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Setting precedent.

## 401(k) PLAN BASICS

Greta E. Cowart

ERISA Basics

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## 401(k) Plans

- Basics for a 401(k) Plan
- Exception to Constructive Receipt Doctrine with Strings
- Contributions
  - Employee Elective - CODA
    - Automatic Enrollment vs. QAC
    - Actual Election
    - Evergreen Election
    - Default Investments
  - Catch-up Contributions
  - Employer Contributions

## 401(k) Plans – cont'd

- Nondiscrimination
  - 401(k) and 401(m) funds
    - General Rules
    - Safe-Harbors
      - 401(a)(4)
- Distributions
  - Loans
  - Hardship
  - Separation from Employment
  - Disability
  - Death
  - Age 59-1/2 and Older

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## 401(k) Plans – cont'd

- Investments
  - 404(c)
  - Employer Stock
  - SEC Rule 22c
- Default Investments

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## Type of Tax Qualified Retirement Plan

- Subject to 401(a) Requirements
  - Participation
  - Vesting
  - Nondiscrimination
    - 401(a)(4) – BRF
  - Distributions
- Employer Deduction Limits
  - Elective Deferrals treated as employer contributions
  - 25% of Compensation Paid or Accrued to Beneficiaries (404(a)(3))

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## Type of Tax Qualified Retirement Plan – cont'd

- Limitations on Accruals By Individual
  - § 415
    - \$44,000 in 2006; \$15,500 in 2007
    - 100% of compensation
  - Top heavy rules
- Trust Requirements of 501(a)
- Subject to ERISA

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## Types of Employers

- All types of private organizations
  - LLC
  - Sole proprietorships
  - Partnerships
  - S corporations
  - Tax exempts
  - Indian Tribal Governments
- Not permitted by state and local governments
  - Grandfathered plans prior to May 6, 1986

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## Contributions

- Elective Contributions
  - Cash or deferred election
- Matching Contributions
- Discretionary Contributions
- After-tax Participant Contributions
- Deemed IRA Contributions
- Roth 401(k) – beginning in 2006

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## Elective Contributions

- Cash or Deferred Election
  - Election to receive cash that is not currently available or have amounts contributed to the plan
  - One time irrevocable elections made upon commencement of employment or participation not cash or deferred arrangement
    - Partnership plans

## Elective Contributions – cont'd

- May be Automatic – Negative Election
  - Negative election must be prospectively revocable
- Partnership / Sole Proprietor 401(k) Plans
  - Elections of partners / proprietor must be made by last day of plan year
- 100% Vested

## Elective Contributions – cont'd

- Deferral limit – per calendar year (§402(g))
  - \$15,000 in 2006; \$15,500 in 2007
  - COLA thereafter in \$500 increments
- Applies to individual / not by plan
- Exception for reemployed veterans makeup contributions

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## Additional Points on Elective Deferrals

- Deferrals made on definition of compensation contained in plan
  - If want deferrals to apply to bonuses, then should include in definition
  - May have separate election for bonus
- Must be active employee to make deferrals
  - Deferrals cannot be made out of severance payments (Depends on final 415 regulation content)

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## Transmission of Deferrals

- Elective Deferrals – Plan Assets
  - Must be deposited in trust
  - As soon as can reasonably be segregated from employer’s general assets
  - No later than 15<sup>th</sup> business day of month following month otherwise payable in cash to employees
- 15 Business Days is NOT SAFE HARBOR

## Transmission of Deferrals – cont’d

- Limited extension of 15 day rule
  - Written Notice to Participants
  - Notice to DoL
  - Performance Bond or Letter of Credit
  - Only two per year
- Voluntary Fiduciary Correction Program
  - Restoration of lost earnings or profits resulting from delay
  - Form 5330 and Payment of Excise Tax

## Contribution Limits

- 402(g)
- 415
- 404
- Catch Up
- ADP/ACP Later

## Elective Contributions – cont'd

- Excess Deferrals – Over 402(g) Dollar Limit
  - Refunded by 4/15
  - Plus income for year
  - Gap income from year end to distribution if plan provides
- Failure to timely correct
  - Inclusion in income in year of deferral and year of correction
  - Loss of tax qualification of plan

