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Session 4:
Hot Topics in Plan Operation and Administration

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Agenda

~You Work for Me??
~ M&A Mania
~ FDL Craziness
~ Late Deferrals & VFCP
You Work for Me???

Or ... the ERISA version of

“Are You My Mother?”
Scenario 1

• Jack and Jill are both anesthesiologists at the Mother Goose Hospital
• They both own their own PC
• While they generally work alone, they find that the paperwork related to billing is getting overwhelming
• They decide to jointly hire Shrek (each will pay 50 percent of his salary), who will work full time from home, to do their billing and accounting
Scenario 1

- Jack’s PC sponsors a cash balance plan with a maximum formula
- Jill’s PC has no plan
- Is Shrek entitled to any benefits?
Who Does Shrek Work For?

- **Possibility 1**: Shrek is a shared employee, working for both Jack and Jill
- **Possibility 2**: Shrek works for either Jack or Jill, and is leased to the other
- **Possibility 3**: Shrek works for both Jack and Jill and is not a shared employee
Guidance Re: Shared Employees

• Rev. Rul. 73-447: Facts:
  – Two nurses work for two separate physician practices that are housed together
  – Both doctors can use the nurses whenever they need them
  – Hours worked for a given doctor vary as needs arise, but nurses work a total of 30 hours per week
  – Ruling: total hours worked for both doctors are considered to apply to each practice (i.e., nurses were full-time employees of both practices)
How Is Shrek Different?

• “Shared facilities” – does the fact that he works out of his home for both make any difference?
• “Available for each as needed” – facts indicate that he is paid by salary (i.e., not paid hourly) and that each doctor pays 50 percent
• Result?
What Is Shrek’s Compensation?

• Rev. Rul. 68-391 provides that compensation for shared employees from each employer’s company is the pro-rata share
  – Therefore, Jack is considered to employ Shrek full time, but his company’s share of Shrek’s compensation is 50 percent of the total
  – Same for Jill ...
How to Handle Shrek?

• Jack and Jill could adopt a multiple-employer plan
  – Benefits in that plan must be sufficient to ensure that the doctors’ plans are nondiscriminatory
  – Note, if Jack’s plan is a DB, he will have a 401(a)(26) problem if he doesn’t cover Shrek

• One doctor could cover Shrek in his plan with regard to all his compensation
  – But if one doctor is not a sponsor, how can that compensation be covered under the other doctor’s plan? (Think §§415, 404)
How to Handle Shrek?

• Jack could cover Shrek under his plan and Jill could cover Shrek under hers
  – Compensation for Shrek in each plan is what that doctor pays
  – Be careful re: integration (or use of imputed disparity in cross-testing)
Scenario 2

- Pinocchio and Gingie are both separate law firms in Duloc
- Donkey works as a paralegal for both firms
- Pinocchio employs Donkey and pays all of his compensation, issues W-2, etc. Pinocchio then bills Gingie for the work that Donkey performs for Gingie
Guidance

- Under Code Section 414(n), a leased employee is considered to be an employee of the recipient for benefits purposes.
- A leased employee is:
  - Any person who is not an employee of the recipient;
  - Who works on a substantially full-time basis for the recipient for a period of at least one year;
  - Pursuant to an agreement between the recipient and “any other person” (i.e., the leasing organization);
  - And whose services are under the primary direction and control of the recipient.
Guidance (continued)

• Once a leased employee meets the one-year rule above, service is considered to have begun on the date when the service relationship began (i.e., the person will have one year of service once the rules are met)

• Not a leased employee if:
  – Leasing organization sponsors a 10 percent MP with immediate eligibility and vesting
  – No more than 20 percent of leasing organization’s NHCEs are leased
Who Is the Real Employer?

• This is a facts-and-circumstances analysis and is not clear. Some factors:
  – Who can hire and fire me (likely to be the real employer)?
  – Who trains me, ensures my work, provides me with tools of my trade?
  – Who dictates the terms of my employment?
  – Will the leasing organization find me someone else if the recipient rejects me?
  – If the recipient doesn’t pay for me, will the leasing organization still pay my salary?
What Plan(s) Cover Donkey?

• Assuming Pinocchio is the common law employer:
  – Pinocchio's (leasing organization) plan must:
    • Cover Donkey; or
    • Meet IRC §410(b) with Donkey excluded
  – Gingie’s (recipient) plan:
    • Must cover Donkey or meet IRC §410(b) with Donkey excluded
    • May take into account the benefits in the Pinocchio plan for purposes of nondiscrimination testing
    • Includes only Donkey’s pay for Gingie’s company
What Plan(s) Cover Donkey?

• Assuming Gingie is the common law employer:
  – Pinocchio's (leasing organization) plan:
    • May not cover Donkey, as he is not an employee (violation of Exclusive Benefit Rule)
  – Gingie’s (recipient) plan:
    • Must cover Donkey or meet IRC §410(b) with Donkey excluded
Is Donkey a Shared Employee?

