FBA NEWS NOTES

Fall 2004

NEWS AND INFORMATION ON EMPLOYEE BENEFIT PLANS

IRS Announces 2005 Limitations For Qualified Retirement Plans

In IRS News Release 2004-127, the IRS announced the 2005 Benefit and Contribution Limits as adjusted for cost-of-living increases.

Highlights of the limits are as follows:

Limit	Amount
401(k), 403(b), and 457 Deferrals Limit	$ 14,000.00
401(k), 403(b) & 457 Catch-Up Contribution Limit	$ 4,000.00
SIMPLE Deferral Limit	$ 10,000.00
SIMPLE 401(k) Catch-Up Contribution Limit	$ 2,000.00
Annual Compensation Limit	$ 210,000.00
Defined Benefit Dollar Limit	$ 170,000.00
Defined Contribution Dollar Limit	$ 42,000.00
Dollar Limit for HCE	$ 95,000.00
Dollar Limit for Key Employee	$ 135,000.00
Comp Limit for SEP Eligibility	$ 450.00
Social Security Wage Base	$ 90,000.00

Please see the enclosed chart for more details.

Reminder – Timely 401(k) Deposits

The Department of Labor is strictly enforcing regulations on the timing of 401(k) deposits and has now increased the number of DOL audits related to timely deposits.

Beginning with the 2003 plan year, the 15th day "safe-harbor" rule is no longer applicable. The regulations mandate that the amounts withheld from participants' paychecks be remitted as of the earliest date that the contributions can "reasonably be segregated" from the employer's general assets. In any event, that date can be no later than 15 business days after the end of the month in which the contributions are received by the employer [DOL Reg §2510.3-102(a)]. Many employers have erroneously believed that the 15th day rule meant, literally that they had until the 15th business day to segregate the deposits. As a practical matter, the contributions can almost always reasonably be segregated earlier than the 15th business day of the following month. Thus, while many plan sponsors believe that the outer limit (i.e., the fifteenth business day rule) is the applicable limit, it is actually much earlier. In enforcing this rule, the DOL seldom allows deferrals to be deposited later than 7 to 10 days after they are withheld from participants' paychecks.

The vagueness of the regulations allows the DOL to review the *facts and circumstances of each individual plan to consider what is timely*. Among the factors to take into account in determining when the deferrals can be "reasonably segregated" are the number of employees in the plan, the number of locations at which the employer operates its business, the number of different payrolls or payroll services the employer uses, whether information is transmitted electronically or manually, and whether deferrals are wired or transmitted by way of check. Once a time period is established, any payment beyond that period is considered late, interest and excise taxes are assessed on the late remittances. Failure to abide by the regulations is a violation of ERISA trust requirements, a breach of fiduciary duty and a prohibited transaction occurs. Except in unusual circumstances, the best practice is for deferrals to be deposited no later than seven days after each payroll date.

Question 4(a) in the 5500 Form (Schedule H for large filers and Schedule I for small filers) specifically asks plan sponsors: "Did the employer fail to transmit to the plan any participant contributions within the time period described in 29 CFR 2510.3-102. An affirmative response to this question will be considered by the Department of Labor as an impermissible loan from the plan to the employer: therefore a prohibited transaction and a breach of fiduciary duty. This may be used by the DOL to trigger an audit of the plan.

Sponsors should answer this question truthfully since the form is signed under penalty of perjury. The Department of Labor does allow sponsors to correct any failures via its Voluntary Fiduciary Correction Program.

For more information on timely remittance of employee deferrals, contact your FBA Plan Administrator or visit the Department of Labor web site at www.dol.gov. ♦

Retirement Flash

Social Security estimates that over the next 10 years, 24.2 million of the oldest baby-boomers will reach retirement.

Final Regulations on Participant Loans effective January 1, 2004 clarified

The regulations were issued in 2002 effective for new participant loans made on or after January 1, 2004.

The initial requirements for loans to avoid taxation continue to be the same:
- Loan terms may not exceed five (5) years, unless used for the purchase of a primary residence
- Terms must provide for substantially level repayments, made at least quarterly, over the life of the loan, and
- There must be a written loan agreement stating the loan terms and repayment schedules

The participant loan when added to the account balance may not exceed the lesser of: (1) $50,000 minus the difference between the highest outstanding balance of loans during the last 12-month period and the outstanding balance of loans as of the loan issue date; or (2) the greater of 50% of the vested account balance or $10,000.