## Catch-Up Contributions

- Age 50 by end of tax year
- Contribution Limit – per participant not per plan
  - Dollar limit for year
  - Participant's compensation
  - Plan limit
- Dollar Limits
  - \$5,000 – 2006 and in 2007
  - COLA in \$500 increments thereafter

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## Catch-Up Contributions – cont'd

- If in one plan must be in all plans
  - Employer is controlled group
  - No union exception
- May match
  - Design match formula to match dollars you want to match of all salary deferrals
- Not subject to nondiscrimination rules
- 100% vested

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## Nondiscrimination

- Actual Deferral Percentage Test – ADP
  - Elective Deferrals
  - Does not apply to Catch-up contributions
  - Not applicable to SIMPLE
  - Not applicable if safe harbor contribution formula and notice

## Nondiscrimination – cont'd

- Actual Contribution Percentage Test – ACP
  - Matching Contributions
  - After-tax Participant Contributions
  - Not applicable to SIMPLE or SAFE HARBOR 401(k)
- General Nondiscrimination Test
  - Discretionary Employer Contributions

## ADP

- Actual Deferral Percentage = ratio of elective deferrals to compensation for all members of group (HCEs vs. NHCEs)
- Applies to “Eligible Employees”
  - All employees who satisfy minimum age and service requirements of plan regardless of contributions

## ADP – cont’d

- Must Satisfy One of Two Tests
  - ADP of HCEs not more than 125% of ADP of NHCEs
  - ADP of HCEs not more than 2 percentage points greater than the ADP of NHCEs and the ADP of HCEs is not more than 2X ADP of NHCEs
- Prior year vs. Current Year Testing
  - Plan must reflect
  - Changes limited
  - Impacts timing for correcting contributions

## ADP Test

- May use “Qualified Matching Contributions” and “Qualified Nonelective Contributions” to satisfy test (aka “booster contributions”)
- QMACs and QNECs must be 100% vested and subject to same restrictions on distributions as elective deferrals
- Made no later than 12 months after the plan year to which they relate (prior year testing – end of plan year being tested)
- Plan must provide for use of QMACs and QNECs

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## Correction of ADP Failure

- Amount which violates test = “Excess Contributions”
- Various methods of correction
  - Use QMACs / QNECs
  - Restructure plan- no restructuring, but can test <21 and <1 year of service separately, if plan so provides
  - Recharacterize Excess Contributions – treated as catch-up or after-tax
  - Distribute Excess Contributions + income

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## Correction of ADP Failure – cont'd

- If Distribute (pre-PPA rules):
  - By 12 months after close of plan year
  - But 2-1/2 months after end of plan year to avoid 10% excise tax + filing Form 5330
  - Post 2007 – 12 months to distribute
  - Gap income included for daily valued plan thru 2007
  - Include in income in year of deferral if made within 2-1/2 months
  - If cannot after 2-1/2 months, include in year paid, unless <\$100

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## Correction of ADP Failure – cont'd

- If Distribute (PPA changes), income is included:
  - Include in income in year deferred if made within 12 months before 2008 and after 2007, distribute within 12 months and include in year distributed
  - Distribute within 12 months to avoid 10% excise tax and filing Form 5330
  - If after 12 months in 2008 or later, then include in year the deferral is refunded, unless less than \$100
  - If distributed after 2007, included in year deferral distributed
  - Six months post 2008 for deferrals in error under QAC

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## ACP Test

- ACP = Average of the sum of matching contributions and after-tax as percentage of eligible employee's compensation determined on a group basis (HCEs vs. NHCEs)
- Eligible Employee
  - Eligible to receive a match, even if temporarily suspended
  - Includes those who do not contribute

## ACP Test – cont'd

- Must Satisfy One of Two Tests
  - ACP of HCEs not more than 125% of ACP of NHCEs or
  - ACP of HCEs not more than 2 percentage points greater than the ACP of NHCEs and the ACP of HCEs is not more than 2X ACP of NHCEs
- Prior Year vs. Current Year Testing

## ACP Test Correction

- Failure of ACP Test = Excess Aggregate Contribution
- Correction of ACP Test
  - QNECs / QMACs
  - Recharacterization of Excess Deferrals
  - Forfeiture of Excess Aggregate Contributions
    - Plan Must provide
    - Non-vested only

