For Your Benefit

A newsletter on current legal issues impacting employee benefits and executive compensation

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New Guidance on Locating Missing Retirement Plan Participants

By Susan Foreman Jordan

On August 14, 2014, the U.S. Department of Labor issued updated guidance to plan administrators and other fiduciaries as to their obligations to locate missing participants to complete benefit distributions. While the guidance technically applies only in the context of the termination of a defined contribution plan, it is helpful in other circumstances as well.

This new guidance, Field Assistance Bulletin (FAB) 2014-1, replaces a similar publication that dates back to 2004. It was prompted primarily by the discontinuance of the letter-forwarding programs that previously had been maintained by both the IRS and the Social Security Administration and had proven to be effective and inexpensive means of reaching these lost participants.

Required Search Steps

Acknowledging that reasonable expenses incurred in connection with the search may be charged to the account of the missing participant, FAB 2014-1 lists four low-cost search steps that are to be taken in all cases. These steps, which need not be taken in any particular order, include the following:

1. **Certified Mail** – Fiduciaries should attempt to contact missing participants by certified mail using the last known address.
2. **Check Related Plan and Employer Records** – It is conceivable that the employer or records relating to another employer-sponsored plan, such as a group health plan, may have current information. To address any privacy concerns, a plan fiduciary can ask that the employer or other plan fiduciary reach out directly to the missing participant or forward a letter to the missing individual, asking that he or she contact the plan fiduciary.
3. **Check With Designated Plan Beneficiary** – It is possible that an individual whom the missing participant has designated as a beneficiary (e.g., spouse, children, etc.) may have, or be able to obtain, more current contact information. Again, if there are privacy concerns, the plan fiduciary can request that the designated beneficiary contact the missing individual or forward a letter to the missing individual.
4. **Use Free Electronic Search Tools** – Plan fiduciaries must make reasonable use of internet search tools that do not charge a fee. These tools include internet search engines, public record databases (such as those used for licenses, mortgages and real estate taxes), obituaries and social media.

Additional Search Steps

If the four required search steps do not yield any results, the plan fiduciary then must consider whether additional steps may be appropriate, in light of the size of the account balance and the costs of further search efforts. Among the additional search options that might be considered are the use of fee-based internet search tools, commercial locator services, credit reporting agencies, information brokers, investigation databases and analogous services.

Distribution Options

The Department of Labor recognizes that there will be situations in which, despite having taken all required search steps, as well as such additional steps as are reasonable under the circumstances, the missing participant cannot be located. In such cases, the preferred option for distribution of the benefits is rollover to an individual retirement account (IRA), following the same rules, which are applicable for mandatory rollover distributions.

Other options include depositing the funds into an interest-bearing, federally insured bank account in the name of the missing individual or transferring the account balance to a state unclaimed property fund. However, in making the decision to utilize one of these options, the plan fiduciary must take into account the adverse tax consequences to the participant and consider whether a searchable database is maintained by the applicable state that would enable the participant to locate the missing funds. Finally, the guidance confirms that a distribution with 100 percent income tax withholding, effectively transferring the entire account balance to the IRS, is not an acceptable option for fiduciaries.

Some fiduciaries have expressed concerns about their ability to establish individual retirement accounts or bank accounts for

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missing participants, particularly in light of the Customer Identification and Verification Provisions (CIP) of the Patriot Act. In its guidance, the Department of Labor indicates that, in the case of employee benefit plans, this verification will be required only when the participant contacts the financial institution to claim or exercise control over the account and not when the plan initially establishes the account in the name of the missing participant.

Conclusion

Although FAB 2014-1 applies specifically in the context of a terminated defined contribution plan, the guidance is helpful in determining appropriate procedures for locating missing participants in other circumstances. Best practices would dictate that, at a minimum, the four required search steps be undertaken in all cases.

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Draft Instructions for PPACA Reporting Requirements: Get Ready for 2015

By Keith R. McMurdy

The Internal Revenue Service (IRS) promised it would be coming. On August 28, 2014, the IRS issued draft instructions for Forms 1094-C and 1095-C and Forms 1094-B and 1095-B. These forms were provided in draft format and are used to satisfy PPACA's "information reporting requirements." Also issued were draft instructions for Form 1095-A that relate to the statement about the Health Insurance Exchange Marketplace. The IRS has indicated it will finalize the forms and instructions in 2014. On top of that, it issued some FAQs that address the reporting requirements.

It is important to note that reporting for the 2015 year is due in 2016, so the instructions and guidance should help employers and plan sponsors put together a framework to follow in 2015 so that they can properly report.

