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THE INSIDER'S GUIDE TO PLAN DESIGN, ADMINISTRATION, FUNDING & COMPLIANCE

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IRS also wrestles with complexity of contribution limits

The IRS actively promotes better understanding of plan compliance through plan specific Web sites (*www.irs.gov/ep*) and periodic e-mail newsletters, such as *Retirement News for Employers* (subscriptions for this newsletter are available at the EP Web site). The most recent issue of *Retirement News for Employers* is the winter 2008 issue. The opening article of the winter issue provides guidance to employers on contribution and deduction limits for various types of retirement plans. We noted an error in the contribution limits that just might help demonstrate how complex plan administration can be for both employers and the IRS.

The IRS newsletter states, "Maximum contribution [for profit-sharing and money purchase pension plans] is the *smaller of 25 percent* [italics added] of an employee's compensation that does not exceed $225,000, or $45,000. Maximum deduction is 25 percent of all participants' compensation that does not exceed $225,000."

As practitioners know, this 25 percent contribution limit now only applies to Simplified Employee Pensions (SEPs), not qualified plans. For qualified plans the individual contribution limit—the total annual additions that may be allocated—is the lesser of 100 percent of pay or $45,000.

We will bet that the IRS has caught what was probably a typographical error by the time you read this, but for those of you in the middle of plan administration season and wrestling with the complexity of the Code, we thought you would appreciate reading this. ❖

Sixth Circuit decision foreshadows Supreme Court holding

We have previously noted that the Supreme Court is currently considering the appeal in *Larue v. Dewolff*, which presents the issue of whether a plan participant can bring an action to recover losses attributable to his individual plan account that were caused by a breach of ERISA fiduciary duties. In *Tullis v. UMB Bank*, the Court of Appeals for the Sixth Circuit considered the same issues and issued a decision resoundingly in favor of the plan participants.

David Tullis and Michael Mack were two physicians who had plan accounts in a 401(k) plan sponsored by a Toledo clinic. They chose an investment advisor for their accounts that was subsequently hit with an SEC restraining order due to fraudulent activities by two of its brokers. Tullis and Mack contended that UMB Bank, the plan trustee, knew of the fraud but failed to inform them. The bank eventually sued the investment advisor over its activities but did not tell Tullis and Mack about that either. In addition, the bank continued to accept and honor "allegedly forged investment directives" from the advisor without consulting or warning the doctors. When the dust finally settled, Tullis alleged that his plan account had lost almost $600,000, and

continued on page 8 ➤

Fixing plan failures with retroactive amendments

By Gregory E. Matthews, CPA, and Martin J. Burke, Esq.

An operational failure will occur when the plan's operation does not follow the terms of its plan document. It is an event that frequently harms no employees, but must be corrected when discovered. When such an error occurs, the plan sponsor may ask if it is possible to amend the plan retroactively to reflect what actually occurred.

The answer to those plan sponsors is: "In some situations you can." For those situations, a correction using a retroactive plan amendment generally requires a submission to the Voluntary Correction Program (VCP) of the IRS's Employee Plans Compliance Resolution System (EPCRS) program. However, there are three types of operational failures that can be self-corrected through a retroactive amendment without a need to file under EPCRS. Self-correction is seen as a simpler and less costly procedure than making corrections under a VCP filing, which requires payment of a user fee and a formal EPCRS filing. Self-correction under the Self-Correction Program (SCP) of EPCRS is only available for correcting operational failures where either the failure is *de minimus* or the correction occurs within two years following the plan year in which the failures arose.

In general, a failure to follow a plan's terms is corrected by either fixing what was done in the plan's operation to match the plan's terms, or retroactively amending the plan to match the way the plan was operated. If the employer wants to self-correct, then it generally follows the first option. However, in three situations self-correction for failure is possible.

These three operational failures are listed in Revenue Procedure 2006-27, Appendix B, section 2.07. The correction must follow this guidance using the correction methods set forth in Appendix B. The three are: (1) correcting certain contributions made on compensation in excess of IRC § 401(a)(17) ($230,000 for 2008), (2) plan loans or hardship distributions made when the plan did not permit these benefit events, and (3) inclusion of an ineligible participant.

The first type of correction is for a defined contribution pension plan that allocates contributions (or forfeitures) on a participant's compensation that exceeds the limits of IRS § 401(a)(17). This error occurs when the employer fails to properly limit compensation in the contribution calculations. Under the correction, the affected participant's contribution must be recalculated using the correct compensation. Excess contribution amounts that result from the lower compensation for the employee are then allocated to the other employees. However, under a pension plan an allocation to the other employees is not permitted unless the plan is amended to allow a larger contribution for those employees. A retroactive amendment in that situation is permitted.

Of the three types of retroactive amendments, this is the least likely to be used. It only has application to a money purchase plan or other defined contribution pension plan where the excess cannot be allocated until the plan is amended to allow a higher contribution to the other employees.