## ACP Test Correction – cont'd

- Correction of ACP Test – cont'd
  - Distribution of Excess Aggregate Contributions + income
    - 12 months to avoid disqualification
    - 2-1/2 months to avoid 10% excise tax and Form 5330 – after 2007 – 12 months to distribute
    - Gap income included if provided by plan (no gap income after 2007)
    - Included in income in year contributed if distributed within 2-1/2 month period. If later, then in year of distribution

## ADP Safe Harbors

- Avoid ADP and ACP Tests by Adopting Safe Harbor Plans
- Requires at least 30 day advance notice to participants
- 100% vesting in all safe harbor contributions

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## ADP Safe Harbors – cont'd

- Required Employer Contribution
  - \$ for \$ match up to 3% and 50¢ on \$ between 3-5% = basic match
  - 3% nonelective contribution
  - Alternative match (enhanced match) can be used, as long as
    - rate of match is at least equal to match under basic match,
    - rate of match may not increase as rate of elective contribution increases
    - rate of match for any HCE is not greater than rate of match for NHCE
    - Example – 100% on up to 4%

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## ACP Safe Harbor Also

- Plan that satisfies ADP safe harbor can also satisfy ACP test for matching contributions
- Plan must provide basic match or enhanced match that does not match contributions in excess of 6% of compensation
  - May also provide additional discretionary match
    - Total match may not exceed 4% of employee's compensation

## ACP Safe Harbor Also – cont'd

- Plan could provide match other than safe harbor if:
  - Match not made on employee contributions in excess of 6% of compensation
  - Rate of match does not increase as rate of contributions increase
  - Rate of match that applies to any HCE cannot exceed rate of match that applies to NHCE at same rate of contributions
- Safe Harbor does not apply to after-tax contributions

## Qualified Automatic Contribution ("QAC") Safe Harbor

- Each eligible participant automatically makes contribution:

<u>Deferral</u>	<u>Year of Participation</u>
3%	1
4%	2
5%	3
6%	4 or more

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## QAC Safe Harbor

- Participants may elect out of QAC
- Participants may elect a higher contribution rate
- Need not apply to current employees with elections in effect

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## **QAC – Safe Harbor - Match**

- 100% of first 1% of Compensation, plus
- 50% of deferrals above 1% of Compensation up to 6% of Compensation
- 3.5% of Compensation Max Match Cost if employee defers 6%

## **QAC Safe Harbor – QNEC Alternative**

- QNEC of 3% of Compensation
- Match or QNEC subject to distribution restrictions
- Match or QNEC must vest after two years

## **QAC – Safe Harbor**

- Notice Required
- Explain rights to elect at different rate
- Explains default investments
- Provide reasonable period after notice delivered to change election

## **QAC - Preemption**

- ERISA supersedes state laws prohibiting or restricting automatic salary reduction contributions
- Plan amendment timing
- QAC effective plan years beginning after December 31, 2007

## Variations for Small Employers

- SIMPLE Plans – Savings Incentive Match Plan for Employees – IRA version 408(p)
  - 100 or fewer employees who received at least \$5,000 of compensation in prior year
  - No other tax qualified retirement plan
  - Contribution made to IRAs for Plan, not to Trust
  - Salary Deferral limited to \$10,000 in 2005 and later years
  - Match
  - All who earned \$5,000 in either two prior years eligible + expectation

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## SIMPLE Plan

- Limited to small employers
  - Less than 100 employees who earn at least \$5,000
  - Two year grace period if go over 100
- Exclusive Plan – no other plan even of predecessor

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## **SIMPLE Plan for Small Employer – 401(k)(11)**

- SIMPLE Plan with Trust
  - Contributions to Trust, not IRAs
  - Elective Contributions up to \$10,000 in 2005 plus index
  - Match Vested up to 3% or Nonelective 2%
  - Annual Notice of Rights Required

## **SIMPLE Plan – 401(k)(11) – cont'd**

- Contributions Limits
  - \$15,000 in 2006; \$15,500 in 2007
  - COLA in \$500 increments thereafter
- Catch Up Contributions
  - \$2,500 in 2006; \$2,500 in 2007
  - COLA in \$500 increments thereafter

