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Employee Benefits Update

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IRS clarifies meaning of plan "contribution" for tax deduction purposes

When is an employer contribution to a retirement plan truly a contribution eligible for a tax deduction under ERISA Section 404(a)? Although this might seem like a rhetorical question, it was deemed worthy enough to warrant a ruling by the U.S. Supreme Court. The IRS also addressed the matter in a chief counsel memorandum (CCM). The issue can arise when a plan sponsor does something more complicated than simply transfer corporate funds from its own bank account to that of the retirement plan trust in a straightforward manner.

The case

The Supreme Court addressed the issue in *Don E. Williams Co. v. Commissioner*. The 1977 opinion involved a company that was seeking a tax deduction for contributing a secured promissory note to its profit sharing plan trust.

The Court ruled that "a promissory note cannot properly be equated with a check, since a note … is still only a promise to pay." In contrast, "a check is a direction to the bank for immediate payment, is a medium of exchange, and is treated, for federal tax purposes, as a conditional payment of cash."

The IRS memo

Building on that case, in August 2019, the IRS CCM laid out how it might address several comparable scenarios. But remember that, because the IRS deems CCMs only to be "general legal advice," you can't cite one as legal precedent.

The CCM provided a pair of tests that must be applied on a "facts and circumstances" basis to determine whether an employer has truly made a contribution to a retirement plan that warrants a tax deduction for that contribution under ERISA Sec. 404(a). First, the court will determine whether the employer has made an "outlay of assets," followed by an inquiry into whether the retirement plan trust can take full advantage of whatever the employer has contributed.

To have an outlay of assets, the employer "must experience … a reduction in assets."

Outlay of assets test. To have an outlay of assets, the employer "must experience … a reduction in assets." As noted, the Supreme Court didn't consider giving a promissory note to the plan as a reduction in assets.

Some CCM examples

The IRS's chief counsel memorandum (CCM; see main article) provided several examples of contributions and whether they fit into the ERISA Section 404(a) definition. For example, scenarios described in the CCM that wouldn't make the cut as an ERISA Sec. 404(a) contribution for deduction purposes include:

Publicly traded debt. This wouldn't pass the test because, even with the added liquidity of a traded security, it still just represents a promise to pay and not an actual payment.

Book entry. Merely designating a liability on your books on an accrual basis without a corresponding transfer of assets isn't a contribution.

Assets in escrow. Even if a contribution is in cash, if that cash is held in escrow and the plan cannot immediately access it, no deduction can be taken.

Less clear-cut examples in which all the facts and circumstances must be taken into account, according to the CCM, include the employer retaining the option to buy back assets contributed to the trust for a price deemed fair by another fiduciary. The same applies to assets contributed to the trust when the trust retains the option to sell them back to the plan sponsor at fair market value.

But what if the promissory note was secured by collateral? In the *Don E. Williams* case, the plan sponsor argued that, because the promissory note was fully secured, it was the equivalent of a contribution. But as the IRS memo states, "It is irrelevant whether the employer's promissory note is secured, because the provision of collateral is not payment and does not transform the promise into an actual payment within the meaning of Sec. 404(a)."

"Take full advantage" test. In this test, the "degree of encumbrance on the asset restricting the trustee's flexibility to use it to best fit the needs of the plan" is critical, and determined by facts and circumstances. According to the CCM, an "employer who retains significant control over the contributed asset has not actually made a payment to the trust, because no amount is irrevocably set aside for the plan."

Draw the line

Ideally, your company's liquidity will never be strained to the point where you're tempted to push the envelope on the definition of a "contribution" to your retirement plan. But if that happens, thanks to the CCM, you should have sufficient guidance to know where the line is drawn. ◻

Now is the time for MEPs

DOL regulations liberalize commonality requirement

Is there a multiple employer plan (MEP) in your future? What about an "open" MEP? If you sponsor a small defined contribution plan, the chances are greater today than they were a year ago, thanks to a liberalization of the Department of Labor (DOL) regulations governing MEPs that took effect last October. But what is a MEP (open or otherwise) anyway, and what's in it for you?