As a starting point, the FAQs provide that some short-term penalty relief will be available for incomplete or incorrect information returns that are filed (or employee statements provided to employees) in 2016 for coverage offered, or not offered, in 2015. Under this relief, the IRS will not impose penalties on employers that can demonstrate they made good faith efforts to comply with the information reporting requirements. This relief applies to returns and statements filed and furnished in 2016 to report offers of coverage in 2015 for incorrect or incomplete information reported on the return or statement, but the relief is not available if you fail to file. You have to show a good faith effort to comply, so you cannot simply not file anything and expect relief.

With respect to the instructions themselves, to say that they are lengthy is an understatement. Employers should read them in detail to understand their obligations. However, some key provisions that help in compliance include:

- Clarification that employers must file Forms 1095-C and 1094-C with the IRS and provide a copy of Form 1095-C to employees.
- A statement that, as noted above, Forms 1095-C and 1094-C information returns are not required for 2014. Actual filings are not required until 2016 for the 2015 calendar year, but employers may voluntarily file these forms in 2015 for 2014. If by chance an employer does choose to voluntarily file in 2015 for the 2014 year, penalties for the employer mandate payments will not be assessed for 2014.
- Establishment of specific due dates for Forms 1095-C and 1094-C information returns. They must be filed by February 28 (for paper filings) or March 31 (for electronic filings) of the year following the calendar year to which the return relates.
- Clarification that a Form 1094-C must be attached to any Forms 1095-C filed by an employer. Each employer must file one 1094-C that reports aggregate employer-level data for all the employer's full-time employees, which is referred to as the "authoritative transmittal" (and denoted accordingly on Line 19 of the Form 1094-C). Only one authoritative transmittal may be filed for each employer.
- Employers also must provide a Form 1095-C to each full-time employee by January 31 of the year after the year to which the form relates (so that would be January 31, 2016, for the 2015 reporting year). Incidentally, employee statements must be furnished to individuals in paper format by mail, unless the individual affirmatively consents to receiving the statement electronically.

As with the forms, the instructions are in draft format and subject to change and finalization. However,

between the draft forms and the draft instructions, employers should now be able to ascertain generally what is required of them in reporting. Even though the mandatory reporting requirement does not completely kick in until after 2015, employers should spend some time reviewing these requirements with their plan professionals, preferably sooner rather than later, to get a sense of what data they will have to collect and who has responsibility for making sure the information is accurate.

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Critical Time To Review Compensation Arrangements for Section 409A Compliance

By Pauline W. Markey

Earlier this year, an Internal Revenue Service attorney informed the American Bar Association Section of Taxation that the IRS began a compliance initiative project (CIP) focused on Internal Revenue Code Section 409A. This CIP is relatively narrow and is expected to only include the 10 most highly compensated individuals at 50 large companies. The IRS plans to issue Information Documents Requests, commonly referred to IDRs, to these 50 companies. These IDRs will focus on the initial deferral elections, subsequent changes in deferral elections and the timing of payouts. Even though this initial CIP is limited in scope, practitioners expect that the IRS will implement a much broader Section 409A enforcement initiative in the not-so-distant future. Before the IRS begins its examination of deferred compensation arrangements for Section 409A compliance in full force, all compensation arrangements, especially customized deferred compensation plans for highly paid executives, should be carefully reviewed for Section 409A compliance.

Section 409A was added to the Internal Revenue Code in 2004 in response to perceived abuses of deferred compensation arrangements revealed by scandals relating to Enron, WorldCom, and other corporations, several years earlier. The general purpose of Section 409A is to govern the timing of the payment and taxation of compensation deferred under nonqualified arrangements. The application of Section 409A has been broadly interpreted and impacts almost every type of compensation arrangement, including employment agreements, severance agreements, equity plans and even incentive bonus plans.

Section 409A essentially imposes three different design and operational requirements. First, the plan may not permit deferred compensation to be distributed earlier than certain events or specific dates. Permissible distribution events include the executive's death, disability and separation from service, and a change in control of the company. Second, except as otherwise provided, the arrangement may not accelerate (or delay) the payment of the deferred compensation or change the form of such payment (i.e., from lump sum to installment payments). Finally, a taxpayer electing to defer compensation must generally make such election before compensation is earned and within a certain period of time established by Section 409A and its underlying Treasury Regulations.

If a deferred compensation arrangement fails to comply with these requirements, in either form or operation, then the compensation deferred under such arrangement will be subject to current taxation and an additional tax of 20 percent will be imposed on the deferred amount. It is important to note that the additional tax, if applicable, will be imposed on the executive and not the corporation operating the plan. Nonetheless, corporations operating deferred compensation arrangements are incentivized to comply with the requirements of Section 409A because the executives participating in such plans are valuable to the success of its operations.