• It is possible for someone to be both a leased employee and a shared employee

• Under the facts as illustrated here, one can argue that Donkey is a shared employee:
  – Covered under plans of both companies based on actual compensation paid by that company, without double permitted disparity
Scenario 3

- King Farquaad owns Royal Employee Staffing, which provides its employees to perform nursing or office services to various doctors at Mother Goose Hospital

- RES:
  - Pays the employees and provides them with W-2s
  - Provides the employees with a retirement plan and other benefits
  - Invoices the recipient companies for the services provided by the staffing employees
RES Is a PEO

• Professional employer organizations (PEOs) are organizations that do what RES does
• Although not specifically defined in the law, a PEO is essentially a leasing organization whereby the leased employees (commonly called “Workplace Employees”) work for and at the direction and control of the recipient (called “Client Organizations”)
• IRS PEO rules are found in Rev. Proc. 2002-21
PEO Plans

• Under Rev. Proc. 2002-21:
  – The recipient (CO) is the common law employer
    • The recipient may cover the workplace employees under its own plans
  – The PEO is not the common law employer
    • If it covers the workplace employees under its plan, it’s a violation of the Exclusive Benefit Rule
  – Therefore, the only way for the PEO to provide retirement benefits is through a multiple-employer plan (MEP)
Remember: For MEPs

**Applied to All Employees**
- Eligibility service
- Vesting
- §415 limits
- General plan qualification

**Applied Separately Per ER**
- Nondiscrimination (§§404(a)(4), 401(k), 401(m))
- Coverage
- Top-heavy
- Deductions
- Compensation limitation
Reporting and Disclosure

• The PEO MEP appears to be an “open MEP” for DOL purposes – i.e., it covers employers whose only connection is that the PEO provides services for them
  – Need to do a separate Form 5500 for each employer’s part of the plan
  – Need to provide separate independent audits if any employer’s part of the plan has more than 100 participants
Scenario 4

• Pinocchio hires Fiona to provide deposition reporting and transcription services on an as-needed basis
• Fiona signs a services contract with Pinocchio that makes it clear that she is not an employee of his law firm, but an independent contractor
• Fiona asks Pinocchio if she can please contribute to his 401(k) plan, as the cost of maintaining such a plan is beyond her means
Okey Dokey?

• **NO!!!!!**

• A qualified plan may only cover employees of the sponsoring entity(s), not independent contractors
  
  – Violates Exclusive Benefit Rule

• Solutions:
  
  – Pinocchio can hire Fiona as an employee
  
  – Pinocchio can allow Fiona’s company (i.e., her sole proprietorship) to adopt into his plan, turning his plan into a multiple-employer plan
  
  – Fiona can get her own plan
Merger Mania
Plan Merger Overview

• Plan mergers can be confusing and overwhelming
• Key:
  – Organization
  – Deal with things in advance of the actual merger
  – Good communications
  – Good documentation
  – Keep the employees calm
  – Make sure process progresses as planned
Mechanical Suggestions

• Use a checklist showing everything to be done and who is responsible (see sample Merger Checklist)
• If a plan restatement will be needed (e.g., change in prototype sponsor), have someone knowledgeable review and compare both plan documents (see sample Plan Comparison)
• Think ahead about the issues to resolve and document the resolution (see sample Merger Agreement)
Merger Conundrum #1

• Merging safe harbor plans
  – Historically, the prohibition on amending safe harbor plans mid-year made this very risky, if not impossible
  – Do the new amendment rules of Notice 2016-16 change that position?

• Certain mid-year amendments remain difficult, if not impossible:
  – Adoption of a short plan year or change to the plan year
  – Adoption of a safe harbor plan mid-year
  – Reduction/suspension of safe harbor plan mid-year
Merger Conundrum #1

• Merging safe harbor plans
  – **Scenario 1**: Plan A is a safe harbor non-elective contribution plan. Plan B is a safe harbor matching-contribution plan. The sponsors of the plans are involved in an M&A transaction during the year, and the new Entity AB wants to merge the plans effective July 1, 2016.
  
• To do this merger, we would need to change the type of safe harbor of one of the plans mid-year; this is prohibited under Notice 2016-16, §III.D.3.

• Maintain two formulas? No – SH rules provide that no HCE can get a larger contribution than any NHCE.
Merger Conundrum #1

• Merging safe harbor plans
  – **Scenario 2**: Plan A and B are both safe harbor matching plans, but A is a basic safe harbor match and B is an enhanced safe harbor match. The sponsors of the plans are involved in an M&A transaction during the year, and the new Entity AB wants to merge the plans effective July 1, 2016.