## **SIMPLE Plan – 401(k)(11) – cont'd**

- Matching Contribution required \$ for \$
  - Up to 3% of contributions
- Or nonelective contribution of 2% of compensation
- All employer contributions 100% vested

## **Participant Loans**

- Loans
  - Available to all participants on reasonably equivalent basis
  - Not available to HCEs in amounts greater than NHCEs
  - According to specific provisions in plan
  - Bear reasonable rate of interest
  - Adequately secured
  - Enforceable
  - Katrina Relief
  - Soldiers & Sailors Civil Relief Act

## Participant Loans – cont'd

- Not taxable if:
  - Repaid within five years
    - Unless used to acquire principal residence
  - Substantially level amortization of principal and interest with payments at least quarterly
  - Limited to the lesser of
    - \$50,000 reduced by highest outstanding balance of loans during the one year period ending on day before loan is made, or
    - Greater of  $\frac{1}{2}$  participant's account balance or \$10,000
    - Only Exception is Katrina Effected Individuals

## Loans – Katrina Relief

- Up to \$100,000 less amounts treated as Hurricane Katrina distributions
- Not limited to  $\frac{1}{2}$  of nonforfeitable accrued benefit

## Loans – Katrina Relief – cont’d

- Repayment
  - At any time in three year period beginning on date after distribution paid may contribute to eligible retirement plan and that will treat the contribution as an eligible rollover distribution and as having transferred amount to plan in direct trustee-to-trustee transfer
  - Must have principal place of abode on August 28, 2005 in Hurricane Katrina disaster area and suffered economic loss by reason of Katrina
  - Income inclusion for Katrina distribution only must be included ratably over three years unless elect to include in current year

## Loans - Katrina Relief – cont’d

- Outstanding plan loans for payments due between 8/25/05 and 12/31/06 – due dates delayed one year
- Subsequent repayments adjusted for interest during delay
- One year delay disregarded for five year maximum

## Distributions - Hardship

- Hardship Distributions
  - Limited to elective contributions only (no earnings)
  - Immediate and heavy financial need (events test)
  - Necessary to satisfy the need (needs test)

## Distributions – Hardship – cont'd

- Events Test – Safe Harbor
  - Payment of medical care incurred by participant, spouse, dependents, or necessary to obtain care
  - Purchase of principal residence
  - Tuition, related educational fees, room and board for next 12 months of post-secondary education for participant, spouse, dependents
  - Prevent eviction from or foreclosure on participant's primary residence

## Hardship Withdrawals

- Needs Test – Safe Harbor
  - Amount does not exceed amount necessary to relieve financial need
  - Participant taken all distributions and nontaxable loans
  - Participant does not make elective deferrals or after-tax deferrals for at least six months

## Hardship Withdrawals – cont'd

- Needs Test – Written Statement that need cannot be satisfied by:
  - Reimbursement or compensation by insurance or otherwise;
  - Liquidation of participant's assets
  - Ceasing contributions under the plan
  - Other distributions or nontaxable loans
  - Borrowing from commercial sources on reasonable terms

## Hardship Withdrawals – cont'd

- Subject to ordinary income tax
- Subject to 10% early distribution tax if taken before 59-1/2
- May take out amount plus amount to cover taxes
- Not subject to 20% mandatory income tax withholding because not “eligible rollover distribution”

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## Katrina Relief

- Hardship Withdrawals for Katrina Individuals
  - § 72(t) – 10% withdrawal penalty does not apply
- Plan Amendments
  - Last day of First Plan Year beginning on or after January 1, 2007

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## PPA Hardships for Called to Active Duty

- Post 9-11-01
- No 10% withdrawal penalty

## Distributions – In Service

- Nonelective contributions may be distributed after fixed number of years
  - At least two
- Elective Contributions
  - After attainment of age 59-1/2
  - Termination of plan
  - Severance from employment
    - Sale of substantially all assets of a corporation
    - Sale of a subsidiary

## **ROTH 401(k) Account**

- Beginning in 2006
- Employee designates salary deferral as
  - pre-tax or
  - ROTH (post-tax)
  - Unlike Roth IRA, there is no limit on whom may have based on modified AGI

