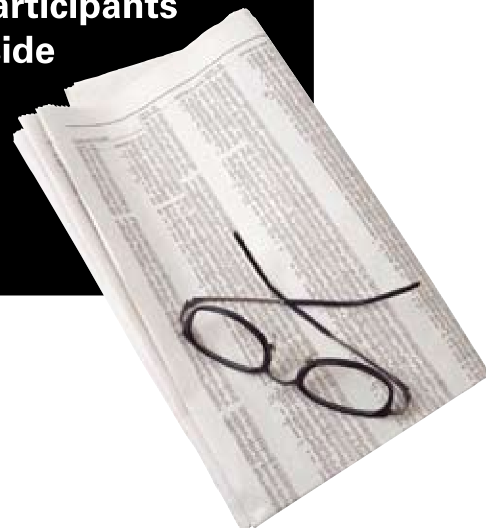
401(k) match suspensions

What does it mean to sponsors and plan participants?

What you can do when participants really need their money

"Waiving" bye-bye to 2009 RMDs

Remind your participants about the upside of investing



401(k) match suspensions

WHAT DOES IT MEAN TO SPONSORS AND PLAN PARTICIPANTS?

Many companies have felt their budgets tightening in this economy. One way to shore up your firm's budget is to suspend your 401(k) matching dollars. What implication does this hold for plan sponsors and participants? Let's explore this option.

Matching contributions 101

Used as a staff retention tool, 401(k) plans are where employees often look for the "free money" that such plans provide them in the form of a company match or profit sharing. Employers generally deposit matching contributions as a payroll deposit directly with the 401(k) deferrals or as an annual or quarterly contribution to the plan. The employer benefits from these contributions because it can deduct them on its corporate tax return.

In the event you want to suspend a match, you're free to do so at any time in a traditional 401(k) plan.

Employers can design conditions for receiving the matching contribution as a part of the plan. For example, you can set a specific number of hours worked or certain percentage of deferral contribution (the money the employee contributes) to participate. You can subject the contributions to a vesting provision that allows employees the right to earn a certain percentage of the money after a specified number of years of service. A common vesting schedule is a six-year graded formula where employees vest in 20% increments each year to 100% after six years of service.

Your plan document will most likely have two options for matching contributions:

1. A fixed match with a specified formula in which the employer commits to providing the matching contributions for the employees, or
2. A discretionary formula that allows the employer to pick and choose the amount given each year (normally on an annual basis), with no specific formula written into the document.

If the matching formula is fixed, employers must provide the amount of the match to employees in the summary plan description. You can communicate information about a discretionary match formula by a memo or other means of communication to the employee.

Suspending the match

If you're thinking about suspending your company's matching contribution, your considerations will vary depending on the type of retirement plan you have:

Traditional 401(k) plan. If you want to suspend the match, you may do so at any time in a traditional 401(k) plan. Don't forget about your plan document. If your plan contains a discretionary formula, you're

not required to change your plan document, even if you want to stop the funding during the plan year. A fixed formula requires a plan amendment.

Regardless of whether an amendment is needed, notify employees. You can do this using e-mail or another form of employee communication. Make sure your corporate resolution or other minutes making the change become part of the company records.

Safe harbor 401(k) plan. You can discontinue safe harbor 401(k) contributions if you notify participants 30 days in advance of the discontinuance and meet other requirements, such as document amendments. This allows plan sponsors to know they aren't locked into a formula for the entire year and it gives the option of returning to the safe harbor in the future. Give employees the choice of changing or reducing their deferral elections. This election may require a plan amendment.

Instead of a matching contribution, some safe harbor plans use an employer profit sharing contribution. You cannot suspend these amounts midyear. Plans generally fund these contributions annually. In this case, follow the "maybe" approach: The employer has 30 days before the end of the plan year to determine if the safe harbor nonelective contribution can be made.

SIMPLE 401(k) plan. If your SIMPLE 401(k) plan uses the IRS model form as a plan document, IRS regulations state that you shouldn't change the matching contributions midyear. Consult a benefits professional when considering reducing matching contributions in a SIMPLE plan.

How suspending matching contributions affects testing

There are certain tests required by the IRS each year that 401(k) plans must pass; otherwise, the employer must modify the plan to maintain its tax qualified status. Regular 401(k) plans require that certain tests be performed on the matching contributions. If you suspend your matching contributions, the requirements for these tests are eliminated.

Safe harbor and SIMPLE 401(k) plans are deemed to pass certain tests automatically. If you eliminate the matching contribution, these plans take on the character of regular 401(k) plans and your plan will then have to pass specific IRS tests. Additionally, if any matching contributions were made into a safe harbor or SIMPLE 401(k) plan that was subsequently converted to a regular plan, these contributions are subject to testing that the plan may not have been subject to.

