retirement
plan news

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Qualified Retirement Plan Protection from Creditors

The Employee Retirement Income Security Act of 1974 (ERISA) sets standards for employee benefit plans, including qualified retirement plans. Included in the law are provisions to ensure that plan assets are protected. For example, under ERISA Title I, participant accounts are protected from garnishment, levy, or attachment by creditors.

Generally speaking, a retirement plan that covers more individuals than just an owner-employee and his or her spouse, or just the business's partners, has ERISA Title I protection.

Exceptions to ERISA Protection. A participant's assets are not protected from a federal tax levy or a qualified domestic relations order (QDRO). ERISA also has a provision permitting a participant's account to be used as collateral for a participant loan. In addition, if a participant places a qualified plan distribution into an account or investment outside the plan, creditors may seek assignment of those assets.

IRS Tax Levy Exception. If a plan receives an IRS tax levy against the account of a plan participant, the levy must be honored. However, based on guidance from the IRS, the plan may refuse to process a distribution to satisfy the levy if the participant is not eligible for a distributable event. If the participant is eligible for a distribution, the IRS levy may be processed — with or without the participant's consent — after the plan's administrative policies for IRS levies have been followed.

Although rarely used, and only in "flagrant and aggravated" cases, IRS policy does allow the levy to be enforced before a participant is eligible for a distribution. The IRS will make it clear if the levy must be treated in this manner.

If the individual is under age 59½, the 10% premature distribution penalty *does not* apply; but income tax will be due on the distribution. Note that the ERISA exception regarding federal tax levies does not apply to states; state tax levies cannot be applied against a participant's qualified retirement plan balance.

QDRO Exception. A QDRO is a court order issued following a divorce or legal separation (separate maintenance agreement) that directs a portion of a participant's plan assets to be paid to an "alternate payee." The alternate payee may be the participant's spouse, ex-spouse, or dependent children. To be considered "qualified," a domestic relations order (DRO) must be written according to very specific rules. If it does not meet the qualification requirements, the DRO must be returned to the court for revision.

Once a DRO has been qualified, the plan administrator must follow its instructions and segregate the affected plan assets or pay the designated sum to the alternate payee(s), as identified in the QDRO. One of the things a QDRO may not do is require a payment option that is not otherwise available under the plan.

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No Exception for a Criminal Sentence or "Bad Boy" Clause. Generally, the terms of a criminal sentence may not order the plan to pay out a participant's benefits to a third party as restitution, even for a crime committed against the employer. For example, suppose an employee embezzled $20,000 from the employer. The employer is not permitted to recover the $20,000 by taking the participant's 401(k) plan assets because of the protection ERISA provides for retirement benefits.

There is a limited exception when a crime is committed against the plan. Had the employee stolen $20,000 from the plan's assets instead of from the employer, then a federal court or the U.S. Department of Labor could order the plan administrator to offset the plan's loss against the participant's account. In this case, the participant is presumed to have already received a distribution from the plan for the amount embezzled.

Using a One-time Distribution To Pay a Creditor. If a participant wishes to do so, a distribution may be used to pay a creditor *provided* the participant is eligible to take a distribution (e.g., he or she has terminated employment or reached age 59½). As long as the participant requests a distribution voluntarily, and not under duress, the payment may be assigned to a creditor. Once the participant makes a specific request for a third-party distribution to be made, the plan administrator must contact the third party to obtain an acknowledgement that the payment may be made.

Paying a Creditor from Installment Distributions. A participant who is receiving installment distributions may assign an amount to be paid to a creditor from his or her installment or annuity distributions. However, under ERISA, no more than 10% of each payment may be paid to a creditor. In addition, the participant must be allowed to revoke the assignment.

Participant's Interest in the Plan Excluded from Bankruptcy Estate. A participant's assets in a qualified retirement plan are protected from creditors in the event of a bankruptcy, whether or not the plan is a Title I plan. ❖

IRS and Social Security Cost-of-Living Adjustments

IRS LIMITS	2009	2008
Defined Contribution Plan Limit on Annual Additions	$49,000	$46,000
Defined Benefit Plan Limit on Annual Benefits	$195,000	$185,000
Maximum Compensation Limit for Allocation and Accrual Purposes	$245,000	$230,000
401(k), SARSEP, 403(b), and 457 Plan Deferrals/Catch-up	$16,500/$5,500	$15,500/$5,000
SIMPLE Deferrals/Catch-up	$11,500/$2,500	$10,500/$2,500
IRA Contributions/Catch-up	$5,000/$1,000	$5,000/$1,000
Compensation Defining Highly Compensated Employee (2008 amount for use in 2009 plan year tests)	$110,000	$105,000
Compensation Defining Key Employee/Officer	$160,000	$150,000
Social Security Taxable Wage Base (SSTWB)	$106,800	$102,000

Back to Basics: Guidance on Missing Participants

The Department of Labor's (DOL) Field Assistance Bulletin 2004-2 provides defined contribution plans with guidance on a difficult topic: locating missing participants. The guidance emphasizes that the employer has a fiduciary responsibility to attempt to locate missing participants when a plan is being terminated or when a former employee with $5,000 or less is being involuntarily cashed out and a distribution election cannot be secured.