Military leaves of absence:

The Uniformed Services Employment and Re-employment Rights Act (USERRA) provides an exception to the general five-year loan repayment rule for plan participants on military duty, allowing loan repayments to be suspended until the military leave is completed. The participant loan does not go into default but interest will continue to accrue. Upon return to employment, the participant loan must be repaid by the original term of the loan plus the time equivalent to the period of military service.

The Service Members Civil Relief Act became effective in December 2003, it updates the 1940 law that requires any loan to an active service-member to be limited to a 6% interest rate, including Retirement plan loans. The law also dictates that the payment patterns while on active duty not accelerate the principal portion of the repayment. This means the loan may not be re-amortized at 6% and the original interest rate, producing an increasing payment pattern during active duty.

New Loans following Default:

Failure to make loan repayments at least quarterly results in a taxable distribution equal to the outstanding loan balance. The new regulations prohibit plans from providing additional loans to participants who have defaulted on previous loans and no plan loan offset exists, unless one of the following conditions apply:
- An agreement to repay the loan by payroll withholding exists, or
- Adequate security for the loan in addition to the participant's account balance is received

Loan refinancing:

The new regulations clarify that the repayment term of the original loan cannot exceed the maximum term of five (5) years (unless for the purchase of a primary residence). It may exceed the original term of the loan if initially the loan term was less than 5 years.

A plan amendment is not required to update plan provisions with these regulations as Loan provisions are usually outlined in a separate document. It is suggested that plan sponsors review their current Loan Policy. Emphasis should be placed on sponsors assisting participants in understanding the Loan Policy provisions and regulations regarding failure to follow loan repayment requirements. ♦

Trends – 401(k) Plans at year end 2003

401(k) plans held an estimated $1.9 trillion in assets and represented approximately 16% of the $12.1 trillion U.S. retirement market
- Approximately 49% of 401(k) plan assets were held in mutual funds
- Mutual fund assets held in retirement accounts stood at $2.7 trillion, 36% of overall mutual fund assets
- The average account balance (net of plan loans) was $51,569
- On average, participants had approximately 67% of their 401(k) plan balances invested directly or indirectly in equity securities (equity funds, company stock, and balanced funds)
- Younger participants tend to concentrate their assets in equity funds while older participants tend to invest more in fixed-income securities, such as GICs and bond funds
- 86% of plans allow participant loans
- Only 18% of participants in plans allowing loans had outstanding loan balances at year-end 2003
- The average unpaid loan balance was $6,839

Information obtained through research from the Employee Benefit Research Institute (EBRI) and ICI Participant-Directed Retirement Plan Data Collection Project. ♦

Tips for Employers hoping to increase 401(k) Participation rates

401(k) plans are a benefit only if employees perceive them as such.
1. Educate: make sure that employees have access to information about the 401(k) Plan, particularly information regarding the tax saving benefits.
2. Match: the easiest way to promote participation. Communicate the company's match policy emphasizing that 'free' money is left on the table when not taking advantage of the plan benefits.
3. Gimmick: gimmicks are great motivators. An example is a "sock-it-away" campaign. Give a new pair of socks to each employee who enrolls in the plan.
4. Automatic Enrollment: it is permissible to enroll employees automatically, provided that the employee is notified in advance and is permitted to leave the plan if they choose to do so. Automatic Enrollment, also referred to as "negative enrollment" has been shown to increase worker participation in §401(k) plans. ♦

Final Safe Harbor Regulations for Deemed IRAs

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), amended the Internal Revenue Code to require that absent an affirmative election by the participant, distributions from qualified plans between $1,000 and $5,000 must be transferred directly to an Individual Retirement Account (IRA).

On September 27, 2004, the U.S. Department of Labor released a final regulation creating a “safe harbor” for plan sponsors that automatically roll over the funds in a terminated employee’s tax-qualified retirement plan account to an individual retirement account (IRA). The new regulations take effect March 28, 2005.