The second permitted self-correction with a retroactive amendment is to fix an operational failure arising from making hardship distributions or plan loans to employees when the plan does not allow them to be made. This failure may be corrected by retroactively amending the plan to provide for the hardship distributions or plan loans

continued on page 8 ➤

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Retirement expectations and investment monitoring

By Kenneth Robertson, CIMA, CPC, CRA

Saving and investing have provided two big advantages in life: they reduce our consumption (thereby lowering our lifestyle expenditures), and they provide resources for future consumption (thereby helping us to achieve future lifestyle objectives). The first is as important as the second, as they both contribute to a smoothing of our lifetime consumption of goods and services. Humankind reacts with horror, depression, and gossip to changes that significantly reduce lifestyle consumption. In this election year, "seniors retiring with dignity" is a theme in the rhetoric of both parties. A major component of "retiring with dignity" is the relative continuity of lifestyle consumption (though it is just one component).

In other words, at some point in the future, one's retirement investments become a series of expenditures drawn from several sources that finance a lifestyle that is hopefully consistent with one's pre-retirement lifestyle. Accountants call such a stream of expenditures a liability stream, or more simply, liabilities.

This discussion may seem drawn out in making an obvious point, but if it is obvious, it hasn't made its way into how retirement portfolios in defined contribution plans are measured and evaluated. The emerging popularity of target-date portfolios has fiduciaries scrambling to figure out how to evaluate these complex portfolios, a discussion that is by no means settled. With the sole purpose of a participant's portfolio being to fund a stream of retirement liabilities, the success of the portfolio *has to be measured against how it is doing relative to the liabilities*.

What does "asset/liability evaluation" mean? Retirement liabilities are quite complex, so we will use a simple example (and even simplify its assumptions, not worrying about taxes and other real world concerns). Say I expect my daughter to start college in 2018. Today, I happen to have $172,150 saved up for her college education. I want her to be able to go to a private school, so I am planning on providing her $30,000 a year in today's dollars. College education costs generally rise between 5%–8% a year, so I am assuming a 7% inflation rate. From 2018–2021, I need to provide $59,015, $63,147, $67,566, and $72,295 (that's my liability stream).

Now I can buy four zero coupon Treasury bonds that mature in each of those years, providing the cash that is needed to fund my daughter's education. Let's say for each bond I get a 3.7% interest rate. If I buy the bonds today, I have a good chance of meeting my goal of funding my daughter's college education, *i.e.*, matching my liabilities. There is a word for this: immunization. An immunized portfolio, if possible, is the prudent choice—I may make more or less in the market, but I have met my objective. Of course, college inflation may alter things, but I can check on my portfolio periodically, fill in actual costs as they occur, and check to see where I am—taking further action, if needed.

This set of four zero coupon government bonds is my "liability portfolio": a group of zero coupon bonds that immunize my liabilities. My liabilities are also affected by what happens in the market; they can grow or shrink. Suppose I only have $72,150 to set aside for my daughter's future college expenses. Now I am "underfunded" because my liability portfolio is $100,000 greater than my investment portfolio. So I invest in a diversified portfolio of stocks and bonds pursuing a higher return. Now consider the scenarios in Table 1 (equivalents of both are not uncommon).

In the first scenario, my investment portfolio loses money but my liabilities have shrunk because of rising interest rates, so at the end of the year, my unfunded liabilities have been reduced by more than $17,000 after taking my loss into account. In the second scenario that market heated up and so did my investments, making a gain of 10%. Unfortunately, it heated up because of a drop in interest rates, and so my liabilities are also up by 12%. Now I am worse off, even after the gain, because my unfunded liabilities are more than $13,000 greater than I was at the beginning of the year. Perhaps when my daughter's college "investment committee" meets, we are sad in the first scenario, and joyful in the second—but if so, it is only because of ignorance of where we truly stand with respect to our expectations.

Is asset/liability evaluation for retirement expectations more complex than this? Yes, it's more complex, but the beginning is to understand its fundamental nature and importance. Do "liability portfolios" affect how a portfolio should be constructed? Yes. Do opportunities for partial immunization arise? Yes, and they often should be exploited.

Table 1

Return & Value of Investments ($72,150)	*Return & Value of Liability Portfolio ($172,150)*	*Unfunded Liabilities (–$100,000)*
–5% / $68,543	–12% / $151,492	$82,949
+10% / $79,365	+12% / $192,808	$113,443

continued on page 8 ➤

Q&A

Update on bankruptcy and plan benefits

From an interview with Richard Naegele, Esq.

It has been a little over two years since the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) applied to bankruptcy filings. That legislation contains a general exemption for retirement plan benefits that are in a plan that is tax exempt under Code §§ 401(a), 403(b), and 457(b). This month we have asked ERISA Specialist Richard Naegele, an attorney and shareholder at the law firm Wickens, Herzer, Cook and Batista Co. in Avon Ohio, to discuss the current status of creditor protections affecting employee benefits. He can be reached at RNaegele@wickenslaw.com.

Q Could you provide an overview of the creditor protection under BAPCPA?