Consult your employee benefits specialist to find out more.

Reinstating the match

You can reinstate the contributions for a regular 401(k) plan at any time. If your plan had a fixed matching formula, amend your plan document accordingly and provide a notice to your employees. Reinstate SIMPLE and safe harbor 401(k) plan matches at the beginning of a plan year. These plans also require specific notice requirements in advance of the plan year that you're going to fund.

Finding balance

Although unfortunate to plan participants, plan sponsors may find it necessary to suspend an employer sponsored contribution for an upcoming plan year. Don't forget: You can reinstate these contributions when your bottom line isn't so tight.

Upcoming compliance deadlines: July 31

- Form 5500 is due, or a request for an extension on Form 5558
- Form 5330 to report excise tax on prohibited transactions
- Summary of material modifications is due to participants (210 days after end of plan year)

What you can do when participants really need their money

Money isn't locked away as tightly within their retirement accounts as plan participants think it is. They can take a few different routes to gain access to the money in their account before the age of 59½, while still actively participating in the plan. Two of the most convenient are participant loans and hardship withdrawals.

Participant loans

Because participant loans aren't considered taxable distributions, they're an excellent way for participants to take money out of their accounts without incurring tax liability. However, participant loans aren't a required plan provision, so not all plans have them available. Check your plan document before discussing the possibility with any of your participants.

Even if your plan has a provision for participant loans, you'll need to make sure that a loan isn't considered a prohibited transaction, and thus a taxable transaction for the participant and the plan. To do so, your plan provision must make sure loans are:

- Available to all participants and beneficiaries on a reasonably equivalent basis,
- Not made to highly compensated employees in an amount greater than the amount available to other employees,
- Made in accordance with specific plan provisions,
- Charged a reasonable rate of interest (consistent with interest rates charged by commercial lenders for a loan made under similar circumstances),
- Repaid within five years unless the loan was made for the purchase of a principal residence,
- Paid at least quarterly with a substantially level amortization of principal and interest, and
- Adequately secured.

To remain a nontaxable distribution, the rules limit the loan to a set dollar amount. It must be equal to the lesser of:

1. $50,000 reduced by the highest outstanding balance of loans during the one-year period ending on the day before the date a loan is to be made less the outstanding balance of loans on that date, or
2. The greater of $10,000 or one-half of the vested accrued benefit.

Finally, to make sure your participant loans aren't converted into a taxable distribution, they must be in a legally enforceable agreement.

Hardship distributions

Hardship withdrawals are also an optional plan feature that allows participants to withdraw money from the plan. But hardship distributions must come from employee contributions only and are subject to ordinary income tax as well as the 10% additional income tax on distributions before age 59½.

A distribution is viewed as made because of a hardship if it meets one of two tests: the events test or the needs test. The regulations provide for two different ways to meet these tests: the safe harbor standard and the general standard (sometimes referred to as the facts-and-circumstances standard). The same standard doesn't need to be used to meet both tests.

1. Events test. This is met if the need is due to an immediate and heavy financial need. It's satisfied under the safe harbor standard if a distribution is made for any of the following reasons:

- Certain medical care expenses,
- Costs related to the purchase of a participant's principal residence (not including mortgage payments),
- Payment of certain education related expenses for the participant or the participant's spouse, children or dependents,
- Payments necessary to prevent eviction or foreclosure on the participant's principal residence,
- Payments for burial or funeral expenses for the participant's deceased parent, spouse, children or dependents, or
- Certain expenses for repairing damages to the participant's principal residence.

2. The needs test. This is met if the distribution is necessary to satisfy a need. It's satisfied under the safe harbor standard if the participant has obtained all distributions (other than hardship) and all nontaxable loans from all plans maintained by the employer. Also, the participant cannot make contributions to the plan and all other plans maintained by the employer for at least six months after he or she receives the hardship distribution. This six-month suspension may be a deterrent in using this safe harbor standard.

The general standard may also be used for both the events and needs tests and is more flexible, but requires much more documentation and intrusiveness. It also doesn't give the qualification assurance that the safe harbor standard gives. Each plan sponsor must decide which standard works best for them.

Your call

While it's always best for participants to leave their money growing in their retirement plan, some circumstances may require tapping into this resource. Having the option in your plan is up to you. Speak with your employee benefits specialist to determine whether these options are right for you and your participants.

“Waiving” bye-bye to 2009 RMDs

The economic downturn has impacted every facet of the American economic system, including retirement plans. At a time when account values are the lowest they’ve been in years, IRS rules force some participants to take a distribution under the required minimum distribution (RMD) rules. Many of those affected believe that, if the money were left in the account, it would have a chance to recover some of its lost value when the economy turns around and stocks make up some of their lost ground.

