1300 Ethan Way
Suite 175
Sacramento, CA
95825

phone: 916.922.3200
fax: 916.922.3400
www.benefit-resources.com

TERMINATING QUALIFIED RETIREMENT PLANS

Considerations, alternatives, and requirements

Beth Harrington, QPA
July 2009

Revenues are down. You've had to lay off employees. Every expense is being examined. What about the retirement plan? Is it time to shut it down?

These are discussions that many business owners have been having this year. But plan termination is a drastic step, and there are other ways to save money on your plan. There is a lot to consider; and there are alternatives that may prove to be easier and less expensive than outright termination.

CONSIDERATIONS

What is it about the plan that is causing you concern? Is it the cost of the contributions? Perhaps it is the administration or audit fees? Did you have to lay off the person at your office who helped operate the plan? There may be ways to mitigate any of these concerns.

Plan termination is time consuming. There's an old saying that plans are a little like marriages – they're easy to get into, and hard to unwind! The steps to plan termination are outlined later.

Vesting is eliminated with plan termination; all accounts become 100% vested upon termination. This includes participants who terminated prior to the termination date.

ALTERNATIVES

Contributions: Depending on the type of plan that you have, you may be able to suspend employer contributions until business improves.

- **401(k) Plans** – Employer match, Safe Harbor contributions, and/or Profit Sharing contributions may be suspended. Contributions for future payroll this year can always be discontinued, and sometimes the suspension can be for the full year. *If you discontinue Safe Harbor contributions, however, you will no longer be exempt from the compliance tests required for your plan and top-heavy minimum contributions (3% of compensation) may still be required, so the Highly Compensated Employees payroll deductions may be limited.*

- **Profit Sharing Plans** – Profit Sharing contributions can be suspended for several years without consequence. The IRS regulations say that contributions must be "significant and recurring," however given a down business cycle if there profits are down the contributions are likely to be down as well!

- **Defined Benefit and Cash Balance plans** – Pension plan funding has been given some additional leeway under recent legislation. If your plan has been well funded in the past, the minimum contribution may be zero in the current year. Then when you return to profitability, you may be able to contribute up to 150% of your contribution liability. Investment losses for 2008 are amortized over seven (7) years, with interest only due over the next two (2) years.

- Pension plans may also be *frozen.* Freezing a pension plan essentially stops all future benefits from accruing. Contributions made after freezing benefits are used to either restore plan losses or to reduce future contributions. The plan can be unfrozen at any time. It is important to note that you can only freeze *future* accruals. If the participants already have 1,000 or more hours in the plan year, you can only freeze benefits for the next plan year.

Summary – Profit sharing plans have always offered discretionary contributions, and defined benefit plans have recently been allowed some funding flexibility. Why not continue to offer the elective deferral for the 401(k) without any employer funding until things turn around? Talk to your administrator at *Benefit Resources* to discuss your contribution alternatives.

Fees: There are a variety of fees charged to qualified retirement plans: investment management fees, custodian fees, transaction fees, recordkeeping fees, administration and possibly audit fees. One cost-saving measure is to <u>use the plan assets to pay all plan-related fees</u> to save out-of-pocket expenses.

- **Investment-related charges** – Generally, the fees for services provided by investment custodians and managers are charged against plan assets. The rate at which these fees are deducted is disclosed in the prospectus and/or contract. They are rarely illustrated as a dollar cost shown as a deduction, but typically included in the investment return figures. Ask your investment representative to review your plan assets. Get an understanding about what the dollar amount being charged is, and work together to determine if there are ways to reduce any of those fees. Anything you save here, may be used toward other fees without increasing costs to the participants.

- **Administration fees** – Annual administration services are necessary to confirm that the plan meets the rules and regulations outlined by the government for qualified plans. There is an annual review of employee participation records, contribution limits, non-discrimination, trust activity and preparation of financial statements for the plan assets. Administrators also prepare required reporting (Form 5500) and maintain the plan document to keep it up-to-date.

  If you have been paying administration fees as a company expense, consider using plan assets to pay the fees. Many plans charge participants for requests that they make (distribution and loan processing, for example) but did you know that all of the administration fees can be charged against the plan? You can charge the plan in one of three ways:
  1. Forfeitures – use plan forfeitures
  2. Per-capita – charge a flat fee to each participant's account
  3. Pro-rata – charge the fees to each participant's account based on their account balance

- **Audit fees** – If your eligible participant count is over 100 you may be required to have an independent CPA auditor's report attached to your plan's Form 5500 filing. These audits often start at $8,000-$10,000 per year. Again, plan assets can be used to pay these costs.