A Effective for bankruptcies filed after October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005—we'll just call it the "Act"—provides specific protection under the Bankruptcy Code for tax-qualified retirement plans and for IRAs. We didn't have those protections under the bankruptcy code prior to the Act. We had a decision from the Supreme Court going back to 1992 in a case called *Patterson v. Shumate* that addressed this issue. In *Patterson*,the U.S. Supreme Court decided that benefits in "ERISA qualified plans" were excluded from a participant's bankruptcy estate. That means that these benefits are not included in the estate. You don't worry about whether something's exempt or non-exempt—it's just not part of the estate.

But since 1992, there have been a lot of decisions that have picked away at the *Patterson v. Shumate* decision. It was becoming unclear and somewhat complicated as to whether benefits under a qualified plan were protected in bankruptcy. IRAs really had no protection from bankruptcy other than state law. There was no federal law protection for IRAs. The Act created protections under Section 522 of the Bankruptcy Code. That section says that there's an unlimited dollar exemption for retirement assets described as being exempt from taxation under the Internal Revenue Code § 401(a) (for tax-qualified plans), § 403(b) (for tax-sheltered annuities), and § 457(b) (for deferred compensation plans available to tax-exempt and state and local government employers). Basically, if the plan was qualified under § 401(a), § 403(b), or § 457(b), then it fits within the protection of the Act, and that's an unlimited dollar protection.

Q Are there conditions on these bankruptcy protections?

A Yes, but they are pretty broad. Section 522 says that the plan has to be exempt from tax. Section 224 of the Act provides a pretty lenient rule on what that means. It says that, basically, if you've got a determination letter from the IRS, then there is a presumption the plan is exempt from tax. So, if the plan sponsor has requested and received an individual determination letter from the IRS, the benefits under that plan are presumed exempt. But many plans—probably 80+ percent of the plans in existence—do not request such an individual favorable letter of determination. For those plans, their bankruptcy status is unclear. Those are prototype and volume submitter plans that are pre-approved by the IRS, but are often not submitted to the IRS for an individual determination letter. It is still up in the air if that IRS pre-approval in the form of an advisory or opinion letter satisfies the determination letter requirement of the Act.

Clearly any plan with an individual ruling satisfies the requirement. Where bankruptcy protection is an important consideration, I would go and get an individual letter. The Act does say that if you don't have a letter, but the plan can be shown to be in substantial compliance with the Code, it's going to be considered to be exempt from tax. Finally, the Act says that even if the plan doesn't have a favorable ruling and it is not in substantial compliance, benefits will still be considered exempt for bankruptcy law purposes as long as the individual debtor in bankruptcy is not materially responsible for the non-compliance of the plan. So the Act gives you three bites at the apple to get excluded. I should note that there are some recent decisions that may affect the first threshold of this protection—having a favorable determination letter.

Q Are you recommending that your professional service employers with prototype and volume submitter documents file for a determination letter?

A I think it's a good idea; it is a safer way to go.

Q Are participant benefits rolled from a qualified plan to an IRA protected in bankruptcy?

A With the Act, we have good protection for rollover IRAs. In addition to protecting benefits from qualified plans under Sections 401(a), 403(b), and 457(b), rollover IRAs are provided with unlimited protection, just like qualified plans. SEPs and SIMPLEs also have unlimited protection; however, for traditional IRAs—those to which the individual has contributed outside of a plan—the contributory part of the IRA is protected up to $1 million.

Because different protections apply to rollovers and contributory IRAs, I think that it makes sense to have your rollover IRA in a separate IRA from your contributory IRA. Then, if someone does wind up in bankruptcy, we can point to the contributory IRA and say, "I have $1 million of protection on this account," and then point to the separate rollover account saying, "I've got unlimited protection over here." If you roll over money from the qualified plan into an existing contributory IRA, you now have a proof issue as to what's what, if the account is valued at more than $1 million.

Q Are there conditions on the protections for SEPs and SIMPLEs?

A As I mentioned, SEPs and SIMPLEs have unlimited protection in bankruptcy. But keep in mind, we have just been talking about bankruptcies. That means that the debtor either voluntarily or involuntarily is in bankruptcy, and there's a bankruptcy estate consisting of his or her assets. Thus, our question is whether something is exempt or included in the bankruptcy estate.

When we get outside of bankruptcy, we have different creditor protection issues. Qualified plans are still generally protected from creditors under ERISA and the Internal Revenue Code outside of bankruptcy by ERISA's non-alienation provisions. ERISA creditor protections do not apply to SEPS and SIMPLEs, which are basically IRAs. With IRAs, we have to look to state law to see whether those are protected from creditors outside of bankruptcy. This is normally decided by state law. Here there have been several decisions, most notably in the Sixth Circuit Court of Appeals, which is Michigan, Ohio, Kentucky, and Tennessee, which limit protections. In those decisions, the court said that SEPs and SIMPLEs are not protected outside of bankruptcy.

So we've got this bifurcation between being in bankruptcy and being subject to creditor claims outside of bankruptcy. When you are in bankruptcy, SEPs and SIMPLEs have unlimited protections; but outside of bankruptcy it's possible that an SEP or a SIMPLE might not be protected at all, depending on your residence. The issue of creditor protection of IRAs is a state law issue and varies from state to state.

Q Do the Act's protections continue to apply when IRAs are transferred to a beneficiary?