Terminated employees’ failure to roll over small sums in their 401(k) or other tax-qualified defined contribution plan accounts is a common source of distress for retirement plan fiduciaries. Sponsors continue to incur administrative expenses on behalf of former employees to maintain small, inactive accounts; yet, rolling these funds over to an IRA without specific instructions from the former employee, poses a fiduciary liability under federal pension law.

The automatic rollover safe harbor will protect plan fiduciaries exercising the automatic “cash-out” plan distribution option. This will apply to benefits not exceeding $5,000 rolled into IRAs when former participants fail to make an election between a direct rollover or receiving a distribution. After March 28, 2005, if no election (or incomplete election) has been made by the former employee, the safe harbor will protect plan fiduciaries from liability under the Employee Retirement Income Security Act of 1974 (ERISA), when they select a financial institution to provide the IRA and choose certain investments specified under the safe harbor for the IRA.

Under the Internal Revenue Code of 1986, tax-qualified retirement plans are permitted to incorporate plan provisions requiring an immediate distribution to a separating participant without the participant’s consent if the vested value of the participant’s account is less than $5,000 (Code Sections 411(a)(11) and 417(e). Plans that have adopted the mandatory distribution, also referred to as “cash-out” provisions, are required to provide terminating participants with a written notice explaining, among other things, the Code provisions and the provisions regarding income tax withholding.

Fiduciaries must satisfy six conditions to receive protection under the new safe harbors.

1. Distribution Amount: automatic rollovers are limited to distributions that don’t exceed $5,000. The safe harbor applies to distributions that are $5,000 or less with a minimum of $1,000.

2. IRA Providers: the automatic rollovers may only be made to IRAs and individual annuities maintained by the following institutions:
   - State or Federally regulated bank or savings association (FDIC Insured Accounts)
   - Insurance company (the products of which are protected by state guaranty associations)
   - Mutual fund company regulated under the Investment Company Act of 1940
   - Financial institutions eligible to offer IRAs under Treasury Department Regulations

   The regulations require that, a plan fiduciary enter into a written agreement with the IRA provider. The agreement must address the investment of the rolled-over funds, and the applicable fees and expenses related to the IRA. The fiduciary can rely on the IRA provider’s commitments as set forth in the agreement and is not required to monitor the IRA provider’s compliance with these terms once the rollover has occurred. Further, the terms of the agreement must be enforceable by the participant on whose behalf the automatic rollover is made.

3. Investments: the agreement with the IRA provider must state that the rolled-over funds be invested in an investment product designed to preserve principal and provide a reasonable rate of return, and whether or not the return is guaranteed. The regulations specifically identify permissible investments as:
   - Money market funds maintained by registered investment companies;
   - Interest-bearing savings accounts and certificates of deposit of banks or similar financial institutions; and
   - “Stable value products” issued by regulated financial institutions.

4. Fees and expenses: IRAs receiving automatic rollovers may only charge fees and expenses that do not exceed the amounts charged for comparable IRAs that are not established to receive automatic rollovers. Fees and expenses include establishment charges, maintenance fees, investment expenses, termination costs, and surrender charges.

5. Participant Notices: the regulation requires that prior to an automatic rollover, plan fiduciaries provide participants with a Summary Plan Description (SPD) or Summary of Material Modifications (SMM) that describes the plan’s automatic rollover provisions. The notice must explain the investment product in which the distribution will be invested and the extent to which the IRA fees and expenses will be borne by the individual or shared with the distributing plan or plan sponsor. Additionally, the notice must identify the name, address, and telephone number of a plan contact from whom to obtain further information concerning the plan’s procedures in connection with automatic rollovers, the IRA provider and the related fees and expenses.

6. Prohibited Transaction Class Exemption: the safe harbor is not available where the distributing plan fiduciary engages in a nonexempt “prohibited transaction” under ERISA in connection with the selection of the IRA provider or investment products. For example, a plan fiduciary that receives consideration from a financial institution in exchange

for selecting that financial institution would ordinarily constitute a prohibited transaction under ERISA. The DOL issued a Phobitited Transaction Class Exemption, which permits a bank or other financial institution to select itself or its affiliate as the IRA provider for automatic rollovers from its own retirement plans, choose its own funds, or investment products for the investment of such automatic rollovers, and receive fees for such services. The Class Exemption was evidently designed to preclude IRA providers from being required to use their own competitors to service their own retirement plans' automatic rollovers.

