BENEFIT PROFESSIONALS, INC.

Building a better future, together.

P.O. Box 1789
302 East Main Street
Albertville, AL 35950
(800) 545-6741

This Issue

Correcting missed matching contributions

The 2013 Employee Plans Compliance Resolution System (EPCRS) introduced a number of changes, including a change in the procedure for correcting missed matching contributions. Specifically, the correction is for situations in which an employee was improperly excluded from making deferrals in a non-safe-harbor plan and did not receive the matching employer contribution on the missed deferrals.

New correction option.

The procedure for calculating the missed employer matching contribution has not changed. However, the corrective contribution is no longer required to be a *qualified* nonelective contribution (QNEC), which is always 100% vested. The new procedure permits the employer to make a corrective nonelective contribution that is subject to the vesting schedule that applies to the employer's matching contributions.

Two corrective contributions.

If a plan sponsor that matches employee deferrals happens to exclude an employee from the plan or fails to implement an employee's deferral election (pretax or Roth), the appropriate correction is to make a matching contribution based on the full deferral amount that should have been withheld from the employee's wages, plus earnings.

The plan sponsor must also provide a corrective contribution for the *missed deferral opportunity*. The missed opportunity contribution must be 50% of the amount that should have been withheld, plus earnings, and it must be 100% vested.

Example 1: John's bonus of $10,000 was incorrectly excluded from deferrals. John's deferral rate is 10%, and the plan's matching formula is 100% of deferrals up to 6%, so John missed deferring $1,000. Under EPCRS, John's employer must make a QNEC of $500 ($1,000 x 50%) plus earnings (100% vested) to remedy the missed deferral opportunity and a corrective employer nonelective contribution of $600 ($1,000 x 6%) plus earnings to remedy the missed match.

Example 2: Jane was mistakenly excluded from the plan for one year. Her compensation for the year was $40,000, and the plan's matching formula is 100% of deferrals up to 6%. The deferral rate is 4%,* so Jane missed deferring $1,600. Under EPCRS, Jane's employer must make a QNEC of $800 ($1,600 x 50%) plus earnings (100% vested) to remedy the missed deferral opportunity and a corrective employer nonelective contribution of $1,600 ($40,000 x 4%) plus earnings to remedy the missed match.

If an eligible employee is excluded from deferring for a short period and there are still nine months of the plan year left, no correction is required for the missed deferral opportunity. However, the rule doesn't apply if the eligible employee would have received a match on his or her deferrals. The missed match plus earnings must be corrected even for short periods.

* Determined by the plan's actual deferral percentage (ADP) test

Tips on selecting target date funds

In response to the growing popularity of target date funds (TDFs), the Department of Labor (DOL) recently published guidance* through the Employee Benefit Security Administration (EBSA) to help plan fiduciaries select and monitor TDFs (and other investment options) in 401(k) and similar participant-directed individual account plans.

Target date funds are long-term investments that typically include a mix of equities, bonds, and other investments. A fund's "target date" is the approximate date the fund's investors expect to retire. Over time, a TDF's investment mix changes, becoming more and more risk averse (i.e., more and more conservative).

A popular choice

TDFs are an easy way for participants to "set and forget" their retirement investments. They select one fund and it changes over time. In addition, plan fiduciaries often choose target date funds as a qualified default investment alternative (i.e., an automatic default investment for participants who fail to make their own investment elections).

Many investment providers offer TDFs. And while there are many different funds with the same target date (e.g., "Portfolio 2020" or "Portfolio 2030"), there can be considerable differences between them due to fees, investment strategies, and "glide paths." Glide path is the term for the sloping line on a chart that shows how a TDF's asset mix changes over time from equities to more conservative investments, such as bonds and cash alternatives. Plan fiduciaries need to make sure they understand the many differences between TDFs.

Comparing and selecting

The EBSA guidance urges plan fiduciaries to establish an objective process for evaluating a TDF to ensure that it is a prudent plan investment option. An understanding of the plan's participant population (salary levels, turnover rates, ages, likely retirement dates, contribution rates, withdrawal patterns, and whether a defined benefit plan is available) will help fiduciaries evaluate whether a current or prospective TDF is appropriate.