With this in mind, late last year the Worker, Retiree, and Employer Recovery Act of 2008 became law. What does this mean for your participants and RMDs? Here’s what you need to know.

What’s the law?

RMDs generally are minimum amounts that a retirement plan account owner must withdraw annually starting with the year that he or she reaches 70½ years of age or, if later, the year in which he or she retires. However, if the retirement plan account is an IRA or the account owner is a 5% owner of the business sponsoring the retirement plan, the RMDs must begin once the account holder is age 70½, regardless of whether he or she is retired.

Section 201 of the act waives any required minimum distributions for 2009 from retirement plans that hold each participant’s benefit in an individual account. This includes 401(k) plans, 403(b) plans and certain 457(b) plans.

As a result of the act, most participants and beneficiaries otherwise required to take minimum distributions from these types of accounts aren’t required to take a distribution in 2009. Those participants who turn 70½ in 2009 can defer their first distribution until April 1, 2010.

Keep in mind that the act didn’t waive any 2008 RMDs, even for those individuals who turned 70½ in 2008 and were able to defer taking their first distribution until April 1, 2009. The IRS encouraged all financial institutions to inform those in such a position that they were still required to take the distribution by April 1, 2009. Check with your investment provider to make sure this was made clear to your affected participants.

How are distributions affected?

Under the act, a beneficiary receiving distributions over a five-year period can waive the 2009 distribution. This effectively means that the beneficiary will be receiving the distribution over a six-year period instead of a five-year period.

In addition, certain types of 2009 distributions that would have otherwise been RMDs may be considered as an eligible rollover distribution (ERD) for 2009. For example, if a participant was scheduled for an RMD distribution, but the plan didn’t make it because of the waiver, the participant can choose to consider the distribution an ERD and roll the money over into another qualified retirement plan.

What amendments are needed?

Keep in mind that you must amend your plan to add language reflecting the 2009 RMD waiver. Under the act, an employer has until the last day of the 2011 plan year to amend the plan for the 2009 RMD waiver provisions.

However, governmental plans have until 2012.

What actions should you take?

So, what should you do for participants whose distributions are affected by the 2009 RMD waiver? Right now, there’s no clear answer or guidance from the IRS about how a plan should handle distributions impacted by the waiver.

Here are a few potential routes to follow:

1. Make distributions according to previous elections, notwithstanding the RMD waiver. For example, if a participant had previously elected to receive installment payments and the installments satisfy the RMD requirements and aren't a series of substantially equal installments, the plan could continue to follow these instructions. But advise the participant that the distribution isn't considered an RMD for 2009 and that the participant may be able to roll over the amount into another qualified retirement plan to avoid taxable income.

2. Suspend all RMDs for 2009. The upside to this route is that it avoids the issue of potentially distributing money that isn't eligible for rollover under the long-term installment payment exception. This approach requires notification to the participant of the 2009 RMD waiver provisions, which may increase necessary correspondence and recordkeeping. The plan also risks alienating a participant who is relying on the distribution in 2009.

3. Let the participant choose whether or not to take a distribution of the 2009 RMD amount. Although this route is the most participant friendly, it also requires notifying all participants of the waiver provisions and providing them with an election form. The plan will have to establish a default provision to either make or suspend the distribution if a participant doesn't return the election form.

Make your decision

For participants who felt they were unfairly impacted by being forced to take an RMD during this time of economic downturn, the IRS responded. Now plans must determine how they will handle the response.

Remind your participants about the upside of investing

It's fair to say the economy is in upheaval and the stock market has been volatile in the past year. Although some participants may believe it's time to get their money out of your company's 401(k) plan and head for the hills, they'd be missing the bigger picture. Here are a few ideas that may help quell the participant nervousness.

Stocks on sale. Consider that stocks are near their lowest point in years. While this may have hurt participants' account values, remind them that this is an opportunity to buy shares at a discounted rate compared to just a year ago. In other words, stocks are on sale and participants will get more shares for less money. Shares will recover as the market recovers, leaving participants with more shares in their account and ultimately, more money.

Recovery on the way. Participants over the age of 50 may wonder how they're supposed to retire in a few short years if their account value is now significantly lower than what it was a year ago. The answer isn't to take their money out and put it into a savings account earning 3% interest. The market fell hard in 2001 and recovered by 2005. Although past performance doesn't guarantee future results, there's no reason to think that a similar recovery isn't ahead that will beat a 3% return.

Catch-up contributions. Remind those over the age of 50 that they're eligible to make additional catch-up contributions to help keep their account balance growing, even during a down time. And remember, the more cash they're contributing, the more of those "on sale" shares they'll get to purchase.

In turbulent times, it's sometimes hard to keep your eye on the future. Although the stock market is still lower than it was a year ago, a continued investment now could pay big dividends down the road.

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2009 EBUjj09