Plan administrators should begin to take steps to comply with the regulations. In particular, administrators should review their plan's cash-out provisions for required changes, select an IRA provider that will accept the rollovers and update SPDs to include the required participant notices. For additional guidance contact your FBA Plan Administrator or visit the Department of Labor web site at www.dol.gov. ♦

Mandatory Redemption Fees for Mutual Funds

The American Society of Pension Actuaries (ASPA) [1]responded to the Securities and Exchange Commission ("Commission") rule proposals relating to mandatory redemption fees. ASPA's response reiterates concerns that non-uniform redemption fee requirements imposed by different mutual fund families will result in significant confusion and additional administrative and other costs for working Americans participating in tax-qualified 401(k) and similar tax-qualified defined contribution retirement plans. The adverse impact on plan participants and beneficiaries from non-uniform redemption fee requirements should not be underestimated. ASPA believes that the Commission should act to facilitate the adoption of more uniform mutual fund redemption fee policies. In particular, ASPA continues to urge the Commission to consider adopting:

- A standardized redemption fee percentage and holding period;
- A mandatory *de minimis* rule providing that redemption fees may not be applied unless the value of the redemption exceeds $5,000; and,
- A rule that limits the application of redemption fees to participant-directed exchanges and transfers, which are the only transactions participants can use to engage in abusive "market-timing" activities.

Participants of participant-directed plans direct their investments among plan investment options that are selected by a plan fiduciary. Plan fiduciaries very often select mutual funds as plan investment options and are able to offer, under an "open architecture" model, a broad, diversified selection of mutual funds from several different fund complexes and other investment options.

Having a variety of mutual fund options available to plans and plan participants is now proving to be problematic because of the new mutual fund redemption fee policies under consideration. Until recently, most mutual funds waived redemption fees on shareholder transactions.

Currently, mutual funds impose a broad array of differing redemption fees on individual trades. There are different holding periods and different fee rates. Some mutual funds may use "tiered" redemption fees (e.g., 2% for a short holding period and then 1% for redemptions made within a longer holding period). These variations may occur even on different funds within the same mutual fund complex.

The lack of uniformity among mutual fund redemption fee policies means that each investment option offered to plan participants is likely to be subject to a different redemption fee policy. Further complicating matters, when a plan invests among funds from different fund complexes. As a result, plan recordkeepers and administrators are finding that imposing redemption fees on plans and plan participants involves burdensome complexity. According to ASPA , this burdensome complexity will adversely impact plans and plan participants, in a variety of ways.

All different redemption fee rules must be communicated to plan participants, increasing plans' costs for producing and reviewing participant communications materials.

To effectively apply redemption fee rules and collect redemption fees, recordkeeping and participant order taking systems (e.g., automated voice response systems and Internet order taking systems) must be programmed. This reprogramming will be initially expensive for plan administrators and recordkeepers, but it will be far more expensive if systems must be programmed to accommodate a broad range of redemption fee rules, including different rates, different holding periods, different de minimis rules, and application to different participant transactions.

On an ongoing basis, plan recordkeeping systems and participant-order taking systems must be maintained to apply each fund's policy on redemption fees. Maintaining systems that support a range of different rules and requirements relating to redemption fees will be more expensive than maintaining systems imposing uniform redemption fee policies, resulting in ongoing additional plan administrative costs.

In addition, the complexity of a non-uniform system of redemption fees increases the possibility of errors, resulting in greater potential liability for plan administrators and recordkeepers. This potential liability further increases the costs of plan recordkeepers and administrators, which ultimately will be paid by plans and participants.

The Commission can address the problems that would be caused by a non-uniform regime of mutual fund redemption fee policies by proposing rules imposing some uniform requirements. In particular, it is critical that the Commission establish uniform holding periods and uniform rates for assessing redemption fees, given the enormous number of possible variations that mutual funds may impose if the standards are not uniform.