The guidance also mentions that there are a growing number of commercial sources of information and services to assist plan fiduciaries in reviewing and selecting investments.

Investments and glide path

Fiduciaries should read the TDF's prospectus and understand the strategies and risks of the fund or of any underlying asset classes or investments that are held in the TDF. Fiduciaries also need to understand the glide path and identify when the point of "least risk" is achieved. If a TDF uses a "to retirement" glide path, the fund reaches its most conservative asset allocation *at* the target date. If the TDF uses a "through retirement" glide path, the fund reaches its most conservative asset allocation *after* its target date.

According to the DOL, TDFs with a "to" glide path may be more suitable for plans whose participants typically withdraw their account balance from the plan when they retire. TDFs with a "through" glide path would be more appropriate for plans whose participants generally do not plan to withdraw their funds at retirement (other than required minimum distributions or as installments).

Fees and investment expenses

TDF costs can vary significantly, in both the amount and type of fees. Plan fiduciaries must have an understanding of a TDF's fees and expenses, as well as the fees and expenses that apply to any underlying funds plus possible sales loads. If the expense ratios of the individual funds that comprise the TDF are substantially less than the TDF's overall expense ratio, fiduciaries should find out what services and expenses account for the difference.

The added expenses may be for asset allocation, rebalancing, and/or access to special investments that can smooth returns in uncertain markets. And the extra costs may be worth it. It's important for fiduciaries to ask — and to become familiar with this type of information.

Custom and non-proprietary options

There's an alternative to "prepackaged" TDFs from investment providers. The DOL suggests that plan fiduciaries at least inquire about the availability of custom or non-proprietary TDFs. Although they may not be appropriate for every plan, custom TDFs can incorporate a plan's existing investments into the fund. Another benefit

(continued on Page 3)

(Continued from Page 2)

is that non-proprietary TDFs include funds managed by different investment providers, which can help improve diversification. Of course, special administrative costs and processes that are associated with these types of TDFs must also be considered.

Employee communications

Under the new fee disclosure rules, fiduciaries are required to provide participants with information about all the plan's investments, including TDFs. Participants may benefit further from receiving information about TDFs in general. Note that the DOL is developing new disclosure rules specifically for target date funds.

Periodic review

Plan fiduciaries are required to periodically review a plan's investment options (at least once a year) to ensure the investments should continue to be offered. A change in a TDF's investment strategy or management team, or a change in the plan's reasons for offering a TDF, could result in the TDF being replaced with a different investment. Plan fiduciaries should always document the investment selection and review process, including how decisions about individual investment options were reached.

- "Target Date Retirement Funds — Tips for ERISA Plan Fiduciaries" is available at *www.dol.gov/ebsa/pdf/fsTDF.pdf*

Hardship distribution to pay casualty loss

For participants to be eligible for hardship distributions from their 401(k) plans,* there must be an immediate and heavy financial need. An increase in natural disasters may lead to more requests for hardship distributions to cover the damages that result.

The IRS outlines six safe harbor reasons that meet the hardship withdrawal requirements. This article focuses on the "casualty deduction" reason.

Becoming more common

Plan administrators and participants are generally least familiar with the casualty deduction reason (added by the final 401(k) regulations that generally became effective in 2006). Given that hardship withdrawals for casualty deduction reasons may become more common, it's important that plan administrators understand the various types of situations that can be considered a casualty for hardship withdrawal purposes.

Definition in the final regs

The final 401(k) regulations define the casualty deduction reason as: "*Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under Section 165 (determined without regard to whether the loss exceeds 10% of adjusted gross income).*"

The parenthetical is important because when a taxpayer files for a casualty deduction on his or her federal income-tax return, the casualty amount must exceed 10% of the taxpayer's adjusted gross income, whereas there is no such threshold for a hardship distribution.

If a participant wishes to take a distribution from a qualified plan (e.g., a 401(k) plan), the participant must have a distributable event. If a distribution occurs without a distributable event, the plan could be disqualified by the IRS. Thus, it is important for the plan administrator to ascertain whether there is a distributable event. In the case of a casualty hardship, the plan administrator must understand what constitutes a casualty under Section 165.

