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KRAVITZ Retirement Plan News

Preview of changes for 2010

Not only is 2010 the beginning of a new decade (and the name of the movie sequel to *2001: A Space Odyssey*), it also marks the effective date of a number of retirement plan changes. Following is a preview of coming attractions — at least the ones we know of at this point.

EGTRRA amendment deadline

The deadline for plan sponsors of preapproved defined contribution plans to restate their plans onto an EGTRRA plan document is April 30, 2010. Preapproved master, prototype, and volume submitter plans must be restated every six years. Failing to restate a plan by the deadline will result in a nonamender failure. To bring a plan back into compliance, the plan sponsor must make a correction through the IRS's Employee Plans Compliance Resolution System (EPCRS) and pay associated nonamender penalties.

In addition to the EGTRRA plan restatement (which many plans have already completed), there will be "snap-on" amendments required by provisions in the Pension Protection Act of 2006 (PPA), the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART), the Emergency Economic Stabilization Act of 2008 (EESA), and the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA). The PPA amendments are generally required by the end of the 2009 plan year. Other provisions are required in 2010 and 2011 for WRERA. To ease the burden, many plans have put the latter components into the PPA amendment completed in 2009.

DB(k) plans

PPA introduced the DB(k) plan effective January 1, 2010. This new qualified plan is available to businesses with at least two and not more than 500 employees. The DB(k) permits a defined benefit plan to accept elective deferrals. The defined benefit component must either provide a minimum formula of 1% of final average pay for up to 20 years of service or use a cash balance design. The 401(k) component must provide for automatic enrollment with a minimum deferral rate of 4% of pay (with no automatic annual increase) and a fully vested employer matching contribution of 50% on the first 4% of compensation deferred. Any additional employer contributions — matching or nonelective, which are permitted — must be fully vested after three years of service. Additional details include:

- Uniform provision of contributions and benefits is required.
- Permitted disparity may not be used.
- The plan satisfies the top heavy rules.

- The ADP/ACP tests are satisfied by the 4% automatic deferral and the 50% employer match on the first 4% contributed.
- Amounts deferred or matched above those minimums will be subject to ADP/ACP testing.

At press time, we were still awaiting detailed guidance for the DB(k) from the IRS.

RMDs for 2010

WRERA permitted participants to waive their required minimum distribution (RMD) amounts for the 2009 distribution calendar year (DCY). The following rules apply for the 2010 DCY:

- Participants who had been receiving RMDs prior to 2009 must receive an RMD for 2010.
- Participants who turned age 70½ in

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KRAVITZ
Los Angeles • Atlanta • Las Vegas
Denver • Washington DC • Salt Lake City
Ann Arbor • Minneapolis • Charleston
tel 818.995.6100 fax 818.379.6100
www.kravitzinc.com

2010 IRS
cost-of-living adjustments

For the first time, the retirement plan limits shown below did not change as a result of cost-of-living adjustments. Thus, the limits in place for 2009 will continue for the 2010 tax year.

The reason these limits did not increase as they typically do is that the cost-of-living index for the quarter ending September 30, 2009, was lower than the cost-of-living index for the quarter ending September 30, 2008.

IRS limits	2009 and 2010
401(k), SARSEP, 403(b), and 457 plan deferrals/catch-up	$16,500/$5,500
SIMPLE plan deferrals/catch-up	$11,500/$2,500
Compensation defining highly compensated employee*	$110,000
Compensation defining key employee/officer	$160,000
Defined benefit plan limit on annual benefits	$195,000
Defined contribution plan limit on annual additions	$49,000
Maximum compensation limit for allocation and accrual purposes	$245,000
IRA contributions/catch-up	$5,000/$1,000

Traditional IRA changes. There are a few changes in 2010 relating to the adjusted gross income (AGI) "phaseout" limits for determining what portion of contributions to a traditional IRA are deductible. For taxpayers who are active participants filing a joint return (or a qualified widow(er)), the deduction begins to phase out with a combined AGI of $89,000 (unchanged from 2009). For taxpayers other than "married filing separate returns," the deduction phaseout begins at $56,000 AGI (up from $55,000 in 2009). For a taxpayer who is not an active participant but whose spouse is an active participant, the deduction phaseout begins at a combined AGI of $167,000 (up from $166,000 in 2009).