## **ROTH 401(k) Account**

- Since employees must designate whether their deferrals are Roth or Pre-Tax, you need to solicit all participants to elect and designate
- Enrollment forms need to be modified for the election and communication of consequences of the election choices must occur

## ROTH 401(k) Account

- Popular for individuals who think marginal tax rate in retirement will be higher than current marginal tax rate
- Popular for people to use as estate planning tool, roll to Roth IRA and pay no MRD
- People who want no tax on earnings for qualified distributions or after-tax savings (effectively increases 415 limit by changing same \$ to post-tax so distributions go further)

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## Potential Value of Roth 401(k)

- Contributions and earnings distributed tax free if “qualified distribution”
- Ignoring bets on tax rates in the future in order to accumulate same benefit from a pre-tax account as in a Roth for the same dollar amount deferred, the pre-tax saver in the 401(k) must also save the tax savings he realizes from the pre-tax contribution to equate his pre-tax dollars saved to the post-tax savings of the same amount in a Roth 401(k) – this does not account for the earnings on the savings

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## Potential Value of Roth 401(k)

- If you saved \$15,000 of post tax dollars in a Roth 401(k), that is \$15,000 saved after paying tax of \$4,500 assuming a 30% rate, he has \$4,500 less of current spending money, but more retirement savings
- The pre-tax saver saves \$15,000, but it will be taxed later with its earnings and the \$4,500 of taxes he saved by making the pre-tax contribution, if not saved, is lost retirement savings when compared to the Roth 401(k) account because Roth \$ can come out without tax on distribution
- When pre-tax deferrals are distributed both the pre-tax deferrals and the earnings are taxed (if not rolled over)
- Roth distribution has no tax on Roth contribution or earnings

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## ROTH 401(k) Account

- Must be attached to 401(k)
- Not available for SARSEP or SIMPLE (IRA model)

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## **ROTH 401(k) Account - cont'd**

- Roth Account Contributions combined with pre-tax and combined subject to one 402(g) limit
- Roth contributions subject to ADP
- Once elect Roth treatment, the election is irrevocable for those dollars
- Roth election must be in place before \$ allocated to account
- All other election rules for elective deferrals continue to apply to Roth \$

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## **ROTH 401(k) Account - cont'd**

- Roth \$ tracked separately in Payroll and in Plan Accounts
- Roth \$ must be in account five years to get favorable tax treatment on distribution as a qualified distribution
- Only Direct Rollover of Roth \$ from another qualified plan preserves years of participation carry forward toward 5 year requirement

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## Roth 401(k)

- May use default or negative election
- If a default or negative election is used, the plan must provide for the allocation of the amount contributed pursuant to the default or negative election between Roth and pre-tax accounts
- If the plan provides the default contributions are Roth, then the employee is deemed to have irrevocably elected to make the contributions Roth as required Treas. Reg. §1.401(k)-1(f)(4)

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## ROTH 401(k) Account

- Tests and Rules
  - § 410(b)
  - § 415
  - § 402(g)
  - § 72
  - Contingent Benefit Rule § 1.401(k)-1(d)(6)
  - § 401(a)(4) – BRF
  - §414(v) Catch up contributions

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## **Roth 401(k) Account- Excess Deferrals**

- Distribute by April 15 in next tax year
  - Earnings on excess are taxed
  - Excess deferrals distributed (either by employee election or plan design) from Roth account are not subject to income taxes, if timely

## **Roth 401(k) Account- Excess Deferrals**

- Distribution of excess deferral that occurs after April 15 in next tax year means a different tax result for the participants
  - Proposed Regulations tax the earnings on the excess deferral distributed
  - The excess deferral distributed from the Roth account is taxed as income to the participant a second time
  - The Roth account is reduced for the distribution

## **Roth 401(k) Account- Excess Deferrals**

- Gap period income from end of year of deferral until distributed
- Calculate using the gap period income rules for 401(k) and 401(m) violations per the proposed regulations from January 26, 2006

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## **ROTH 401(k) Account - Distributions**

