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Notice 97-2 Provides 401(k) Guidance for 1997

by Craig P. Hoffman, Esq., APM

The pension law changes made by the Small Business Job Protection Act of 1996 will have a dramatic impact on 401(k) plans. Some of these changes will not take effect for several years. For example, the new safe harbor contribution formulas for 401(k) plans will not be available until 1999. However, there are a number of important 401(k) changes that take effect right away, beginning with the 1997 plan year. This article will take a closer look at some of these changes which, for better or worse, are already upon us. Unfortunately, exactly how the new rules should be applied is not entirely clear. Thankfully, the Internal Revenue Service has moved quickly to answer the more important questions with the recent release of interim guidance.

Notice 97-2 was published in the January 13, 1997, edition of the Internal Revenue Bulletin. The purpose of the notice is to provide guidance and transitional relief with respect to the changes in the 401(k) rules that take effect in 1997. It begins by addressing the issues raised by the revisions made to the ADP and ACP tests.

ADP/ACP Testing

One of the problems under the old law had been the inability to determine whether the ADP or ACP tests had been satisfied until the plan year was over. This was because the limit for the highly compensated employees was based on the average deferral or contribution rate for the non-highly compensated employees for the very same year.

SBJPA attempts to remedy this problem. Beginning with the 1997 plan year, in applying the ADP test, the limit on the average deferral rate

Legislation Introduced Creating SAFE Plans for Small Business

by Brian H. Graff, Esq., ASPA Executive Director

On May 16, U.S. Reps. Nancy Johnson (R-Conn.), Earl Pomeroy (D-N.D.), and Harris Fawell (R-Ill.) introduced the Secure Assets For Employees (SAFE) Plan Act of 1997, which would create a new simplified defined benefit retirement plan for small business.

ASPA's Government Affairs Committee worked closely with Reps. Johnson, Pomeroy, and Fawell, and their staffs in developing the legislation, and believes the new SAFE plan will encourage small-business owners to offer a defined

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for the highly compensated group of employees will be based on the average deferral rate of the non-highly compensated employees for the preceding plan year. However, the new law also gives the plan sponsor the option to test using the current-year data approach that had previously been mandatory. Under SBJPA, once an employer elects to use the current-year data approach, the election may only be changed as permitted by the IRS.

Although the new law appears clear on its face, there arose some debate among practitioners as to the exact meaning of the changes Congress made. One area of controversy was with respect to determining which non-highly compensated employees should be considered in running the 1997 test. Some commentators suggested that the 1996 deferral rate for the non-highly compensated employees, as determined based upon the census data for 1997, would be the appropriate measure. This approach would have greatly complicated the testing process since the 1996 averages could not simply be "plugged-in" to determine the 1997 limits. ASPA's Government Affairs Committee submitted comments to Treasury and the IRS outlining the significant problems associated with this approach. Thankfully, the IRS followed ASPA's suggestions and reached a more practical result in the latest guidance.

Notice 97-2 provides that for the 1997 plan year testing, the 401(k) ADP test should be applied by using the 1996 deferrals of the employees who were non-highly compensated in the 1996 plan year. In addition, the notice clarifies that for this purpose, the old law definitions should be applied for determining who were the highly and non-highly compensated employees in 1996. This same approach should also be followed for 1997 ACP testing. Thus, for purposes of applying the ADP and ACP tests in 1997, the individuals taken into account in determining the prior year's average will be the employees who were non-highly compensated in 1996 without regard to their status in 1997.

As a result of this guidance, a plan sponsor can calculate the 1997 limit as soon as the 1996 data on status, contributions, and compensation becomes available. However, there is one complicating factor, the effect of which is uncertain at this time. Specifically, Notice 97-2 indicates that the IRS is uncertain as to how qualified nonelective contributions, or QNECs, and qualified matching contributions, or QMACs, made with respect to the 1996 plan year should be treated in determining the 1997 plan year limit. The concern is that the plan sponsor should not have the unbridled right to count the QNECs (and QMACs) in both the 1996 tests and again in setting the limit for 1997. The IRS has requested comments in this regard and in particular, sugges-

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Actuaries, Consultants, Administrators and other Benefits Professionals

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The purpose of ASPA is to educate pension actuaries, consultants, administrators, and other benefits professionals, and to preserve and enhance the private pension system as part of the development of a cohesive and coherent national retirement income policy.

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Focus on Government Affairs

Employees or Independent Contractors?

by S. Derrin Watson, APM

The classification of workers as employees or independent contractors is receiving increasing attention from practitioners, the Internal Revenue Service, and ASPA's Government Affairs Committee. The issue has far-reaching and fundamental consequences for qualified plans.

If individuals are actually an employees of a plan sponsor, they enter into determinations of the plan's qualified status. For example, they must be considered in determining whether the participation requirements of Internal Revenue Code section 410(b) are met. Moreover, as soon as they meet the plan's eligibility requirements (assuming they are not somehow excluded), they are entitled to participate in the plan.

If individuals are treated as though they were independent contractors and hence excluded from a plan, when they are actually an employee that should have been included, the plan has qualification problems for failure to comply with its terms and possibly for specific tax code violations. Furthermore, as Microsoft recently learned (and is appealing) the employer may well be liable to the excluded employees themselves for failing to include them in the plan.

On the other hand, if workers are treated as employees and covered under a plan, when they are really independent contractors, then the plan faces disqualification for failure to meet the exclusive benefit rule of IRC section 401(a). This means a plan sponsor in a close situation cannot simply resolve the matter by treating a worker as an employee. Either incorrect decision, treating employees as independent contractors or treating independent contractors as employees, carries the potential for disqualification or sanctions.