[1] ASPA represents more than 5,000 retirement plan professionals who assist employers in establishing and maintaining retirement plans, including senior representatives of "third party administrators" and banks, trust companies and insurance companies providing recordkeeping and other plan administration services.

ASPA further urges the Commission to establish a uniform de minimis rule, under which redemption fees are not imposed unless the redemption transaction exceeds $5,000. This rule would promote uniformity while substantially simplifying the number of individual participant transactions subject to redemption fees. Finally, ASPA recommends that the Commission establish a rule providing that the only transactions considered for redemption fees should be participant-directed exchanges and transfers, which are the only types of participant transactions that have the potential to involve market timing activities. By taking this approach, the Commission would protect mutual fund investors against abusive trading by plan participants, while substantially reducing the adverse impact and administrative costs of new mutual fund redemption fee policies that will apply to plans and plan participants. ♦

The Joint Committee on Employee Benefits (JCEB) of the American Bar Association (ABA) and officials from the IRS and Treasury Department informal question and answer session of May 2004,

Participant Loans

Question: regarding the "date of the loan" for purposes of the five-year term limit on loans is (a) the date that the loan application is signed, (2) the date that the note is signed, or (c) the date that the check is delivered to the participant. The IRS agreed with the proposed answer that the date of the loan is the date that the loan is funded (i.e., the date that the check is delivered).

Question: regarding the situation where a participant pays off an outstanding loan in order to take out a new loan. The participant's check to pay-off the original loan bounced after the proceeds of a new loan were paid to the participant. The IRS noted that this is an operational failure (for which it is not clear what the proper correction would be) but that good plan administration procedure would require the payoff check to clear before the new loan's proceeds are distributed.

Hardship Distributions

Question: regarding definition of "principal residence" for purposes of qualifying for a hardship distribution. An employee wished to take a hardship distribution to purchase a new home. The employee's wife and children would be living in the new home, but the employee would not be living there for at least a year. The IRS stated that this home would not qualify as a "principal residence" because to qualify, the home must be the principal residence of the employee, not just of the employee's family.

Question: regarding whether buying out the equity of the employee's current home from an ex-spouse would qualify as the "purchase of a principal residence." The IRS agreed with the proposed answer that the buyout would qualify, because the employee is purchasing a part of her principal residence that she didn't own before.

Question: regarding whether a hardship distribution can be made on account of college expenses incurred in the previous year. The IRS agreed with the proposed answer that a prior year's college expenses will not qualify; college expenses can be covered by a hardship distribution only on a prospective basis.

Catch-Up Contributions

Question: whether an employer is required to match catch-up contributions that are re-characterized as elective deferrals at the end of the year, when the plan terms say that catch-up contributions are not matched. The IRS noted that the plan should be drafted to say what contributions are matched, not what contributions are not matched and that proper plan drafting "can eliminate most of these issues." In the situation described, the answer depends upon the interpretation of the plan's specific terms. ♦

Clarification on plan fees charged to participants

The Department of Labor (Field Assistance Bulletin 2003-3) and the Internal Revenue Service (Revenue Ruling 2004-10) clarified the extent to which plan expenses may be charged to participant accounts.

The basic requirements are:
1. The Plan Document must allow such allocation of expenses
2. The Summary Plan Description (SPD) must address the circumstances under which the plan will charge fees directly to a participant's account.
3. The fees must be reasonable and allocated in a nondiscriminatory manner

A Summary of Material Modifications (SMM) attachment to the SPD can be used to notify participants of the circumstances under which fee will be charged directly to their accounts. These are:

1. A pro-rata share of the plan's administration expenses for terminated participants (regardless of whether the employer pays these expenses on behalf of active employees)
2. Lump sum distribution fees for terminated participants
3. Installment distribution fees
4. Participant loan origination and maintenance fees
5. QDRO review and processing fees
6. Hardship distribution fees
7. In-Service distribution fees
8. Required minimum distribution fees
9. Annual fee for a self directed brokerage account option
10. Benefit calculation fees
11. And administrative processing to eliminate small account distributions (when the account balance is less than the distribution fee) ♦

U.S Department of Labor published the most frequently asked questions regarding how reservists are impacted upon call to duty.