• A mid-year change to modify the matching formula is not permitted unless the change is adopted at least three months before year end and is made retroactive to the first day of the plan year. Notice 2016-16, Section III.D.4
Merger Conundrum #1

• Merging safe harbor plans
  – **Scenario 3**: Plan A is a safe harbor nonelective contribution plan and B is not a safe harbor plan. The sponsors of the plans are involved in an M&A transaction during the year, and the new Entity AB wants to merge the plans effective July 1, 2016.

• Conversion of Plan B into a safe harbor plan mid-year is possible only if a maybe notice was provided at the beginning of the year.

• Plan A can be amended to remove the SH contribution only if a maybe or maybe-not notice was provided or if suffering an economic loss.
Merger Conundrum #2

• Plan A is a current-year tested 401(k) plan. Plan B is a prior-year tested 401(k) plan. A bought B during the year and they want to merge plans.

  – Issue #1: CY or PY in merged plan?

  • Per 1.401(k)-2(c)(1)(i), can change from prior year testing to current year testing anytime. So, if Plan A is the surviving plan, the change of Plan B to current-year testing should be okay.
  
  • Per 1.401(k)-2(c)(1)(ii), can change to PY if part of transaction, it’s done during transition period, and there are two or more plans with inconsistent testing. So, Plan A can change to PY if Plan B survives.
Merger Conundrum #2

• Plan A is a current-year tested 401(k) plan. Plan B is a prior-year tested 401(k) plan. A bought B during the year and they want to merge plans.

  – Issue #2: Who are HCEs?

• If asset acquisition, none of acquired employees are HCEs unless they got stock

• If stock acquisition or merger of companies:
  – How to consider service with target prior to acquisition?
  – How to consider compensation with target prior to acquisition?
Merger Conundrum #2

• Plan A is a current-year tested 401(k) plan. Plan B is a prior-year tested 401(k) plan. A bought B during the year and they want to merge plans.

  – Issue #3: How to test?
    • Regulations are silent (sigh!)
    • If plans have the same plan year, can probably test together for the entire year on chosen testing method (CY or PY)
    • If different plan years, test:
      – Disappearing plan for period from beginning of its plan year to date of merger;
      – Surviving plan for enter year, showing merged-in employees as you would new entrants
Transition Rules

• It is not plan mergers but company transaction that cause the transition rules to be important
  – Stock or asset sale, merger of unrelated companies

• Transition period relates to coverage only, not nondiscrimination testing

• Transition period runs from:
  – Date of company transaction, through
  – Last day of the plan year following the plan year in which the transaction occurred
Transition Rules

• To get transition rule, plans must have met coverage rules before the transaction
• Early termination of transition rule for *amendments*
  – Type of amendments that are “safe”?  
  – Effect  
  – Handling “serially acquisitive” companies
FDL Craziness
Limit on FDLs

• Generally, cannot get FDL on preapproved plans
  – Exception: significant changes to preapproved language
• Can get FDL on individually designed plans
• But, the IRS has announced that, as of January 31, 2017, FDLs will be available only on:
  – Initial plan adoption
  – Plan termination
What Does This Mean?

• Not entirely sure yet, but it is clear that:
  – Unless there is a significant reason to be on an IDP, you should consider using preapproved plan
  – Significant reasons:
    • Type of plan is not available on preapproved basis:
      – Some types of hybrid plans
      – Some types of ESOPs/stock bonus plans
      – Some types of 403(b) programs
    • Plan needs to be changed commonly to accommodate acquisitions/dispositions that are treated differently based on the desires/needs of each acquired entity
More Time to Go Pre-Approved

• A DC plan that is currently on an IDP can sign a Form 8907 and restate up until January 31, 2017, and get full remedial amendment period for PPA
Unanswered Questions

• When does an IDP’s remedial amendment period end?
  – IRS has announced that expiration dates on FDLs are no longer meaningful

• How to comply with EPCRS FDL requirement?

• What happens when the IRS changes what can be in a plan document? How long to amend?

• “Who can I sue?” – may be time to modify service agreement to protect yourself if you do IDPs
Late Deferrals
Deferral Deposits

- Must separate deferrals/loan payments from general assets of the employer as soon as they can reasonably be segregated, but not longer than the 15th business day of the month following the month in which the amount would have otherwise been paid to the employee as cash compensation.
Deferral Deposits

• Right Away!
  – Rule of thumb? Three days from payroll date (maybe)
  – Small plan safe harbor:
    • Need fewer than 100 participants at beginning of plan year
    • Rule: not later than seventh business day after the payroll date
Missed Deferral Deposits

• If deposits are made late:
  – DOL considers this to be a loan to the company (i.e., a prohibited transaction)
  – To correct, need to:
    • Deposit late amount
    • Deposit earnings on late amount
    • Pay excise tax under IRC 4975 (based on the interest, not the principal amount)
Missed Deferral Deposits

