

Responsibilities of a Plan Sponsor

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A qualified retirement plan can provide many benefits for an employer and its employees. In order for the plan to run smoothly so that its usefulness can be maximized, the employer should be aware of the ongoing responsibilities related to the administration of the plan.

Once procedures have been established, the plan can function to its potential and remain within the qualification guidelines of the Internal Revenue Code ("IRC") and the fiduciary requirements of the Employee Retirement Income Security Act ("ERISA"). This newsletter will examine the basic responsibilities of the plan sponsor of a qualified plan.

Allocation of Duties

The plan and trust documents establishing the plan name a plan administrator and plan trustee(s). The plan administrator has the legal responsibility for running the plan and is often the employer sponsoring the plan. More often than not, an outside third party administrator ("TPA") will be hired to perform many of the administrative tasks required under the plan document, though the plan administrator remains legally responsible for all plan activities.

The plan's trustee, appointed by the employer, can be a corporate trustee or one or more individuals. The trustee has a fiduciary responsibility to manage and invest the trust fund in a prudent manner in accordance with the plan's investment policy.

Many 401(k) plans allow participants to direct the investments of their accounts, which can alleviate some of the investment liability from the trustee if participants are given sufficient information and control over their investments. However, where investment alternatives provided to participants are limited, as with a list of mutual funds within a fund group, the trustee is still responsible for monitoring the appropriateness of such alternatives.

Employee Notifications

Plan Summaries

After a plan is established, each eligible employee should be given a copy of the summary plan description ("SPD") which explains the basic provisions of the plan. The deadline is the later of 120 days from the plan adoption date or 90 days after an employee becomes a participant. Upon amendment of a significant plan provision, participants must be given a summary of material modifications explaining the change(s) within 210 days after the close of the plan year in which the change is made.

An updated SPD must be provided at least every five years if one or more amendments have been adopted, or every ten years if no changes have taken place.

Beneficiary Forms

Every new participant should complete a beneficiary designation form which the plan administrator should keep with its permanent records. In general, the death benefit is required to be paid to a married participant's spouse unless the spouse has consented in writing, witnessed by a notary or a plan representative, to another beneficiary. Plans that provide an annuity benefit option require additional notices and waiver forms.

Deferral Elections

Salary deferral plans require participants to complete deferral election forms. If the investments are to be self-directed, they also must complete investment election forms and be given sufficient information about the investment options from which to make an informed decision. All of the forms and information are usually distributed as part of an "enrollment kit."

Safe Harbor Notices

In a safe harbor 401(k) plan, certain nondiscrimination tests can be eliminated by providing safe harbor contributions. A notice explaining the contributions as well as other plan provisions must be given out generally between 30 and 90 days before the plan year begins. If the safe harbor notice states that a 3% nonelective contribution might be made, then a follow-up notice must be distributed before the last month of the plan year, confirming

whether or not the contribution will be made.

Plan Contributions

Salary Deferrals

The Department of Labor ("DOL") has stated that once withheld from participants' wages, deferrals must be remitted to the plan as soon as the funds can reasonably be segregated from the employer's general assets. In no event can this be beyond the fifteenth business day of the following month, but this is not a safe harbor deadline. Depending on the employer's payroll system, the deadline could be within a day or two.

Failure to make timely deferral deposits results in prohibited transaction excise taxes and restoration of lost earnings.

Profit Sharing Plans

The due date for making employer profit sharing plan contributions is the plan sponsor's due date for filing the corporate tax return, including extensions. Safe harbor nonelective contributions and required top heavy minimum contributions are due the last day of the following plan year.

Pension Plans

For defined benefit and defined contribution pension plans, such as money purchase plans, the deadline for employer contributions is eight and one-half months after the close of the plan year. Certain defined benefit plans are required to fund on a quarterly basis.

Participant Statements

At least once a year, participants are generally given a benefit statement showing their account activity or vested accrued benefits as of the valuation date. In plans where participants direct their own investments, statements must be provided at least quarterly if the plan elects to limit fiduciary liability in accordance with ERISA regulations.