Throughout the years, the IRS issued several notices, which provide guidance for the correction of certain operational and/or documentation failures of Section 409A. See Notice 2008-113 (operational failures) and Notice 2010-6 (documentation failures). If such failures are voluntarily corrected, then the executive may avoid or reduce current income inclusion of the deferred compensation and additional taxes. However, the types of operational and/or documentation failures that may be corrected under these notices are limited. Moreover, relief under these notices is not available for an executive if either the executive or the corporation operating the plan is under examination by the IRS, specifically relating to "nonqualified deferred compensation." For this purpose, an executive is treated as under examination with respect to

nonqualified deferred compensation if that individual's federal income tax return (i.e., Form 1040) for the taxable year is under examination. A corporation is treated as under examination with respect to nonqualified deferred compensation if such corporation receives written notification, such as an IDR, from an IRS agent specifically citing nonqualified deferred compensation as an issue under consideration.

The scope of the IRS examination under the new CIP is still unknown. Therefore, now is the critical time for corporations to review all their compensation plans for Section 409A compliance and, if necessary, take advantage of the available operational and/or documentation correction programs before participation is precluded by an unexpected audit.

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ESOPs: A Path To Increasing a Company's Sales, Profitability, Employee Satisfaction and Job Security

By Harvey M. Katz

On numerous occasions, both in this forum and elsewhere, I have extoled the benefits of Employee Stock Ownership Plans (ESOPs). By and large, however, I have focused on the tax benefits to the company and to the selling shareholders. While these benefits are significant, the benefits to the employees and the company in terms of the potential for future growth, profitability and employee retention are often overlooked. This is unfortunate, because numerous studies have shown that ESOP companies tend to be more profitable, more likely to weather economic downturns and more likely to retain and grow their workforce. These claims are supported by numerous studies as well as anecdotal experiences with ESOP companies.

Growth in Sales and Profitability

One of the largest studies was conducted in 2000 by Rutgers University. The study analyzed 343 ESOP companies, comparing them to the performance of non-ESOP companies in the same industry and geographical region, of similar size and character. The results showed that ESOPs increase sales, employment and sales per employee by about 2.3 percent to 2.4 percent per year over what would have been expected absent an ESOP. The results also showed that ESOP companies perform better in the post-ESOP period than their pre-ESOP performance would have predicted.

The first study to show a linkage between ESOPs and increased profitability was conducted in 1986 by the National Center for Employee Ownership. The study compared the difference between pre-ESOP and post-ESOP performance and found that ESOP companies had sales growth rates 3.4 percent per year higher and employment growth rates 3.8 percent per year higher in the post-ESOP period than would have been expected based on pre-ESOP performance. When the companies were divided into three groups based on the level of employee participation in management, only companies with a high level of employee participation showed a gain.

The findings in this study were confirmed by a 1987 Government Accounting Office (GAO) "before and after study" using a similar methodology but covering 110 firms and focusing on productivity and profitability. The GAO study found that ESOPs had no impact on profits but that actively managed employee ownership firms increased their productivity growth rate by 52 percent per year. In other words, if a company's productivity growth rate were 3 percent per year, it would be 4.5 percent after an ESOP. However, this study was criticized as being overly conservative because it assumed no overall increase in employee compensation after the ESOP, which is generally not the case.

Workplace and Job Satisfaction

The most significant job satisfaction statistics relating to ESOP companies were compiled by the Great Place to Work Institute, which is the organization that produces the "100 Best Companies to Work for in America." It is perhaps the largest database ever compiled on employee attitudes, organizational culture and company outcomes addressing employee stock ownership. The information compiled includes the 780 firms that applied to the "100 Best Companies to Work for in America" competition from 2005 to 2007. More in-depth results were gathered from 200-300 randomly chosen workers within each company and a workplace culture assessment was conducted by the Institute for 400 of the companies. Almost 17 percent of the companies had an ESOP and 9.1 percent were majority employee owned. The result is

nothing short of astonishing, when considering that there are less than 12,000 ESOPs in the country and many are sponsored by publicly traded companies. The bottom line is that ESOP companies, especially majority-owned ESOPs, are vastly overrepresented, both in applicants and winners, in these best companies to work, for compared to their representation in similarly sized companies.

Employee Compensation Levels and Job Security

A 1998 study by the Washington Department of Community, Trade and Economic Development and Adria Scharf of the University of Washington shows that employees are significantly better compensated in ESOP companies than are employees in comparable non-ESOP companies. Using 1995 employment and wage data from the Washington State Employment Security Department and 1995 data on retirement benefits from a survey of companies and pension Form 5500, the study compared 102 ESOP companies with 499 companies of comparable industries, business and employment size. The median hourly wage in the ESOP firms was 5 percent to 12 percent higher than the median hourly wage in the comparable non-ESOP companies. The study found the average value of all retirement benefits in ESOP companies was equal to $32,213, with an average value in the comparison companies of about $12,735. In addition, the average corporate contribution per employee per year was between 9.6 percent and 10.8 percent of pay per year, depending on how it is measured. In non-ESOP companies, it was between 2.8 percent and 3.0 percent.