• Interest rate: earnings that would have been made plus interest on the earnings
  – Earnings:
    • Lost profits: what the plan would have earned if there had been no improper loan (corporate underpayment rate per IRC; or
    • Restoration of profits: disgorgement of whatever profit the borrower made on the funds
Missed Deferral Deposits

• Interest rate: earnings that would have been made plus interest on the earnings
  – Earnings: the greater of:

    • Lost profits: what the plan would have earned if there had been no improper loan (corporate underpayment rate per IRC §6621(a)(2) or, if more than $100,000 is to be returned, §6621(a)(1)); or

    • Restoration of profits: disgorgement of whatever profit the borrower made on the funds

  – If using VFCP:

    • Can use VFCP calculator

    • No excise tax on prohibited transaction loan
Missed Deferral Deposits

• Example
  – ABC company should have deposited $10,000 in salary deferrals on February 15, 2016, but did so on March 15, 2016, instead
  – The “full correction” will occur on March 25, 2016
  – DVFC calculator:
    • Principal amount:  $10,000
    • Loss date:  February 15, 2016 (could use February 18, 2016, instead to give self three days, but why bother?)
    • Recovery date:  March 15, 2016
    • Final payment date:  March 25, 2016
  – Amount due:  $23.82 (if you used February 18, it would be $21.35)
If You Don’t Use VFCP

• Technically, need to figure out actual plan earnings
• Need to file Form 5330 and pay excise tax (which is 15 percent of the interest in each plan year in which loan was outstanding)
Calculating Information for Form 5330

• Example:
  – On February 15, 2014, XYZ Company forgot to deposit $10,000 in salary deferrals to the plan
  – This was discovered on March 15, 2016, and corrected
  – Final correction was made on March 25, 2016
  – If use VFCP Calculator, the interest is $644.03 (if you use actual plan investments, the figure could be different)
• Need to have interest calculation for each calendar year

• For 2014:
  – For 2014 Form 5330, the loan was outstanding from February 15, 2014, to December 31, 2014:
    • Interest is $264.65
    • Value of loan on December 31, 2014 = $10,264.65
  – Form 5330 shows the above amounts; tax is 15 percent of $264.65, or $39.70
Reporting on Form 5330

• For 2015
  – Form 5330, the loan was outstanding from January 1, 2015, to December 31, 2015:
    • Amount of loan is $10,264.65
    • Interest is $311.72
    • Value of loan on December 31, 2014 = $10,576.37
  – Form 5330 tax pyramids:
    • Must again pay the 2014 tax of $39.70; plus
    • 2015 tax of $311.72 x 15 percent = $46.76
    • Total tax = $86.46
Reporting on Form 5330

• For 2016
  – Form 5330, the loan was outstanding from January 1, 2016, to March 15, 2016, with final correction on March 25, 2016:
    • Amount of loan is $10,576.37
    • Interest is $64.40
  – Form 5330 tax pyramids:
    • Must again pay the 2014 tax of $39.70; plus
    • Must again pay the 2015 tax of $46.76; plus
    • Must pay 2016 tax of 64.40 x 15 percent = $9.66
    • Total tax = $96.12
Reporting on Form 5330

• Total tax per yearly calculations:
  – 2014: $39.70
  – 2015: $86.46
  – 2016: $96.12
  Total = $222.28

• Question: which will cost more:
  – Tax of $222.28 plus preparation of three years’ Forms 5330?
  – Preparation of a VFCP filing?
Qualifying Under VFCP for Waiver of Excise Taxes

• Either:
  – If amount of tax would be $100 or less, can deposit that amount to the plan as extra earnings, and not pay excise tax; or
  – If amount of tax would be more than $100 OR if you don’t want to pay it at all, need to provide NTIP to affected participants within 60 days of VFCP calculation
A Few Other Thoughts

• If you are late making deposits, you lose the seven-day rule and it reverts back to the soonest you could have deposited the money

• If your late deposits are large, the calculator automatically uses the more expensive rates under IRC §6621(a)(1)

• Under VFCP, filing must be *pristine* to be accepted – cannot vary from the rules or it will be rejected (see checklist that is part of the filing package)
Other Problems That Can Be Handled Under VFCP

- Loans to PII* 
- Below market loans to others 
- Delay in perfecting loan security 
- P-loans that fail to meet plan provisions 
- Defaulted P-loans 
- Purchases from PII at FMV* 
- Sales to PII at FMV* 
- Sales/leaseback of property to sponsor* 

- Purchases from non-PII for more than FMV 
- Sales to non-PII for less than FMV 
- Illiquid assets bought by plan* 
- Benefit payments based on wrong valuation 
- Payment of duplicate, excessive, or unnecessary compensation 
- Improper payment of expenses* 
- Dual compensation to fiduciary

*Eligible for waiver of excise tax
Questions?
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