  If you have fewer than 200 employees, one way to avoid the audit costs is to split your plan into two side-by-side plans; each under 100 participants. The plans are tested together as one plan, and the assets could remain in one trust. There would be two documents, and two 5500 filings each year, but often the additional administration expense is less than the cost of an audit.

Summary – Plans can be self-sufficient and can be structured to minimize the company's out-of-pocket costs. Understand what services are being performed, and what fees are being charged for each of those services. Spending a little bit of time performing this analysis will help you better understand the true cost of your plan. Your administrator at *Benefit Resources* can help you design your document to meet your plan expense payment requirements.

In-house plan functions: If your office staff is stretched thin when it comes to plan-related functions, talk to your administrator at *Benefit Resources* or your investment advisor. The investment custodian may have developed time-saving methods by which some of these functions are processed.

- **Web-based solutions** – Many investment custodians offer everything online: remitting contributions, processing distribution and loan requests, generating statements, and so on. These new systems save time and money over the old paper-driven processes that you may still be using.

- **ACH debit** – Instead of cutting a check to remit your contributions each pay period (for 401(k) plans) ask your investment advisor if the custodian offers an automatic debit feature. So when you upload your payroll file to the custodian website, the funds are automatically withdrawn from your checking account. No lost checks, no delay, no mismatched amounts!

- **Outsource** – If you have a part-time bookkeeper, perhaps he/she could remit the 401(k) contributions for you. Or talk to your payroll service; perhaps they could provide an electronic report so that the remittance process is simpler and faster for your internal payroll processor. Talk to your administrator at Benefit Resources; he or she can discuss options with respect to remitting your payroll data to the custodian.

- **Download** – Census data requests don't have to take days to complete. Use the download features from your payroll records, and/or HR records to put together a simple spreadsheet or text file. *Benefit Resources* can accept your census records at year end in most any format as long as the necessary fields are included. Use our secure website to remit the report, www.benefit-resources.com.

Summary – 401(k) investment custodians are updating their platforms regularly and providing enhanced services. Talk to your investment advisor to make sure that you know what services are available to you to save time spent on your plan.

TERMINATION: If none of our alternatives suit your needs, or if the company will be shutting its doors, termination of the plan may be necessary. Termination typically takes a ***minimum*** of 90 days. So once the decision has been made, please contact your administrator at *Benefit Resources* as soon as possible so that we can help you get the process started.

Steps to terminate a qualified retirement plan:

- **Corporate resolution** – The Board (or owners) must formally adopt a resolution to terminate the plan.
- **Employee notice** – All eligible employees and plan participants must be notified that the plan is terminating at some future date.

- **Year-to-date census** – compliance testing must be performed on the plan for the final year-to-date period (beginning of the plan year to termination date.) Tests must be completed before distributions can begin.
- **Investment custodian notification** – Your investment custodian will have procedures for discontinuing your contract with them. There may also be termination-related fees that need to be determined and allocated to the participants before distributions begin.
- **Document update** – Your plan document must include all current required language before the plan can be terminated. In 2009 this means that your EGTRRA restatement must be adopted, and a PPA/Heart amendment must be included.
- **Contributions deposited** – all contributions must be made to the plan including any deferrals, loan payments, or employer contributions for the final plan year. Forfeitures, if any, are also allocated based on the plan formula.
- **Distribution election forms** – each person with money in the plan must be given a set of distribution election forms. They must choose how to receive their account balance from the plan. Every effort must be made to find all participants and get their elections completed. As a last resort, an IRA can be established for those who cannot be located.
- **Distributions processed** – All distributions are processed only after all of the steps above have been completed, all participant distribution forms have been received, and all fees are paid.
- **Final Form 5500 filing** – Once all assets have been paid from the plan, a final Form 5500 is filed with the IRS/DOL. Annual administration must continue until all assets are distributed from the plan. The final filing is due seven months after the date that the assets are all distributed.

✓ **IRS approval decision** – You may want to submit a request to the IRS to ask that they review your plan and approve the termination. This is called a Determination Letter filing. There is a fee to prepare the filing, and the IRS charges a filing fee. It can between six (6) and twelve (12) months before the IRS issues the Letter, and no distributions are processed until the Letter is received. This process is <u>optional</u>. The Letter gives you some comfort that the plan met IRS standards at the time of termination, but it does not exempt you from audit in the future. You may wish to get a legal opinion about whether or not to submit for a Letter. *Most of our clients do <u>not</u> go through this step.*

Summary – Plan termination is a time-consuming process, primarily in handling the participant distribution paperwork. Administration must continue until all assets have been distributed. Consider all of the alternatives before making this important decision.

Plans are not programs that can be started and stopped easily. And once your terminate a 401(k) plan, you can’t establish another one until one year after all assets were liquidated out of the prior plan. So take some time. Talk to your advisors. Let us work with you to help you come to the right decision for you and your employees.