von Briesen
von Briesen & Roper, s.c. | Attorneys at Law

Is Your Retirement Plan in Need of a Spring Cleaning?

Apr 07 2011

Posted By: Timothy C. McDonald

Practice Area: Compensation and Benefits/ERISA

The Internal Revenue Service (the "IRS") recently issued a list of retirement plan items that employers should review this year. This *Update* briefly highlights those items and provides you with useful resources for proper operation of your retirement plan.

Is Your Retirement Plan Right for Your Business?
An employer should review its retirement plan periodically to determine whether that plan remains suitable given the employer's objectives.

Employers sometimes adopt retirement plans that prove to be overly complicated given the employer's budget, the nature of the employer's workforce, etc. For example, we recently helped a small non-profit organization unwind its defined benefit retirement plan. Given the organization's objectives and budget and the nature of the organization's workforce, the plan was too complex and costly to administer. The organization replaced that plan with a new defined contribution plan that (i) is much easier for employees to understand, (ii) is much less costly to administer, and (iii) provides the organization with needed funding flexibility.

Employers sometimes find that the off-the-shelf plan document that they have been using does not maximize the amounts that could be contributed on behalf of key employees. For example, we recently worked with a professional service corporation that found it could significantly increase its retirement plan contributions for shareholder-employees by implementing a feature known as "cross-testing."

Some employers find that their business environment has become more uncertain so retirement plan designs that make funding requirements more predictable are desirable. For example, potential swings in the funding requirements under a defined benefit retirement plan could be reduced by converting the plan from a traditional pension formula to a "cash balance" formula and implementing an investment policy that tracks projected plan liabilities more closely.

As your business and business objectives change over time, it is important that you review your retirement plan to make sure it continues to be appropriate for your business. The following are some of the factors you might consider in determining whether your retirement plan is still right for you:

- Have you experienced or do you anticipate significant growth in your business and workforce?
- Have you experienced or do you anticipate a reduction in your business or workforce?
- Do you feel that the benefits your plan provides are sufficient?
- What are your total annual costs of maintaining your plan (i.e., record keeping, investment, actuarial, legal, trustee, etc.) and are those costs reasonable given the benefits your retirement plan provides to employees?
- Does your plan document permit, and would it be beneficial to your business to have, the plan pay eligible administrative expenses in accordance with Departmentof Labor guidance?
- Is your plan easy to administer and understand or is it so complex that employees do not understand or appreciate the benefits you provide?
- Do you need more funding stability or flexibility given the cashflow of your business?
- Are your plan's special features (e.g., plan loans, hardship distributions, etc.) utilized sufficiently to justify the administrative effort associated with those features?
- Would you like to consider ways to increase retirement contributions and benefits for key members of your staff?

Careful consideration of these and other factors will help you determine if your retirement plan still suits your business's needs and goals.

Are There Any New Design Features You Might Want to Add to Your Plan?
It is never too late to redesign your retirement plan to make plan administration and operation more efficient and better tailored to your business's goals. You may not be aware of optional plan features that benefit employees and/or reduce administrative burdens, such as automatic enrollment, Roth account features, and safe harbor plan designs:

- Automatic Enrollment: You may want to amend your 401(k) or 403(b) plan to provide that eligible employees will be automatically enrolled, eliminating the need for them to make an affirmative election to participate.
- Roth Accounts: You may want to amend your 401(k) or 403(b) plan to provide a designated Roth account feature. This feature allows employees to contribute after-tax dollars to their retirement plan account. If certain conditions are met, the employee can receive those contributions and investment earnings on those contributions taxfree when he/she retires.
- Safe Harbor Designs: You may want to amend your 401(k) plan so it qualifies as a safe harbor 401(k) plan. A "safe harbor" 401(k) plan is not subject to nondiscrimination testing otherwise applicable to traditional 401(k) arrangements. As a result, participating highly compensated employees can maximize their annual deferrals under a safe harbor 401(k) plan without regard to the amounts other employees elect to contribute. We have worked with a number of employers that found they could convert their traditional 401(k) plans to safe harbor 401(k) plans with minimal design and cost changes.

Have You Updated Your Plan for Recent Law Changes?
The laws regarding retirement plans frequently change and plan documents must be amended to reflect such changes. For example, retirement plans were recently required to adopt special rules regarding retirement benefits for uniformed military members, pursuant to the Heroes Earnings Assistance and Relief Tax Act of 2008. The IRS recommends that all retirement plans review current law changes annually.

Although law changes and required deadlines for amendments are listed in various government and practitioner publications, failure to timely adopt a required amendment is a common plan mistake. If a retirement plan fails to adopt a required amendment by the IRS deadline, the employer should remedy that failure using an IRS compliance tool known as the Employee Plans Compliance Resolution System ("EPCRS"). Correcting an error under EPCRS is generally much less costly than correcting an error the IRS discovers on audit.

Do You Know and Understand Your Plan's Terms?
The terms of your retirement plan document should dictate the way you administer your plan. Unfortunately, many employers are not aware of their retirement plan's terms and have problems operating their plan correctly.

Make sure you know and understand the following questions regarding your retirement plan:

- Which employees are eligible to participate in your retirement plan?
- How does your retirement plan define "compensation" for the purpose of contributions to the plan?
- When and how much are you required to contribute on behalf of employees under the plan?
- What types of notices must you provide to employees and how often should the notices be provided?
- Are you required to test the retirement plan for nondiscrimination and, if so, how often?
- Are you required to file an annual return for the retirement plan?

Are You Operating Your Plan Correctly?
While it is important that you both amend your retirement plan to reflect law changes and understand your plan's terms, you must also operate your plan in accordance with the plan's terms. Incorrect operation of your plan could create serious problems for your business and your employees. In the worst case scenario, incorrect operation can lead to plan disqualification—which would subject your business and your employees to adverse tax consequences.

It is important to regularly review your plan to ensure that:

- Your employees are allowed to participate in the plan when they are eligible under the terms of the plan;
- The correct amount of employer and employee contributions are made based on (1) your plan's definition of "compensation," (2) your employees' elections, and (3) your plan's terms;
- You deposit all employee contributions on time;
- Any loans or hardship distributions allowed by the plan are properly administered; and
- You issue required notices to your employees on time.

If you discover an operational error, please contact your employee benefits counsel. Operational errors can often be easily corrected under the IRS's EPCRS.