Defining MEPs

MEPs, sometimes also known as "association retirement plans," are sponsored by an organization such as a local trade association or professional employer organization (PEO) whose members or clients can adopt the MEP, but not technically be its sponsor. The basic idea is that, by banding together, smaller employers can achieve the economies of scale needed to secure plan administrative and asset management services at a cost comparable to those available to large employers.

Also, MEPs enable small employers to offload most — but not all — of the administrative duties and liability associated with sponsoring a plan on their own. The MEP's administrator files the annual Form 5500, not the employers that adopt the plan. The DOL regulations treat a bona fide group or association as a closed MEP for purposes of the Form 5500 filing requirements. However, adopting employers are responsible under ERISA's fiduciary rules for choosing and monitoring the arrangement and forwarding required contributions to the MEP.

Easing commonality standards

The DOL has eased its "commonality" requirements for companies to join a defined contribution MEP. Previously, employers had to have a lot in common to be deemed a "bona fide" group or association acting in concert, and thus eligible to launch a MEP. A loose affiliation of companies, or those operating in the same industry but scattered around the country, didn't pass the test.

Some "commonality" requirements are still in place, but relatively easy to satisfy. For example, employers operating in the same industry, trade, line of business or profession, wherever they are located, can now qualify. So, too, can employers of different industry sectors who operate in the same metropolitan area or state. That's what has opened the door to local chambers of commerce to jump into the game.

Also, under the new standard, associations eligible to sponsor a MEP must have at least one purpose in addition to providing financial and administrative services to plan sponsors, such as sponsoring a MEP. That means that pension recordkeepers, third-party administrators and financial institutions (such as banks, insurance issuers and broker-dealers) are specifically excluded from MEP sponsorship eligibility.

Clarifying PEO authority

Most PEOs already offer MEPs to their clients, but the new regulations provide clearer guidelines for them. In particular, the regulations provide a four-part "safe harbor" test that PEOs need to satisfy to demonstrate that they perform "substantial employment functions." This includes specified levels of responsibility for:

1. Payment of employees' wages,
2. Employment tax withholding and reporting,
3. Recruiting, hiring, and firing workers, and
4. Employee benefits.

Employers that sign on to a MEP retain fiduciary obligations with respect to how they choose and monitor the MEP, as well as relaying employee contributions to the MEP.

Making the most of MEPs

One organization that was prepared to seize the opportunity to launch a MEP as soon as the ink dried on the

new regulations is the Las Vegas Metro Chamber of Commerce. The organization had been closely monitoring the MEP regulations' progress. It's believed to be the first chamber of commerce to launch a MEP.

That plan doesn't charge a setup fee or recurring fees. The plan's "core expense" covering recordkeeping, administration, participant education, investment fiduciary oversight and plan audit costs is 97 basis points. Asset management fees on individual funds vary and are baked into those funds and netted out of their returns; thus, they're not covered by the 97-basis-point fee.

The MEP is administered by a wealth management company that's a Chamber member. The Chamber expects the MEP offering to be of interest both to members that already sponsor a 401(k) plan and those that haven't yet taken that step.

Will other chambers of commerce around the country follow Las Vegas' lead? An informal survey of local chambers by the U.S. Chamber of Commerce indicates that many are considering it within the next year or two, but aren't in a mad scramble to do so.

Looking ahead

The DOL has been urged to open the doors even wider to MEPs by allowing "open" MEPs that don't impose geographic or industry sector restrictions. The MEP service landscape could change more rapidly if open MEPs are given the green light by the DOL or Congress. Stay tuned for more. ◻

Compliance Alert

Upcoming compliance deadlines:

2/14 Quarterly benefit statements due for defined contribution plans with calendar year plans (due 45 days after the end of the quarter)

2/28 Deadline for filing paper 2019 Form 1099 with IRS (electronic filing deadline is March 31)

3/16* Deadline for making corrective distribution for failed 2019 actual deferral percentage (ADP) / actual contribution percentage (ACP) tests without 10% excise tax penalty

3/16* Deadline for filing 2019 partnership tax return and making contributions eligible for deductibility without extension (or deadline for requesting extension to September 15)

4/1 Deadline for taking first required minimum distribution for participants attaining age 70½ or retiring after age 70½ in prior year