A That's a really interesting question. Had you asked me that a year or two ago, I would have said, "Sure, it shouldn't make any difference." Neither the Act nor the Internal Revenue Code draws a distinction between an IRA of the individual who has contributed to it and an inherited IRA. To me that says there *ought* to be no distinction between the two types of IRAs in bankruptcy. So if the individual in bankruptcy has an inherited IRA, there ought to be no distinction, and that IRA ought to be protected.

Now, having said that, there was a 2007 bankruptcy case in Texas called *In re Jarboe* that draws a distinction between an inherited IRA…and in that case they were drawing the specific distinction of a non-spouse beneficiary and other IRAs. The court looked at Texas law and said that under Texas law, IRAs inherited by non-spouse beneficiaries were not protected in bankruptcy. For technical reasons, most commentators think that the decision is incorrect.

Q Does this case have implications for IRAs in other states?

A Yes, let me explain. When somebody's in bankruptcy, they often have a choice that varies from state to state: they can pick the federal law protections or they can pick state law protections to establish what the exemptions will be. With the bankruptcy protection under the Act for qualified plans and IRAs, there's a specific provision called an "anti-stacking" provision. What that means is generally you're not allowed to take advantage of both the federal rules and the state rules for bankruptcy exemptions; you've got to pick one or the other. However, with respect to qualified plans, the Act specifically says that even if somebody elects the state law protections, they still get the federal law protections with respect to IRAs and qualified plans. In the *Jarboe* case, the bankruptcy court didn't look at any of the federal rules; they just looked at the state rules. For that reason, I think the case is incorrectly decided, because the court should have looked at the federal law protections.

Outside of bankruptcy, however, it looks like there's a real issue with certain inherited IRAs. If you've got a non-spouse inherited IRA and that non-spouse beneficiary with the inherited IRA is the debtor, it looks like, under Texas law, those assets are not going to be protected. There is also a smattering of pre-BAPCPA bankruptcy court decisions raising similar questions on certain inherited IRAs when somebody is not filed for bankruptcy. We have decisions in Wisconsin, Illinois, Alabama, California, and Oklahoma, all stating that under the state law creditor protection, IRAs inherited by non-spouse beneficiaries are not protected from creditors.

continued on page 9 ➤

IRS announces new compliance videos on its Web site

In its continuing efforts to provide educational materials to the retirement plan community, the Employee Plans area of the IRS Web site now includes several videos discussing topics relevant to qualified retirement plans and IRAs. Of the nine videos available, seven directly relate to qualified plan issues. Titles include *The Navigator—Navigating Employer Information on Retirement Plans, Maintaining Your Plan*, *Increasing Your Retirement Savings*, and *IRS Enforcement Priorities*. Other available videos address self-correction of plan mistakes, fixing mistakes discovered during an IRS audit, and stopping retirement plan abuses. The following link will take you to a list of all nine videos: *http://www.stayexempt.org/ep/stopping_abuses.html*.

These videos can be used in combination with the related Web page content at *www.irs.gov/ep* to provide employers and participants with useful information for meeting their retirement plan needs.

The IRS Employee Plans videos are hosted on *stayexempt.org*, the same Web site that hosts IRS.

Investment advisor pleads guilty to felonies involving 401(k) plan distributions

Gordon Moore, a 31-year-old investment advisor employed by AXA Equitable, has entered a guilty plea in Colorado state court to charges of felony theft, felony computer crime, and felony securities

Table 1

Video Title	***Description***	***Video Link on* www.irs.gov/ep *available at:***
Maintaining Your Plan	Tips on what employers/sponsors need to do to keep their retirement plan healthy (6:45 min.)	*Correcting Plan Errors* Web page
Self-Correcting Plan Mistakes	A discussion on using the Self-Correction Program for a common plan mistake (1:59 min.)	*Correcting Plan Errors* Web page
Fixing Plan Mistakes Found During an IRS Audit	IRS EP Examinations Director discusses what happens when EP agents find mistakes while examining retirement plans (4:45 min.)	*Correcting Plan Errors* Web page
Increasing Your Retirement Savings	A short discussion on Individual Retirement Arrangements (IRAs) as a tool to use in planning for retirement years (1:17 min.)	*Plan Participant/Employee* Web page; select “Resources for Retirement Plan Participant/Employee,” then “IRA Online Resource Guide.”
Managing Your IRA	A discussion on basic principals of investing (3:00 min.)	*Plan Participant/Employee* Web page; select “Resources for Retirement Plan Participant/Employee,” then “IRA Online Resource Guide,” then “Information About Traditional IRAs or Information About Roth IRAs.”
Starting an SEP or SIMPLE MA Plan	A discussion on two types of retirement plans (SEP and SIMPLE IRA) that are tailored for many small businesses (2:00 min.)	*Plan Sponsor/Employer* Web page; select “Types of Retirement Plans,” then “SEPs” or “SIMPLE IRAs.”
Stopping Abuses in Retirement Plans	IRS EP Examinations Director discusses stopping abuses in retirement plans (2:33 min.)	*Examinations/Enforcement* Web page; select “EP Abusive Tax Transactions.”
IRS Enforcement Priorities	IRS EP Examinations Director discusses 2008 Employee Plans Examination priorities (3:24 min.)	*Examinations/Enforcement* Web page; select “‘Critical Priorities’—EP Examination Priorities/Goals.”