(Continued on Page 4)

(Continued from Page 3)

IRS casualty rules

According to the IRS,** a casualty is *“the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual. A sudden event is one that is swift, not gradual or progressive. An unexpected event is one that is ordinarily unanticipated and unintended. An unusual event is one that is not a day-to-day occurrence and that is not typical of the activity in which you were engaged. Generally, casualty losses are deductible during the taxable year that the loss occurred.”*

** IRS Publication 547, “Casualties, Disasters, and Thefts” at *www.irs.gov/pub/irs-pdf/p547.pdf* provides an explanation of “casualty.”

A critical criterion to look for when reviewing a hardship withdrawal request due to casualty loss is whether the event was sudden, unexpected, or unusual. The loss of property due to “progressive deterioration” does not qualify. Examples of progressive deterioration include termite damage or a roof that has leaked over time and must now be replaced.

Another important requirement is that the damage must be to the participant’s principal residence. It is not uncommon for participants to attempt to request a hardship withdrawal due to damage to a vacation or rental home.

Deductible and nondeductible losses

Deductible casualty losses can arise from the following types of occurrences: storms, including hurricanes and tornadoes; terrorist attacks; floods; earthquakes; fires, unless set by the participant or someone acting for the participant; government ordered demolition or relocation of a home due to a disaster; vandalism; shipwrecks; and volcanic eruptions.

Nondeductible losses that do not qualify for a hardship withdrawal include progressive deterioration, such as the steady weakening of a building due to normal wind and weather or the damage or destruction of trees, shrubs, or other plants by fungus, disease, insects, worms, or similar pests. However, sudden destruction due to an unexpected or unusual infestation of beetles or other insects may result in a casualty loss.

Hardship rules expanded

Congress often expands participant loan and hardship provisions following major storms. Hardship rules were expanded for hurricanes Katrina, Wilma, and Rita and the severe storms that hit the Midwest.

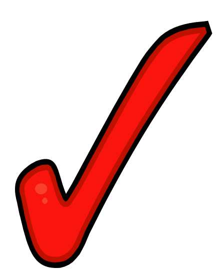
Although Congress did not expand the hardship or plan loan laws for Superstorm Sandy, the IRS temporarily expanded hardship withdrawals in certain situations. Specifically, from October 26, 2012, to February 1, 2013, hardship withdrawals were made available to certain family members who had relatives whose primary residence or place of employment was in an area affected by Sandy. For example, a grandparent living in Hawaii was permitted to request a hardship withdrawal from his or her retirement plan account to assist a grandchild who lived in Seaside Heights, NJ.

In the event of a disaster situation, the IRS’s webpage — Tax Relief in Disaster Situations at *www.irs.gov/uac/Tax-Relief-in-Disaster-Situations* — is the best source for updates about disaster relief that may impact retirement plans.

* Hardship withdrawals are an optional plan feature.

RECENT developments

401(k) compliance check questionnaire



A final report has been published summarizing the results of the Section 401(k) Compliance Check Questionnaire Project.

The key objectives were to measure the health (overall compliance levels) of 401(k) plans, identify the principal tax compliance issues affecting 401(k) plans, evaluate the effectiveness of the voluntary compliance programs and tools under the Employee Plans Compliance Resolution System (EPCRS), and determine how the IRS can foster greater compliance. The final report also includes stratified data highlighting differences in the results based on plan size/number of participants. The report can be accessed at *www.irs.gov/pub/irs-tege/401k_final_report.pdf.*

(Continued on Page 5)

(Continued from Page 4)

403(b) preapproved plan document program

The final 403(b) regulations required virtually all 403(b) plan sponsors to adopt a written plan document by the end of 2009. At the time, the IRS committed to developing a 403(b) preapproved document program. Earlier this year, the long-awaited guidance was issued along with draft document language for the program (which includes prototype and volume submitter documents). The guidance includes the program's requirements, the procedures for applying for opinion and advisory letters, and the conditions under which an eligible employer that adopts a preapproved 403(b) plan will have reliance on the document.

The program will be part of the six-year cycle that preapproved defined contribution and defined benefit programs use. The general time frame for the first preapproved document was included in the guidance: Document drafters will have until April 30, 2014, to submit a 403(b) document to the IRS for review and the IRS review period will be one to two years. Plan sponsors will then have a period of time — expected to be one to two years — to adopt the new preapproved plan.