4/15 Deadline for corrective distribution of 2019 402(g) excess deferral failures

4/15 Deadline for filing 2019 individual and/or corporate tax returns and making contributions eligible for deductibility without extension (or deadline for requesting extension to October 15)

** This reflects an extended due date, as the 15th falls on a Sunday this year.*

Including financial wellness in your retirement plan strategy

Many employees are paying a high price for their inadvertent ignorance about personal finance matters, studies are concluding. The price isn't measured solely in bad investment or spending decisions, but also emotional and physical health, as well as in diminished job productivity. Employees' understanding of your retirement plan, or lack thereof, is a critical piece of the puzzle. Designing a retirement plan educational strategy without considering employees' financial wellness could yield disappointing results.

Connect literacy to health

A study by the Stanford Center on Longevity found that Americans are losing ground in three "interdependent domains": healthy living, financial security and social engagement. As a result, the study found, "many companies are expanding their vision of wellness to include other aspects of an employee's wellbeing," including personal finance. And a report by Prudential found that increasing "numbers of employers are finding it advantageous to address overall wellness — financial and physical and social engagement — in their human capital strategy."

For some, it begins with a crash course in financial literacy. A recent study of Americans' grasps of basic personal finance topics conducted by the TIAA Institute identified "critical gaps in financial literacy among American adults and underscored the connection between financial literacy and financial health." The average survey respondent could answer only around half of the questions in a quiz that was administered as part of the study.

Interestingly, respondents were found to know much more about how to borrow money than how to assess the financial risks they face. Unfortunately, the risk of being unable to afford to retire wasn't high on the list of risks for people who understood how to get into debt.

Similarly, it can be an uphill battle to bring about meaningful retirement savings rates among employees who're strapped for cash. This may be because they failed to buy adequate auto insurance and incurred an expensive claim, or they didn't purchase a health benefit plan best suited to their circumstances. The same may be true of employees who overspend on discretionary convenience services such as restaurant meals to alleviate unmanaged personal stress.

The TIAA Institute's study found a correlation between financial literacy and retirement savings patterns. For example, 83% of the people who got at least three-fourths of the quiz questions right save regularly for retirement. That contrasts with only 37% of those who answered no more than one in four of the questions correctly.

Promote financial wellness

The recognition of the importance of an interdisciplinary approach to employee well-being has spawned a booming industry of financial wellness service providers. Promoting financial wellness effectively requires more than delegating

the task to a vendor, however. The Prudential analysis of financial wellness programs includes five tips for taking a strategic approach to getting the most out of a financial wellness program:

1. Make overall wellness a component of your human capital strategy.
2. Analyze your workplace demographics to understand your employees' financial needs.
3. Design programs to drive positive employee behaviors.
4. Create a personalized experience that engages your employees and motivates them.
5. Align your financial wellness metrics with your business outcomes.

Whether you put a financial wellness program together yourself or engage a vendor for support is up to you.

Measure success

Ideally, the success of such an effort can be measured in more ways than changes in the average employee 401(k) deferral percentage — even if that metric is the easiest to calculate. Changes in employee health and productivity can be trickier to measure, but merely taking success on faith isn't a prudent alternative. ◻

2019 vs. 2020 retirement plan limits

Type of limitation	2019 limit	2020 limit
Elective deferrals to 401(k), 403(b) and 457(b) plans	$19,000	$19,500
Annual benefit for defined benefit plans	$225,000	$230,000
Contributions to defined contribution plans	$56,000	$57,000
Contributions to SIMPLEs	$13,000	$13,500
Contributions to IRAs	$6,000	$6,000
Catch-up contributions to 401(k), 403(b) and 457(b) plans	$6,000	$6,500
Catch-up contributions to SIMPLEs	$3,000	$3,000
Catch-up contributions to IRAs	$1,000	$1,000
Compensation limit for benefit purposes for qualified plans and SEPs	$280,000	$285,000
Minimum compensation for SEP coverage	$600	$600
Highly compensated employee threshold	$125,000	$130,000
Minimum income for "key employee" status for top-heavy calculation	$180,000	$185,000
Income subject to Social Security tax	$132,900	$137,700

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