- Corrective refunds are not qualified distributions or eligible for rollover
- Excess annual addition (>415(c) limit)
- Excess deferral >402(g) limit – double taxed if not refunded by 4/15
- May allow HCE to choose source of corrective distribution of excess contribution (ADP failure), still subject to gap period income calculation rules
- Excess aggregate contribution (ACP failure) and related earnings on such

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## **ROTH 401(k) Account**

- Automatic Rollover permitted but the plan must allocate between pre-tax and Roth
- Deferral Elections must be allowed to change more than one time per year
- On distribution, §72 will determine ordering for tax calculation
  - pro rata
  - exclusion ratio

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## **ROTH 401(k) Account**

- Can be Catch-up Contributions
- Optional for Employer to match even if matches pre-tax \$
- Employee has no recordkeeping responsibility
- Employer has full recordkeeping responsibility- separate accounting is required for contributions and earnings

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## **ROTH 401(k) Account**

- Separate Roth accounts and recordkeeping required - § 402A(b)(2)
- Only Roth contributions and earnings in Roth accounts
- Match must go to another account which is pre-tax

## **ROTH 401(k) Account - Inservice Access**

- Hardship Withdrawals allowed same as for elective deferrals
- Can be a qualified distribution and only partially taxable if five years and over age 59-1/2
- Plan's terms determine source rules for distribution

## **ROTH 401(k) Account - Inservice Access cont'd**

- Loans are allowed
  - Deemed distribution is never a qualified distribution
  - Roth and non-Roth accounts are combined for loan rules

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## **ROTH 401(k) Account - Qualified Distributions**

- Must be a qualified distribution to be tax-free
- Earliest qualified distribution will be after 2010
- A distribution that is not a qualified distribution is taxed pro rata

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## **ROTH 401(k) Account - Qualified Distribution Requirements**

- Must be after end of tax year which is the 5<sup>th</sup> year of participation (starts on first date of plan year with Roth contributions and ends when five consecutive years have elapsed)
- Must be from a Roth account
- Must be paid on account of employee's
  - attaining age 59-1/2 or older
  - death
  - disability

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## **ROTH 401(k) Account - Rollovers**

- Direct Rollovers of nontaxable portion → 401(a) to 401(a) tacks beginning date of five year participation period
- Indirect Rollover of nontaxable portion → 401(a) to Roth IRA must be within 60 days no tacking
- Indirect Rollover of taxable portion → 401(a) to regular IRA must be within 60 days

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## **ROTH 401(k) Account - Rollovers**

- If any portion of an account rolled over is Roth and it is received in a rollover that is not a direct rollover, then the recipient plan must provide the IRS with:
  - employee's name and SSN
  - amount rolled over
  - year in which rollover occurred
  - other information to be specified

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## **ROTH and Negative Enrollment**

- Which account receives auto-enrollment contributions?
  - Pre-Tax
    - Deferral and FICA
  - ROTH
    - Deferral
    - FICA
    - Federal and State and Local Income Taxes
  - Plan must specify

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## **ROTH Plan Design Issues**

- ADP and ACP Violations
  - Refund from ROTH or Pre-Tax?
  - Both have earnings taxed
  - ROTH Contributions Not Taxed
  - Pre-Tax Contributions Are Taxable
- Let Participants Choose Which Account
- Plan Design Decides

## **Investments**

- Individually Directed Plan Investments
- ERISA §404(c)
  - protects plan fiduciaries from losses resulting from a participant's or beneficiary's own investment direction
  - does not eliminate need to consider the prudence of the investment alternatives made available to plan participants or to maintain oversight over the investment options
    - fees
    - restrictions

## ERISA § 404(c)

- Plan must allow Participants to:
  - choose from a broad range of at least three investment alternatives with varying risk and return characteristics,
  - give investment instruction with appropriate frequency (at least quarterly for three core options, but could be more often depending upon the market volatility of the investment options),
  - diversify investments to minimize risk of large losses,

## ERISA § 404(c) – cont'd

- Plan must allow Participants to: (cont'd)
  - requires significant disclosures,
  - disclosure of mutual fund imposed trading restrictions, fees and penalties, and
  - obtain sufficient information to make informed investment decisions (must receive information on the investment alternatives, investment managers, limitations on investments, description of transaction fees, a description that the plan is intended to be covered by 404(c).