fraud. The Colorado Attorney General alleged that Moore had contacted more than 100 Colorado school teachers in 11 school districts and persuaded them to transfer funds held in a 401(k) plan sponsored by a Colorado public employees' association into different accounts at AXA. These distributions totaled $1.7 million and violated IRS rules regarding participant eligibility to take such distributions. The charges also alleged that Moore forged participant signatures on distribution paperwork stating that the teachers had terminated their employment with the school districts. The scheme unraveled when plan officials discovered improper plan distributions. AXA is reportedly cooperating with the plan to recover the improper distributions. Meanwhile, Moore could receive up to 30 years when the court sentences him in late February.

At recent benefit meetings, practitioners have discussed a pattern of abusive "marketing" schemes that encourage plan sponsors to add an in-service withdrawal feature to their plans. Then the advisors assist the participants eligible for the in-service distribution to roll the plan payments into an IRA with higher than normal commissions. In at least one case discussed, the IRA brochure said the investment was not suitable for a plan investment. Fiduciaries are cautioned that while in-service distributions are a permitted option for certain types of accounts, a fiduciary should not facilitate the distribution of accounts for the purpose of transferring to a special type of investment.

Plan sponsor repays plan due to investment advisor's actions

According to a Department of Labor (DOL) press release, the owner-operator of an architectural firm in Salem, NH, has agreed to repay $100,000 to the company's

The DOL has sent "a clear message that employers and plan trustees cannot neglect their fiduciary obligations to oversee the handling and investment of plan assets."

profit-sharing plan. The DOL filed a lawsuit against the owner in 2006, alleging that he violated ERISA when he failed to provide adequate monitoring and control of the activities of the plan's financial advisor—Bradford Bleidt and his companies. The owner also failed to obtain the required bond to protect the plan's assets. Bleidt provided investment and financial management services to the plan for several months in 2004. During that period, he used plan assets for his own benefit and was convicted in 2005, receiving a sentence of 11 years. According to an official with the DOL's Employee Benefits Security Administration, the DOL has sent "a clear message that employers and plan trustees cannot neglect their fiduciary obligations to oversee the handling and investment of plan assets." In addition to the $100,000 payment to the plan, the owner agreed to pay a civil penalty of $10,000, to resign as the plan trustee and fiduciary, and to retain a disinterested institutional trustee to serve as plan fiduciary.

Plan trustee's suit against John Hancock survives motion to dismiss

John Hancock Life Insurance Co. has joined the growing ranks of providers of plan investments forced to defend a lawsuit challenging their fee practices. Hancock failed to persuade a federal district court that it was not a fiduciary.

The suit was brought in the Massachusetts district court by John Charters, the trustee of a 401(k) plan that purchased a group annuity contract from Hancock. Among the fees Hancock charges is an "administrative maintenance charge" for each subaccount that holds plan assets under the contract. These charges ranged as high as 50 to 75 basis points. Charters contends that the only service that Hancock performs regarding the subaccounts is to purchase mutual fund shares and that the administrative maintenance charges were excessive. In addition, Charters argues that Hancock failed to offset these charges with the full amount of revenue sharing payments that Hancock received from the mutual fund companies, as required by the contract.

Hancock argued that it was not an ERISA fiduciary to the plan because it does not exercise discretionary authority or control over the disposition of plan assets. The district court judge refused to dismiss the lawsuit on that basis, however. He noted that Hancock had the right to substitute shares of another mutual fund or investment with similar investment objectives for each subaccount. He concluded that a "fact finder could reasonably determine that such an arrangement gives Hancock authority or control over the disposition of Plan assets." The judge also explained that DOL regulations suggest that if an insurance company holds plan assets in a separate account and earns a return based on investment performance, then the insurance company is responsible for those assets under general fiduciary rules.

Charters' suit seeks class action status on behalf of all trustees, plan sponsors, and plan administrators of plans that owned Hancock variable annuity contracts. Hancock argued that Charters lacked standing to represent trustees and administrators of plans with which he was not associated. The judge disagreed, explaining that several decisions of courts of appeals permit plaintiffs to bring class actions under

ERISA on behalf of plans to "which they are strangers," so long as they meet the class action requirements of the Federal Rules of Civil Procedure.

Hancock did gain one small victory. The district judge agreed that Charters could not pursue his suit on behalf of plan sponsors. ERISA does not give plan sponsors a right to sue, so Charters may not pursue his litigation on their behalf. ❖

➤ Sixth Circuit decision

continued from page 1

Mack claimed losses of almost $1.2 million.

The doctors sued the bank for breach of its fiduciary duties and sought restoration of the losses in their plan accounts. The district court relied on the Fourth Circuit opinion in *Larue* to conclude that Tullis and Mack lacked standing to bring their claims under ERISA and dismissed their suit.