I am being called to active duty and have questions about my employer provided pensions benefits?
The Department of Labor's Veterans' Employment and Training Service (VETS) has information for veterans, National Guard or reservists who may be activated for military-service. National Guard and reserve members called to active duty, and their civilian employers, have certain rights and responsibilities under the Uniformed Services Employment and Reemployment Rights Act (USERRA). VETS has developed a fact sheet and an interactive computer program, the USERRA Advisor, which address the rights and responsibilities of individuals and their employers under the law.

Will my period of active duty be considered a break in service with my employer and impact my eligibility to participate in my employer's retirement plan or my vesting or benefit accrual under the plan?
No. USERRA requires that the period of military duty be counted as covered service with the employer for eligibility, vesting and benefit accrual purposes. Returning service members are treated as if they had been continuously employed regardless of the type of retirement plan the employer has adopted. A person who is re-employed is entitled to accrued benefits resulting from employee contributions only to the extent that he or she actually makes the contributions to the plan.

While I am on active duty is there a requirement for my employer to continue to make employer contributions to my 401(k) plan?
There is no requirement for your employer to make contributions to your 401(k) plan while you are on active duty. Once you return from military duty and are re-employed, your employer must make the employer contributions that would have been make if you had been employed during the period of military duty. If employee contributions are required or permitted under the plan, the employee has a period equal to three times the period of military duty or five years, whichever ends first, to make up the contributions. If the employee makes up the contributions, the employer must make up any matching contributions. There is no requirement that the employer contributions include earnings or forfeitures that would have been allocated to the employee had the contributions been made during their military-service.

I am a participant in a 401(k) Plan. While I am on active duty, may I give my spouse or another individual the authority to change my investment allocations through a power of attorney or other legal document? Can that individual also apply for a participant loan or hardship withdrawal on my behalf?
The terms of the plan would generally govern this situation. If some employees are permitted to designate individuals to act on their behalf in other contexts when they are away from work, the employer should permit the service member to designate someone to act on his or her behalf also. ♦

IRS Flash

Notice to employers who continue to pay employees' salary while on military duty:
The employment relationship between the employee and employer terminates when a worker is called to active military duty with the U.S. Government. Therefore, any payments made to the former employee while in military service are not wages subject to the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act or to the Collection of Income Tax at Source on Wages. Businesses are required to issue a Form 1099 Miscellaneous, as the payments are included as income to the taxpayer.

Top Ten Issues Auditors Review When Preparing an Audit Report

1. **Termination or partial termination of a plan-**
   Potential for vesting/distribution issues
   Large drop in plan participants
   Large number of separated participants
   Low percentage of participants compared to total employee pool
2. **Acquisitions-**
   Potential for acquiring employers to exclude participants or improperly allocate contributions to participants from acquired companies
3. **Deferral Percentage Tests-**
   Correct ADP/ACP calculations
   Potential that sponsors may exclude participants due to incorrect census data
4. **Compensation-**
   Potential for plan sponsors to incorrectly apply deferral percentages or employer allocations
   Plans exceeding compensation limitations as regulated under 401(a)(17)
5. **Plan document-**
   Plans not adopting amendments timely
   Merged plans not timely amended
6. **Vesting-**
   Terminated participants over age 65 should be 100%
   Failure to correctly allocate years of service for vesting purposes
7. **Distributions and loans-**
   Failure to suspend participants obtaining hardship distributions
   Required documentation not obtained for In-Service Distributions or Participant Loans
8. **Assets-**
   Large percentage of assets classified as "other assets" on balance sheet
   Large amounts of administrative expenses
   Significant changes in investment options

Large percentage of assets invested in employer real property or employer securities (other than ESOP)

9. **Limits-**
   Plan exceeding IRC Section 415 limits
   Employees exceeding IRC Section 402g limits
10. **Miscellaneous-**
   Lack of sufficient controls to ensure adequate data
   Large corporations with decentralized payroll systems with inadequate controls to ensure all apply plan provisions correctly

Minimum Required Distributions - Code Section 401(a)(9).

The Internal Revenue Code 401(a)(9) establishes a mandatory date by which payments must commence and continue thereafter.

- Employee Required Beginning Date (RBD) if 5% owner: April 1 following the close of the calendar year in which the employee attains the age of 70 ½ regardless of whether or not he/she retires.