## Default Investments

- PPA
- Notice
- Balanced, Managed, or Life Style

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## ERISA § 101(I) – Blackout Notices

- Applies if participants/beneficiaries may not transact in assets, obtain loans or distributions for more than three business days
- Notice to Participants and Beneficiaries
- Model Notice provided in regulations
- 30/60 day time period to furnish

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## **ERISA § 101(I) – Blackout Notices – cont'd**

- 30 day exemption if
  - Deferral of blackout period would violate ERISA fiduciary duties
  - Unforeseeable events beyond plan administrator's control
  - Arises in connection with a merger, acquisition, divestiture and occurs solely in connection with becoming or ceasing to be a participant
- Notice to issuer of company stock held by plan

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## **Exclusions from Notice**

- Occurs by reason of the application of securities laws
- Regularly scheduled suspension described in SPD, SMM or other investment materials
- QDROs
- Participant or third party responsible

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## Penalties

- \$110/day per participant penalty
- Date of failure to provide to the up to and including the date that is the final day of the blackout period for which the notice was required
- Penalty may be waived if acted reasonably and in good faith

## Employer Stock

- If Employer Stock is publicly traded, securities law aspects of Plan
  - Registration of Plan Interests – Form S-8
  - Registration of Stock
  - Restrictions on Trading = Black out notices (SEC and DoL)
  - Section 16 and 10-b5 issues
    - Discretionary transactions exempt
    - Nondiscretionary transactions not exempt

## PPA - Publicly-Traded Employer Stock Diversification

- Notice required at least 30 days in advance
- Must apply if Participant has three years of service
- PPA 2006 – Effective 1-1-07
- Restrictions no greater than on other funds
- Diversification Notice on Quarterly Statements

## Prohibitions on Insider Trading

- Applies only during “black-out” period under 401(k) and similar retirement plans
  - Not same definition as black-out under ERISA §101(l)
- Applies to public companies (including issuers of public debt and companies who have filed registration statements but not gone public in an IPO)
- Prohibits executive officers and directors from trading in company stock acquired in connection with employment
- Any profit realized is recoverable by the company
- Regulation BTR

## **“Black-out” Period – SOX 306(a)**

- More than three consecutive business days
- More than 50% of plan participants or beneficiaries prohibited from trading company stock
- Applies only to individual account plans that
  - Permit investment in Company Stock fund
  - Include open brokerage which permits investment in any stock, including issuer
  - Match in company stock
  - Reallocate forfeiture of company stock to remaining plan participants

## **“Black-out” Period – SOX 306(a) cont’d**

- Excludes plans maintained outside of US primarily for the benefit of nonresident aliens
- Plan census data on any date within 12 months preceding blackout

## Exemptions from Black-out – SOX 306(a)

- Regularly scheduled
  - Incorporated in plan
  - Disclosed as part of SPD or other official plan communication
  - 30 days of enrollment in plan or adoption of amendment
- Black-out periods in connection with participants becoming or ceasing to be participants
  - As a result of mergers, acquisitions, divestitures

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## Prohibits trading of stock acquired in connection with employment

- Presumption for stock having been acquired in connection with employment as director or executive officer
  - Presumption rebuttable if traceable and identified for all purposes
  - Does not include securities acquired as an employee when not an executive officer or director
    - Except inducement grants
  - Does include securities acquired as an executive officer or director prior to becoming issuer

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## Exemptions

- Dividend reinvestment plans
- 10b5-1 trading plans
  - Not entered into or modified during blackout period
- Non-discretionary transactions under tax conditioned plans
- Stock splits and dividends
- Automatic grants under terms of plans

## Exemptions – cont'd

- Bona fide gifts or transfers by will or laws of descent and distribution
- Transfers pursuant to domestic relations orders
- Required by law
- In connection with mergers, acquisitions or similar transactions

## Notices

- Notice must be provided to officers, directors and SEC
- Notice must specify length of black-out period
  - Follows flexibility of DoL rules
- Provided to executives and directors five business days after issuer receives notice from plan
  - If no notice from plan 15 business days prior to black-out period
- Notice to SEC on Form 8-K

## 401(k) Basics

Thank you for your  
attention