The Court of Appeals reversed this decision. It explained that it did not find the *Larue* decision "to be convincing." It noted that the Secretary of Labor and the U.S. Solicitor General have argued that a denial of standing in these circumstances "frustrates the fundamental purpose of ERISA," which was enacted to prevent abuses such as the misuse and mismanagement of plan assets. The Court read the "plain language" of ERISA § 502(a)(2) to "compel" the conclusion that "an individual participant in a defined contribution plan should have standing to seek recovery for losses to their pension plan." That section authorizes a plan participant to bring a lawsuit under the ERISA provision that makes a plan fiduciary personally liable for losses to the plan resulting from the breach of the fiduciary's duties. The Court agreed with other courts that nothing in that statutory language required that the recoverable losses had to ultimately benefit all plan participants, as argued in *Larue*.

The *Tullis* decision is a strong endorsement of the principle that participants in defined contributions can sue for the plan to recover plan losses to those participants' accounts due to a breach of fiduciary duties. We should soon see if the Supreme Court agrees with its analysis. ❖

➤ Document Update

continued from page 2

that were made. Note, however, that this correction is only available where the plan loans or hardship distributions were mostly made to individuals who were not highly compensated employees. In addition, the loans must have been made according to the limits in IRC § 72(p) (generally the lesser of $50,000 or 50 percent of the vested account balance). In the case of 401(k) plans, hardship distributions of salary deferrals must have complied with the applicable 401(k) rules relating to hardship distributions. If the correction does not meet these requirements, self-correction is not available. However, the correction can be made under the VCP by submitting the correction to the IRS, just not under self-correction.

A plan sponsor that amends a plan to correct under the SCP must submit the amended plan for a determination letter application.

The third permitted plan amendment correction is for an operational failure that includes employees who entered the plan too early. A retroactive amendment can change the plan's minimum age or service requirements or the plan entry date to reflect what actually occurred so as to allow the employees to enter the plan when they did. This retroactive amendment under the SCP is only available when the participants who are affected by the amendment are primarily non-highly compensated employees.

One final note on this plan amendment self-correction technique: A plan sponsor that amends a plan to correct under the SCP must submit the amended plan for a determination letter application, identifying the amendments separately in the application. The determination letter application must be submitted before the end of the plan's applicable remedial amendment period described in Revenue Procedure 2007-44. ❖

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➤ Investment Corner

continued from page 3

Do the corresponding liability portfolios for an investment program affect the type of active managers and the mix of active managers and indexes for a portfolio? Yes. Does the "liability portfolio" impact all time horizons (young and old)? Yes, but ignoring them as retirement approaches and in retirement can cause severe damage, as there is no time to recover from fundamental mistakes and lost opportunities. Retirement expectations require ongoing asset/liability analysis when it comes to monitoring investments, their structures, and the portfolios available to participants. ❖

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➤ Q&A
continued from page 5

This is a relatively new and, I think, troubling development. An individual has to look to the creditor protection laws of the individual state of which he or she is a resident. Note, it's based on your residency, not necessarily where the dollars are held, to see whether IRAs are protected outside of bankruptcy. Some states protect IRAs; some states don't; some states protect traditional IRAs and Roth IRAs, but they don't protect SEPs and SIMPLEs.

Q You said benefits under a qualified plan are protected from creditors outside of bankruptcy?

A Yes. Under ERISA § 206(d) and IRC § 401(a)(13), there are non-alienation provisions that apply to plan benefits. All qualified plans are protected in bankruptcy; that is part of the Act. However, outside of bankruptcy, we have an issue with respect to what we call "owner-only" plans. If the plan only covers the owner of the business or the owner of the business and spouse of the owner, the DOL has stated that it is not an ERISA plan. It doesn't cover any "employees." It just covers employers. It's not an employee benefit plan and thus doesn't have ERISA protection. Therefore, those owner-only plans are at risk.

Now, in dicta, which means it's not the controlling language of the case, there was a U.S. Supreme Court case in 2004 called *Yates v. Hendon* that I should mention. In that case, the Supreme Court, in dicta, favorably referred to that DOL position that the owner-only plans were not covered under Title I of ERISA and, therefore, not entitled to ERISA protections. So there's a real issue as to whether owner-only plans are protected outside of bankruptcy. Again, they are clearly protected in bankruptcy; but there's a real issue outside of bankruptcy.

Q Are there any claims that can be levied against a plan benefit?

A Yes, there are statutorily three claims that can be levied against benefits in a qualified plan, and the three have morphed into a fourth. First are Qualified Domestic Relations Orders (QDROs) (these are the exceptions under § 401(a)(13) of the IRC and § 206(d) of ERISA). A person's benefits under a plan could be attached for a division of assets in divorce or for child support. Second are federal income tax levies. We have to remember who writes these laws. If you owe federal income tax to the government, then that's an exception from the Act's protection. Plan benefits are subject to federal income tax levies. The third exception in ERISA and under the Code is criminal civil judgments and consent decrees regarding fiduciary violations or crimes committed against the plan. This is where somebody's a participant in the plan, and they're also a fiduciary of the plan, and they commit a crime against the plan. Let's say they steal money from the plan, for example. Their account could be attached to repay the plan for the money that they stole from it. This is a pretty limited exception.

