

## CLIENT ACTION BULLETIN

March 14, 2008

CAB 08-09

### New Federal Regulations for 401(k) and Other Defined Contribution Plans

**SUMMARY** Federal regulators recently released several pieces of guidance that should be of help to defined contribution (DC) plan fiduciaries and administrators. The Department of Labor (DOL) issued guidance on the responsibility of fiduciaries to collect delinquent employee and employer contributions, and also proposed a seven-day safe harbor period for small DC plans to deposit employee contributions. The IRS, meanwhile, published guidance on rollover contributions to Roth IRAs. These directives address significant administrative concerns and provide guidance that should be welcome to DC plan administrators.

#### DISCUSSION **Background**

##### **Fiduciary Responsibility for Collection of Delinquent Contributions**

In conducting retirement plan audits, the DOL discovered that some financial institutions serving as plan trustees had entered into agreements that, in effect, allowed them to sidestep responsibility for monitoring and collecting delinquent contributions. In these cases, the duty to collect delinquent contributions was not assigned to another trustee or fiduciary, and the plan documents and trust agreements were silent or ambiguous on the matter.

##### **Safe Harbor for Small Plan Assets**

Under current DOL regulations, participant contributions become plan assets on the earliest date that the amounts withheld from the participant's pay or paid to the employer can reasonably be segregated from the employer's general assets. In addition, with respect to ERISA retirement plans, this date must be no later than 15 business days into the month following the month in which participant contributions are withheld from the employee's paycheck or paid to the employer. Because existing regulations provide no safe harbor, many small employers have been uncertain about how soon they must forward participant contributions to the plan to be in compliance.

##### **Rollovers to Roth IRAs**

The Pension Protection Act included distribution-related provisions that became effective this year. In an effort to assist plan administrators, the IRS recently provided guidance on some of the provisions, including instructions relating to rollovers from employer-sponsored retirement plans to Roth IRAs. The guidance applies to qualified plans, 403(b) tax-sheltered annuities, and governmental 457(b) deferred compensation arrangements.

##### **The Substance of the New DOL and IRS Rules**

##### **Fiduciary Responsibility for Collection of Delinquent Contributions (DOL Guidance)**

The DOL's new guidance (*Field Assistance Bulletin 2008-01*) stipulates that the responsibility for collecting both employer and participant contributions is a trustee responsibility. Furthermore, it states that the plan fiduciary with the authority to hire the trustee(s) is responsible for ensuring that all trustee responsibilities are properly assigned. If the plan has more than one trustee, the fiduciary may assign the duty to a single trustee. If the trustee has limited duties, the fiduciary may delegate the duty to monitor and collect delinquent contributions to an investment manager.

However, if a trustee or investment manager has not accepted responsibility for collecting contributions and the fiduciary with the authority to hire trustees fails to specifically allocate this responsibility, the fiduciary may be liable for plan losses that are due to any failure to collect delinquent contributions.

**Safe Harbor for Small Plan Assets (DOL Guidance)**

With regard to retirement plans, the DOL's proposed rule would create a safe harbor period for participant contributions to a DC plan that has fewer than 100 participants at the beginning of the plan year. Participant contributions to these small plans would be treated as being in compliance with the rule defining when amounts become plan assets if the contributions are deposited with the plan no later than seven business days following the day on which the amount would otherwise have been payable to the participant in cash (or seven business days following the day on which the amount is received by the employer). The following are highlights of the proposed rule:

- To satisfy the seven-day rule, amounts must be placed in an account of the plan. The contributions do not have to be allocated to specific participants or investments of such participants.
- The seven business days are counted from when amounts are withheld by the employer from a participant's wages or when a participant contribution is received by the employer.
- The rule applies to employee contributions, as well as to participant loan repayments.
- Although the seven-business-day safe harbor rule is for small plans, the DOL is seeking comments on whether there is a need for a safe harbor for larger plans.

**Rollovers to Roth IRAs (IRS Guidance)**

The IRS, in *Notice 2008-30*, clarified that a plan must permit participants (or their surviving spouses) to elect to make an eligible rollover distribution to a Roth IRA. A plan may optionally permit direct rollovers to a Roth IRA by nonspouse beneficiaries. Only individuals who meet certain income limits are eligible to make rollovers to Roth IRAs. In addition, it is the individual—not the plan administrator—who is responsible for determining if he or she meets the income limits and is therefore eligible to make such a rollover.

Amounts rolled over into a Roth IRA are considered part of an individual's gross income for the year and thus are taxable (i.e., as if the participant took the distribution in cash and did not roll over the amounts). Even so, the IRS is instructing plan administrators to apply the same rules they use for eligible rollover distributions. This means rollovers to a Roth IRA are not subject to the 10% additional income tax for early withdrawals, and withholding is not mandatory. Individuals may elect voluntary withholding.

**ACTION**

- **Plan fiduciaries** should review their trust agreements to ensure that responsibility for collecting delinquent contributions is properly assigned.
- Small plan administrators who would like some compliance certainty should begin to comply with the **seven-day safe harbor** rule. The new rule is in proposed form and is not effective until finalized; however, prior to the effective date, the DOL will not assert a violation against a small plan for failure to deposit contributions in a timely fashion if such contributions are deposited within the proposed seven-business-day safe harbor period. This provides small plans with compliance certainty now.
- The plan's special tax notice and rollover election forms should be updated to include the availability of **Roth IRAs** for rollovers.

For more information on this latest guidance for defined contribution plans, or for assistance implementing it, please contact your Milliman consultant.