Roth IRA changes. There is also an AGI-based limitation for determining the maximum Roth IRA contribution. For married taxpayers filing a joint return (or a taxpayer filing as a qualifying widow(er)), the contribution phaseout begins at $167,000 AGI (up from $166,000 in 2009). The beginning AGI limitation phaseout for single taxpayers remains at $105,000.

* 2009 amount for use in 2010 plan year tests

Preview of changes for 2010

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2009 and did not take an RMD for the 2009 DCY by April 1, 2010, must take an RMD for the 2010 DCY by December 31, 2010.

- Participants who will turn age 70½ in 2010 (and were therefore not affected by the WRERA provision waiving RMDs for the 2009 DCY) have until April 1, 2011, to take their first RMD.

Charitable IRA donations end

The PPA provision allowing IRA owners age 70½ or older to donate up to $100,000 a year to a qualified charitable organization (and apply the donation amount toward their RMD for the year) ends December 31, 2009. This provision, which was set to expire at the end of 2007, was extended by EESA. **Note:** The WRERA provision allowing 2009 RMDs to be waived may have reduced the number of taxpayers who took advantage of this opportunity.

402(f) notice changes

The 402(f) notice, commonly known as the "Special Tax or Rollover Notice," must be provided to individuals prior to their receiving a distribution. The notice explains everything participants need to know about distributions including eligible rollover options and distribution rules, various tax consequences, and myriad other distribution details.

Even though the IRS required the notice to be updated in 2007, the long-awaited IRS model notice (which was last updated in 2002) wasn't issued until 2009. The model notice is in Question and Answer format and includes important language about designated Roth distributions, distributions from automatic enrollment arrangements, distributions to individuals currently serving in the military, and much more. The effective date for implementing the information in the newly released model notice is January 1, 2010.

Mandatory nonspouse rollovers

For plan years beginning after December 31, 2009, allowing nonspouse beneficiaries to roll over their benefit will be a *mandatory* plan provision. Distributions to nonspouse beneficiaries will now be considered "eligible rollover distributions" subject to the 20% mandatory federal tax withholding and 402(f) notice requirements.

Plan expenses and cost cutting

Employers often find themselves trying to accomplish competing goals: providing benefits for employees and managing the costs of running a business. Tough economic times have made this even more difficult. Some employers have stopped making matching or other employer contributions. Others are looking at paying more of the plan's administration expenses out of the plan's assets.

ERISA allows employers to pay certain plan expenses with plan assets. Both the IRS and DOL have issued guidance on this subject. Employers should use caution when considering charging expenses to assets, however, because not all types of expenses can be paid from plan assets. The manner in which expenses are paid is also subject to certain restrictions.

Exclusive benefit rule

Internal Revenue Code Section 401(a)(2) states that the plan must be established and maintained by the employer for the exclusive benefit of the employees and their beneficiaries. This "exclusive benefit rule" would be violated if plan assets were used to pay for an expense that is considered to be the responsibility of the employer (a "settlor" expense).

Settlor expenses

Settlor expenses are the responsibility of the employer and may not be charged back to the plan since they are discretionary expenses associated with the employer's business decisions.

Settlor expenses include plan design costs; legal costs for corporate issues involved in establishing a plan; nonrequired or discretionary plan amendments, such as changing eligibility or vesting features or adding hardship withdrawals or loan provisions; fees associated with correcting a plan error; and fees for filing Form 5500 late.

Operational expenses

Operational expenses may be charged to the plan since they are necessary to maintain the plan's qualified status. Operational expenses include plan amendments for required law changes or changes in regulations. Thus, the EGTRRA plan document restatement (and other required plan amendments) and future document restatements (the six-year cycle) may be charged to plan assets.