- Employee RBD if NOT 5% owner: April 1 following the close of the calendar year in which the later of the two events below occur:
  1. Participant attains age 70 ½
  2. Participant retires

A 5% Owner is an employee who owns more than 5% of the company for the plan year ending in the calendar year in which the employee attains the age of 70 ½. Attribution rules do apply (IRC 318) in determining who is a 5% owner. If the 5% owner ceases to be a 5% owner after the RBD, he/she is still required to continue the distributions.

The employee must elect not to start the minimum distributions. In absence of an election, distributions must commence. Subsequent distribution must be completed as of December 31st of each year.

A Designated Beneficiary must be determined no later than the RBD and it must be an individual. An estate is NOT a designated beneficiary, if named as such, then the participant is treated as having NO beneficiary. A trust is NOT a designated beneficiary, if named as such; the beneficiaries of the trust may be treated as the designated beneficiaries. An organization is NOT a designated beneficiary, if named as such, then the participant is treated as having NO beneficiary. Multiple beneficiaries may be named.

A minimum distribution is calculated for each of the distribution years. When valuing the account, the value as of the calendar year preceding the distribution year is used. Minimum required distributions completed after the close of the valuation year belonging to the preceding distribution year are subtracted from this balance.

Lump sum distributions – Withdraw the entire account balance. This is can pose a disadvantage since the participant will receive all proceeds as one lump sum payment. The tax consequences will be larger and budgeting for the future will not be as easily accomplished.

Periodic distributions – Payments can be spread over a number of years as long as the minimum required is distributed each year. The account balance will deplete over the life expectancy of the participant. This can be broken down even further for annuity plans. Withdrawals to satisfy the yearly minimum can be done on a periodic basis throughout the year – monthly or quarterly payments. This option is more advantageous to participants since the tax burden is spread over several years and budgeting is feasible.

Participants can elect to receive more than the required minimum amount. However, the excess will not be credited toward future distributions. The excess can be rolled over without incurring any tax consequences.

Mandatory 20% withholding on distributions is not applicable. The participant is required to pay income taxes reflective of their tax bracket. The amount of the distribution is considered gross income and is reported to the IRS via a 1099R. The IRS will impose a 50% penalty on the amount that should have been withdrawn, on any MRDs not distributed.

In January of 2001, the Internal Revenue Service issued revised regulations on the calculation of MRDs under Code 401(a)(9). These regulations simplify the lifetime distribution rules and modify the death distribution rules. The rules provide for a single table of factors based solely on the participant's age. The calculation will be the participant's account balance as of the previous 12/31 divided by the factor from the table matching the participant's current age. The table is based on an assumption of a joint life expectancy with a beneficiary who is ten years younger than the participant is. The table satisfies the MDIB requirement of Code 401(a)(9)(G) with an exception. If the sole beneficiary under a particular account is the participant's spouse and the spouse is ten years, or more, younger than the participant. The distributions can be made over the joint life expectancy of the participant and the spouse, and those expectancies will be re-determined each year based on the ages of the two individuals in the current year. It is NO LONGER necessary to lock in a calculation method for the joint expectancy at the time payments, to the participants, begin.

For additional information regarding Minimum Distributions for 2004, contact your FBA Plan Administrator for assistance. ♦

FULL SERVICE SUPPORT

FRINGE BENEFIT ADMINISTRATORS, LTD. (FBA) and its strategic alliance partners, delivers all of the features you need to make your plan a success:

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- Flexible Plan Design
- Installation / Conversion Support
- Plan Documents & Administrative Manual

Recordkeeping & Compliance
- Daily Account Valuation
- Timely, Consolidated Quarterly Statements
- INVEST-Tel / Telephone Account Access
- INVEST-Net / Internet Account Access
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- Compliance Testing & Government Reporting
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- On Site Enrollment Meetings
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- Complete Trustee / Custodial Services
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WHO TO CALL

For information concerning items in this newsletter, or information about our services, please call one of the following people. They will be pleased to assist you.

- **Your Plan Administrator**
- **Dick Watson - Ext. 1030**
- **J. R. Piper - Ext. 1037**
- **Steve Cranfield - Ext. 1024**
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