The fourth isn't in either ERISA or the Code, but has been established by some court cases and some private letter rulings. The levies involve federal crimes where there are federal criminal penalties. The interpretation has been that these criminal penalties should be treated as if they were tax levies. Some of the courts have jumped on that, and the IRS has agreed. Basically, the IRS has said, "Well, if the federal criminal penalties are to be treated as if they were tax levies, and tax levies are an exemption under 401(a)(13), then federal criminal penalties are an exemption under 401(a)(13) also." The Ninth Circuit Court of Appeals accepted that sort of logic in a case called *U.S. v. Novak*, when it said that the assets of a convicted felon could be attached for some of these penalties.

Q Do you have any recommendations to our readers on how to assure their plan benefits are protected?

A Watch what you do—if you're really concerned about creditor protection. Then get an individual determination letter on your prototype or volume submitter plan document. Second, watch how you handle the plan. Notwithstanding the fact that the Bankruptcy Act says if you've got a letter, you are pretty much home free, you still need to operate it as a qualified plan. There was a U.S. Fifth Circuit Court of Appeals case in Texas in 2007 called *Matter of Plunk*. In that case, somebody really had abused the plan and breached his fiduciary duties with respect to the plan. The Fifth Circuit ruled that the bankruptcy court had the authority to consider whether the plan's qualified status ought to be revoked. Then you don't have a qualified plan, and the assets are available to creditors. ❖

➤ Regulatory & Judicial Update
continued from page 10

to comply with ERISA requirements. The court noted that an ERISA fiduciary may distribute pension benefits to a third-party claimant *only* when presented with a qualified domestic relations order. The court sent the case back to the district court for a proper determination of whether each claimant had presented Goodyear with a QDRO, and if both have, then a determination of the priority of the competing claims.

REGULATORY & JUDICIAL UPDATE

Item	Statement	Status
DOL addresses responsibilities of trustees and other fiduciaries to collect delinquent contributions.	**DOL Field Assistance Bulletin No. 2008-01** According to this Bulletin, a number of pension plan investigations have uncovered agreements intended to relieve financial institutions serving as plan trustees from any responsibility to monitor and collect delinquent employer and employee contributions. In many cases, no other document assigned that responsibility to another fiduciary. In others, the documents were ambiguous. The Bulletin notes that under common law, the duty to enforce valid claims held by a trust "has long been considered a trustee duty." In addition, ERISA § 404(a) requires a fiduciary to perform its duties prudently and solely in the interests of plan participants and beneficiaries. ERISA provisions also mandate various aspects of plan requirements, including trustee duties. Based on these rules, the Bulletin states that authority over a plan's assets, including a plan's legal claim for delinquent contributions, "must be assigned to (i) a plan trustee with discretionary authority over the assets, (ii) a directed trustee subject to the proper and lawful direction of a named fiduciary, or (iii) an investment manager." In addition, a fiduciary with the authority to appoint plan trustees "must ensure that the obligation to collect contributions is appropriately assigned to a trustee," unless the plan expressly makes other provisions. The Bulletin adds that if no trustee or investment manager is responsible for monitoring and collecting contributions, then "the fiduciary with authority to hire trustees may be liable for plan losses due to a failure to collect contributions because the fiduciary failed to specifically allocate this responsibility." Finally, the Bulletin notes that even if a particular trustee is not responsible for collecting contributions, that trustee would be obligated under ERISA §§ 404 and 405(a) "to take appropriate steps to remedy a situation where the trustee knows that no party has assumed responsibility" for collection of contributions and that "delinquent contributions are going uncollected."	**Collection of contributions is a trustee responsibility that cannot be eliminated, and plan fiduciaries must ensure that this duty is properly assigned to a trustee or investment manager.**
Court of appeals rejects assignment of plan assets in the absence of a QDRO.	***Taliaferro v. Goodyear Tire & Rubber Company,* No. 06-4070 (5th Cir., Feb. 7, 2008)** This case had a complicated procedural history, but it boils down to competing claims to plan benefits. Robert Taliaferro was married and divorced twice. The first ex-wife, Mabel Parsons, sought child support arrears and served state court orders on Goodyear seeking Mr. Taliaferro's pension benefits. In the meantime, the second ex-wife, Marcia Taliaferro, presented Goodyear with a QDRO issued by a different state court seeking a portion of the same pension benefits. Eventually, this dispute ended up in federal district court, which held that as a matter of Texas state law, the pension benefits were subject to Ms. Parsons' child support lien without discussing Goodyear's obligations under ERISA. The court of appeals concluded that the district court erred when it did not address the parties' rights and obligations under ERISA. Ms. Parsons' argument that pension benefits are generally subject to domestic support obligations under Texas law was not sufficient. To reach the benefits, Ms. Parsons had *continued on page 9* ➤	**Claimants under state domestic relations law to benefits in a plan governed by ERISA must have a QDRO to have a valid claim on plan benefits.**

Immediate Eligibility Continues Trending Upward

Profit Sharing/401k Council of America *401(k) and Profit Sharing Plan Eligibility Survey 2007*

"In the Fall of 2007, the Profit Sharing/401k Council of America collected defined contribution plan eligibility data from 405 companies. 400 of the plans permit employee contributions to an employer-sponsored defined contribution plan, and 86.2 percent of the plans offer employer matches. Respondent companies represent a diverse range of sizes, industries, and geographic locations. Data were collected for three different eligibility categories: participant deferrals, company matches, and company profit sharing.