Annual Plan Limits

Plan sponsors should keep up to date with annual limits that are subject to cost-of-living adjustments. The 2006 annual limitations include:

- \$220,000 compensation cap;
- \$44,000 annual additions limit;
- \$15,000 401(k), 403(b) and 457 plan deferral limit (plus \$5,000 catch up);
- \$100,000 highly compensated employee threshold; and
- \$140,000 key employee threshold.

Compliance Testing

Once a year every retirement plan has to be tested to insure that it satisfies certain

nondiscrimination requirements under the IRC. There are coverage and participation tests, employee and matching contribution nondiscrimination tests, annual additions tests and top heavy tests.

These tests require that census information for all employees be reviewed at the end of each plan year, including dates of hire, birth and termination, hours worked, compensation, contributions and account balances. Complete employee data is required to avoid inaccurate test results.

The annual testing requires the classification of employees as key vs. non-key and highly compensated vs. non-highly compensated. These determinations are based on employer ownership, officer status and compensation. Since the ownership determination includes family attribution rules, it is important to note on the census if any employees are related to any of the owners of the business.

Employees who worked for a "related" company may also have to be considered. Related companies are either part of a "controlled group of corporations" or an "affiliated service group." Whenever an individual who owns any portion of the sponsoring employer (or the owner's spouse) buys into another business, the TPA should be notified so a controlled group determination can be made. The same applies if another company works together with the employer to provide services to each other or to third persons which could constitute an affiliated service group. These circumstances create important issues that could affect the qualification of the plan.

Participant Loans

Plans that offer participant loans must inform participants of the plan's loan procedures which are often contained in the SPD. Loan repayments, which are usually made through payroll deduction, must be monitored. Missed payments require employee notification that the loan will be in default at the end of the "cure period" if the payments are not caught up. The entire outstanding loan balance of the defaulted loan is taxable to the participant for the year of the default.

Participant loan repayments should be remitted to the plan in the same timely manner as salary deferrals (described above).

Distributions

Many 401(k) plans allow hardship withdrawals. This requires the plan administrator to obtain verification that the hardship meets the statutory requirements spelled out in the plan document. Salary deferrals must be suspended for six months after receipt of a hardship distribution.

Other circumstances that may allow for benefit distributions are retirement, death, disability, termination of employment or the attainment of a specified age. Whenever a participant becomes entitled to a distribution, election forms and tax information must be provided. Also, a participant involved in a divorce or separation may present a domestic relations order to the plan administrator which transfers a portion of the participant's benefits to an alternate payee such as an ex-spouse or a child. The order must be reviewed and responded to in accordance with the plan's qualified domestic relations order procedures

before any benefits can be segregated or distributed.

Bonding

The trustees of every qualified plan subject to ERISA must be covered by a surety bond for at least 10% of the value of plan assets but not more than \$500,000. Certain types of plan investments, such as limited partnerships, may increase the bonding requirement.

Annual Government Reporting

Form 5500

Each year the plan sponsor must file an annual report, Form 5500, with the DOL. This report contains various schedules and is due by the last day of the seventh month following the close of the plan year. A two and one-half month extension is available by filing Form 5558. Generally, plans with 100 or more participants must have the plan audited each year by an independent accountant. The audit report is attached to the Form 5500.

A summary of Form 5500, called the summary annual report, must be provided to each plan participant and beneficiary each year within nine months (or eleven and one-half months with filed extension) from the end of the plan year.

Form 1099-R

Form 1099-R must be provided by January 31 to each participant and beneficiary who received a plan distribution, including a rollover or defaulted loan, during the previous plan year.

Summary

A plan sponsor has numerous responsibilities concerning the ongoing administration of the plan. While many of these duties are often contracted out to a TPA, the sponsor must provide the TPA with complete and accurate census, contribution and asset information. In addition, the sponsor must distribute employee notifications and make timely contribution deposits, to facilitate the smooth operation and maximum utility of the plan.

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