Four Mandatory Search Methods. The DOL provides four efficient and relatively inexpensive search methods that all fiduciaries must use to find missing participants before any further steps may be taken. They are:

1. *Use certified mail.*
2. *Review related plan records* (e.g., other retirement and welfare benefit plans) for a newer address for the participant. If privacy issues arise (a common concern with health plans), a letter may be forwarded asking the participant to contact the administrator of the retirement plan.
3. *Contact the participant's designated beneficiary.*
4. *Use a letter forwarding program*, such as the IRS program (*www.irs.gov/retirement/article/0,,id=110106,00.html*) or the Social Security Administration program (*www.socialsecurity.gov/foia/html/ltrfwding.htm*).

Optional Search Methods. If these efforts are unsuccessful, an employer may use additional search methods (such as Internet search tools, commercial locator services, and credit reporting agencies). If the cost of the optional search is being charged to the participant's account, the employer should consider whether the cost is greater than the amount in the participant's account.

Distribution Options. If the participant cannot be located, the employer may choose from the following distribution options:

1. *Automatic Rollover to an Individual Retirement Account.* If a missing participant's account is $5,000 or less, the DOL permits the account to be automatically rolled over into an IRA. When terminating a plan, the DOL has some advice for accounts over $5,000. "As an enforcement matter," fiduciaries should use the guidance for investment products that is provided in the automatic rollover safe harbor provisions for accounts of $5,000 or less. This allows the fiduciary to avoid liability for the future investment performance of the IRA investments. Note, however, that the DOL's prohibited transaction exemption, which permits a direct rollover into the same institution's IRA, does not apply to amounts over $5,000.
2. *Alternative Arrangements.* If a plan fiduciary is unable to locate an automatic IRA rollover provider, the fiduciary may consider certain alternatives. However, the employer should consider that these alternatives will result in an immediate tax liability for the participant.
   a. *Federally Insured Bank Accounts.* The employer must consider all available information and restrictions on such accounts and review interest rates, guarantee periods, and associated bank charges. The participant must have an unconditional right to withdraw funds from the account.
   b. *Escheat to State Unclaimed Property Funds.* If relevant state law permits, a fiduciary may transfer the missing participant's funds to the state's unclaimed property fund. However, a state cannot force an ERISA plan to transfer unclaimed accounts to its state fund.

Note: The DOL's preference is the IRA rollover option.

Not Applicable for Annuity Option Plans. These rules may not be used by employers who sponsor money purchase plans or defined contribution plans that have an annuity payment option, or by employers who maintain another qualified retirement plan (other than an employee stock option plan).

Pension Protection Act Updates. The Pension Protection Act of 2006 (PPA) extends the Pension Benefit Guaranty Corporation's (PBGC) missing participant program to terminated defined contribution plans. As soon as the PBGC regulations are issued for DC plans, this method will also be available.

The DOL amended the rules for terminating plans to require that an inherited IRA be established for a missing beneficiary of a deceased participant. ❖

recent developments

Charitable Donations from IRAs Extended. The Pension Protection Act of 2006 (PPA) created a provision allowing taxpayers who are age 70½ or older to make direct, tax-free contributions of up to $100,000 per year from their IRAs to qualified charitable organizations. This tax benefit expired on December 31, 2007. The Emergency Economic Stabilization Act of 2008 (EESA) extends the provision for tax years 2008 and 2009, making it effective for distributions after December 31, 2007, and before January 1, 2010.

Distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pension (SEP) plans, are not eligible for this treatment. Further, an individual required to take a minimum distribution from a qualified plan may not roll over that amount to an IRA to take advantage of this provision. However, amounts distributed from a qualified plan *in excess* of the required minimum distribution *may* be rolled over into an IRA and used to make a charitable donation.

Midwestern Disaster Area Tax Relief. EESA also provides tax relief for victims of the midwestern disaster in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin. The provisions are applicable to floods, severe storms, and tornadoes that were declared disasters by FEMA on or after May 20, 2008, and before August 1, 2008.

The relief includes provisions similar to those in KETRA and GOZA (for Hurricanes Katrina, Rita, and Wilma). For example, the 10% penalty tax is waived if a distribution (up to $100,000) from an IRA or tax-favored retirement plan (such as a 401(k), 403(b), or 457(b) plan) is considered a qualified disaster recovery assistance distribution. Also, the 20% mandatory withholding does not apply. Participants receiving a qualified distribution may spread out the income tax on the distribution over three years (ratably). Amounts may be re-contributed to the plan by rollover over a three-year period following the distribution. Plan loan limits have been increased for disaster victims who suffered economic loss and are participants of 401(k), 403(b), or governmental 457(b) plans. Outstanding loan payment deadlines have been extended. ❖

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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