This is the tenth year that PSCA has collected defined contribution plan eligibility data. The changes over time have been significant. In 1998, only 24 percent of plans allowed employees to begin contributing to their 401(k) plans immediately upon employment. This percentage more than doubled by 2007. Fifty-one percent of all plans and 63.8 percent of plans with 1,000 or more employees now permit immediate participation in their 401(k) programs. Employees are eligible to [participate] within the first three months of employment at 70.05 percent of companies and at 82.5 percent of large companies. Only 17 percent have a one-year waiting period.

From 1998 to 2004, our eligibility surveys asked respondents to report their eligibility practices for their 401(k) plan and/or their profit sharing plan. Beginning in 2005, we altered the survey questionnaire to instead ask respondents to report eligibility based on contribution type: employee deferrals, matching contributions, and company non-matching contributions. The historical data below are presented in two tables to reflect these two different approaches."

A full copy of the report can be downloaded at: *http://www.psca.org/linkclick.aspx?fileticket=vODuQY7yag0%3d&tabid=229.* ❖

Figure 1. Eligibility Trends in Profit Sharing and 401(k) Plans 1998–2007

Eligibility Type & Year	Plan Type: 401(k) All Plans	Plan Type: 401(k) Companies with 1,000+ Employees	Plan Type: Profit Sharing All Plans	Plan Type: Profit Sharing Companies with 1,000+ Employees
Immediate*				
1998	24%	36%	9%	17%
1999	29%	50%	14%	23%
2000	37%	50%	18%	21%
2001	37%	53%	13%	12%
2002	32%	43%	15%	16%
2003	37%	59%	15%	22%
2004	42%	61%	18%	28%
3 Months or Less				
1998	32%	47%	12%	23%
1999	40%	57%	18%	24%
2000	52%	66%	24%	27%
2001	55%	64%	20%	14%
2002	50%	67%	21%	21%
2003	51%	68%	22%	25%
2004	60%	80%	27%	37%

Eligibility Type & Year	Contribution Type: Participant Deferrals All Plans	Participant Deferrals Companies with 1,000+ Employees	Company Matches All Plans	Company Matches Companies with 1,000+ Employees	Company Non-Matches All Plans	Company Non-Matches Companies with 1,000+ Employees
Immediate						
2005	48.8%	61.9%	35.8%	47.6%	17.1%	25.5%
2006	48.5%	63.9%	34.1%	47.3%	16.7%	28.3%
2007	51.0%	63.8%	36.7%	48.8%	18.4%	27.3%
3 Months or Less						
2005	64.7%	78.8%	47.6%	59.2%	24.3%	25.5%
2006	69.2%	84.5%	48.8%	60.8%	25.3%	34.7%
2007	70.5%	82.5%	51.0%	61.0%	26.8%	35.2%

*Immediate is defined as 1 month or less.
Source: Profit Sharing/401k Council of America.

EPCRS, the IRS's miracle program

By Martin J. Burke, Esq.

It seems that the IRS has recently begun an all-out assault on correcting plan errors. Following the IRS publishing a list of the most common 401(k) plan mistakes (available at *http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf*), the IRS is selling the Employee Plans Correction Resolution System (EPCRS) with the intensity of a skin cream salesman in a room full of people with problem skin. The thing is, unlike the miracle skin cream, the EPCRS program isn't just designed to take your money and run, it's fairly designed to protect plan participants and help sponsors get back into compliance with the myriad of laws and regulations that they may have innocently overlooked.

In a recent webcast held by the National Institute of Pension Administrators, Avaneesh Bhagat, program coordinator of Employee Plans Voluntary Compliance with the Internal Revenue Service, presented "401(k) Plan Mistakes and Compliance" that reviewed the most common 401(k) mistakes. Of the most common mistakes, Mr. Bhagat spent a significant amount of time extolling the virtues of the simplified process of correction for so-called "interim non-amender failures" using the Appendix F of the EPCRS rules. As many practitioners are aware, Appendix F interim non-amender filings are simpler and travel through the IRS at a rapid rate—a rate at which most would not expect a filing to move through a government agency.

While Mr. Bhagat is correct about the benefits of using Appendix F filings to correct interim non-amender issues, the true beauty of the EPCRS program revolves around the ability to make self-corrections to various operational errors without having to report to the IRS. While the EPCRS self-correction program is already something to cheer, at the recent TE/GE meeting held in Baltimore, Maryland, the IRS representatives hinted that expansions in the self-correction program are coming. While the statements from the IRS at these public events can hardly be relied upon as gospel, we as practitioners should applaud the IRS and continue to urge them to expand any program that assists plan sponsors in voluntarily bringing plans into compliance. ❖

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