In a 2010 project funded by the Employee Ownership Foundation, the National Center for Employee Ownership (NCEO) did an extensive analysis of ESOP companies using data from the U.S. Department of Labor Form 5500 reports. Unlike prior research, the study carefully compiled data from multiple plans within a single company. It was also not a sample. They looked at every ESOP company for which data was available compared to all retirement plans. The study found that ESOP companies are more likely to offer a second defined contribution plan than non-ESOP companies are to offer any defined contribution plan at all (56 percent compared to 47 percent). Considering only defined contribution assets originally contributed by the company, ESOP participants have approximately 2.2 times as much in their accounts as participants in comparable non-ESOP companies with defined contributions plans and 20 percent more assets overall. The average ESOP company contributed $4,443 per active participant to its ESOP vs. the average non-ESOP company with a 401(k) and/or profit-sharing plan, which contributed $2,533 per active participant to its primary plan that year. In other words, on average, ESOP companies contributed 75 percent more to their ESOPs than other companies contributed to their primary 401(k) or profit-sharing plan.

ESOP and broad-based equity plan companies are also less likely to lay off employees. The 2010 General Social Survey found that 3 percent of employees with employee stock ownership were laid off in 2009-2010 compared to a 12 percent rate for employees without employee stock ownership. In 2006, the numbers were 2.3 percent compared to 8.6 percent and in 2002, 12.1 percent and 2.6 percent. The estimated cost in saved unemployment benefits and foregone taxes to the federal government varied between $8 billion in non-recession years to $13 billion in recession years. The difference between ESOP and non-ESOP companies in this regard is staggering.

Conclusion

The foregoing studies and reams of anecdotal evidence paint a compelling picture. ESOP companies with employee participation are more profitable, grow faster, are more likely to weather economic reversals, pay better and lay off fewer employees. Any business owner seeking to achieve better results and wanting to attract and hold quality employees is well advised to consider an ESOP.

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IRA Charitable Rollover Uncertainty Persists

By Rebecca L. Hagan

The IRA Charitable Rollover provision, which was established under the 2006 Pension Protection Act, provides an annual exclusion from gross income up to $100,000 for qualified charitable distributions from an IRA. Therefore, individuals who have reached 70 ½ years of age can donate up to $100,000 to charitable

organizations directly from their IRA, without incurring any income tax on the distribution. Originally enacted as a temporary two-year measure, the provision was extended in two-year increments through December 31, 2013. The IRA Charitable Rollover provision expired on December 31, 2013, but may be reinstated retroactively.

On July 17, 2014, the House of Representatives passed the America Gives More Act. The Act is designed to increase charitable giving and includes both a retroactive and permanent extension of the IRA Charitable Rollover provision. However, the Senate has yet to act on the proposed provision, leaving considerable uncertainty in planning for 2014 IRA distributions.

In order for a distribution to be a "qualified charitable distribution," it: (1) must be made from an IRA or Roth IRA; (2) be made directly from the IRA to the charitable organization; (3) the recipient charitable organization must be a public charity such as churches, hospitals, educational organizations and publicly supported organizations; (4) the IRA owner must be age 70 ½; (5) the distribution must be otherwise includable in the owner's gross income if withdrawn; and (6) the distribution must be otherwise fully deductible as a charitable distribution.

The tax benefits offered by the IRA Charitable Rollover provision have greatly increased the incentive to make charitable contributions using IRA distributions. The Independent Sector reports that in the first two years the charitable rollover option was offered, more than $140 million was contributed to public charities from IRAs. For charitably inclined individuals, utilizing the IRA Charitable Rollover is more beneficial than withdrawing funds from an IRA, paying the income tax on the distribution, and then later contributing funds to charity.

Despite the considerable benefits, the future of the IRA Charitable Rollover is stalled in the Senate, which is not likely to revisit the issue until after the November elections. It is speculated that the Senate will decline to permanently extend the provision, again opting for a two-year retroactive extension (until December 31, 2015). During this period of uncertainty, taxpayers must act carefully. For those who would otherwise utilize the IRA Charitable Rollover, the best course of action is to wait as long as possible to take their 2014 IRA required minimum distribution to see if Congress acts in 2014, as the IRA Charitable Rollover provision, should it be enacted retroactively without changes, will only apply to those distributions made directly from an IRA to a charity or charities.

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