Other operational expenses that may generally be charged to the plan include:

- Plan audit fees
- Qualified domestic relations order (QDRO) and qualified medical child support order (QMCSO) determinations
- Required fidelity bond
- Reporting and disclosure
- Third-party administrator fees
- Trustee and/or custodian fees
- Certain investment advisory and management fees
- Fees for participant enrollment/ investment and election changes
- Check writing and distribution processing
- Loan initiation and annual administration
- Accountant fees
- Appraisal fees
- Actuarial fees

Reasonable plan administrative expenses may be charged to the accounts of former employees and beneficiaries, even though the accounts of current employees are not charged.

Allocating charges

Expenses charged to the plan may be assessed *pro rata* (based on account balance) or *per capita* (based on equally sharing the expense among all the participants). This issue has been addressed in DOL Field Assistance Bulletin 2003-3 and IRS guidance.

Pro rata allocation: Expenses are allocated based on the value of the assets in each individual's account.

Per capita allocation: Expenses are allocated on an equal dollar or percentage basis to each participant's or beneficiary's account, regardless of the value of the individual's assets. This may be used for allocating certain fixed plan expenses, such as recordkeeping, legal, auditing, annual reporting, claims processing, and similar administrative expenses.

Fees that are based on account balances, such as investment management fees, should be charged on a pro rata basis because a per capita charge would appear to be arbitrary. Fees for services that provide investment advice to individual participants may be charged on either a pro rata or per capita basis, regardless of a participant's actual utilization.

RECENT developments

Final regulations for defined benefit plans

On October 7, 2009, the IRS and the U.S. Treasury Department released final regulations under Sections 430 and 436. Section 430 covers the measurement of assets and liabilities for single-employer DB plans, while Section 436 relates to the application of benefit restrictions to underfunded single-employer DB plans. These regulations apply to plan years beginning on or after January 1, 2010.

EFAST2 deadline nears

Retirement plans subject to Title 1 of ERISA must file their annual Form 5500 reports electronically through the Department of Labor's ERISA Filing Acceptance System II (EFAST2) for plan years beginning on or after January 1, 2009. The exception is plans filing Form 5500-EZ, which cannot be submitted electronically and must be filed on paper with the IRS. A "one participant" plan that normally files Form 5500-EZ may be able to file electronically using Form 5500-SF, but only if it meets the eligibility requirements.

The DOL has established an EFAST2 website at *www.efast.dol.gov*. The site covers everything from the registration process to submitting a Form 5500. It also includes a list of approved vendors for EFAST2 software.

Auto enrollment guidance

The IRS recently published Revenue Ruling 2009-30 and Notice 2009-65 to provide guidance to plans with automatic enrollment arrangements. Rev. Rul. 2009-30 contains two examples involving the timing and method of increasing deferrals for plans that contain an annual "escalator" feature. Notice 2009-65 provides two sample plan amendments to be used when adding automatic enrollment features to a plan. The first sample amendment can be used when adding a basic automatic enrollment feature; the second sample amendment pertains to adding an eligible automatic contribution arrangement (EACA). These amendments may be adopted verbatim or modified to conform to the specifics of a particular plan.

Roth IRA conversion rules

Effective January 1, 2010, a provision in the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) eliminates the $100,000 limit on adjusted gross income (AGI) for individuals wishing to convert a traditional IRA to a Roth IRA. Furthermore, taxpayers who convert in 2010 have the option of paying the federal income tax due on the conversion in 2010 or paying half the tax in 2011 and half in 2012. This change opens up a number of retirement planning opportunities. However, higher income taxpayers are still barred from making annual contributions to a Roth IRA because those AGI limits remain.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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Los Angeles • Atlanta • Las Vegas
Denver • Washington DC • Salt Lake City
Ann Arbor • Minneapolis • Charleston
tel 818.995.6100 fax 818.379.6100
www.kravitzinc.com

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