Official IRS guidance on this issue is fairly old and has not been amended to keep up with changing work conditions. In fact, it cannot be. As part of the Tax Reform Act of 1978, Congress forbade the IRS from issuing revenue rulings or regulations dealing with employee status. In an effort to update its materials on the subject, the IRS recently issued training materials dealing extensively with this issue. These guidelines urge examiners to take a neutral and impartial stance to employee questions.

The new training materials recognize that the ultimate test of whether a worker is an employee depends on whether the business for which the services are performed has the right to direct and control the worker, not only in the result to be accomplished, but also in the means and details by which it is accomplished. The IRS had previously developed a list of 20 factors used to assist in that determination (Rev. Rul. 87-41), and these still represent the official, published position of the IRS. The new training guidelines acknowledge, however, that these factors are incomplete and instruct examiners to evaluate situations in light of recent business circumstances and recent court opinions.

Much has happened in the business climate of the last few years which has altered employment relationships. For example, at one time it was reasonable to suppose that someone driving a company truck and wearing a company uniform was a company employee. Now, the guidelines note that safety concerns for consumers may cause a business,

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Accrued Interest Not Taxable Unless "Received"

Tax Court Rules Unpaid Loan Principal Taxable On Loan Default

by Steven R. Oberndorf, J. D.

In a recent memorandum opinion (*Milo G. Chapman, et ux., et al. v. Commissioner* — T.C. Memo 1997-147, March 20,1997), the Tax Court ruled that unpaid plan loan principal is taxable as a deemed distribution from a qualified retirement plan after the expiration of the maximum five-year period for plan loans made for purposes other than purchase of a primary residence. The court disagreed, however, with the Internal Revenue Service's position that unpaid interest accrued before and after the default should also be treated as a deemed distribution with an annual Form 1099-R issued. The court contended that these amounts must actually be "received" by the individual in order to be included in taxable income.

Although the IRS was not successful in gaining acceptance for its position on the taxability of accrued interest on defaulted plan loans, this case is significant because it is the first time (we could find) that the IRS has gone on the record formally on this issue. Until *Chapman*, official IRS pronouncements (including the proposed loan regulations issued in 1996) failed to address the proper treatment of accrued interest postdefault. The IRS's expression of its position in the *Chapman* case lends support to those more conservative plan administrators who have issued Form 1099-Rs on amounts of unpaid interest and principal when a loan default has occurred and have issued annual Form 1099-Rs on the interest that continues to accrue on the unpaid balance until either the outstanding loan is paid or is eliminated by offset when a distributable event occurs. The court's holding also provides support for those administrators who have not issued Form 1099-Rs on interest accrued prior to or after default. Whether the IRS will appeal the *Chapman* decision or issue a nonacquiescence bulletin is unknown at the time of this writing.

The Ruling

On February 22, 1983, a profit-sharing plan agreed to make loans of $37,500 each to two owner participants (Chapman and Christie) at 12 percent interest with a repayment date of December 31, 1984. The individuals stated that the purpose for their loan was to meet "emergency financial requirements." Although Chapman and Christie executed notes payable to the plan on that date, the plan paid $50,000 to the company sponsoring the plan and $25,000 to a related company instead of providing the loan proceeds to Chapman and Christie. The two companies executed notes requiring them to repay the amounts provided to them to Chapman and Christie plus 12 percent interest. Apparently the emergency financial requirements were related to the cash demands of Chapman's and Christie's businesses, and they structured the transactions as plan loans in an attempt to avoid a violation of the prohibited transaction rules of Title I of ERISA and the Internal Revenue Code.

The loans were not repaid by December 31, 1984, the original repayment date. In 1985, the companies made partial repayments of the

loans totaling $20,000 to Christie and Chapman. Neither individual reduced their loan balance at that time. In April 1989, the companies paid the remaining balance of the loans totaling $55,000 plus interest directly to the profit-sharing plan. Because the companies calculated interest on the original balance of the loans unreduced by the amounts repaid in 1985, an interest overpayment of approximately $4,000 occurred on each loan. Interest of $4,500 and $1,500 accrued on each of the plan loans in 1988 and 1989 respectively. Neither Chapman nor Christie reported any income on either the plan loan or the loan to their companies.

The IRS determined that Chapman and Christie had received two deemed distributions under IRC section 72(p). The first was deemed to have occurred for each individual in 1988 when the loan exceeded the five-year repayment requirement, and it was equal to the principal amount ($37,500) plus interest ($4,500). The second deemed distribution occurred due to the accrual of interest ($1,500 each) on the unpaid principal amount through the April 1989 repayment date. In addition, the IRS imposed a 10 percent early distribution penalty under IRC section 72(t) on each distribution. Also, the IRS determined that Chapman and Christie received interest income on the interest payments made on their behalf by the companies and that they constructively had received dividend income in the amount of the overpaid interest.

The court disagreed with the IRS on the treatment of the unpaid interest accrued during and after the five-year repayment period.

Chapman and Christie did not dispute the IRS's determinations but attempted to avoid the personal income tax repercussions by requesting that the Tax Court allow recharacterization of the loans as direct loans between the plan and their companies. This was rejected by the Tax Court on the grounds that Chapman and Christie were bound by the form of transaction they originally chose. (While this tactic may have provided some relief from personal taxes, this ultimately may have been counterproductive if prohibited transaction penalties under Title I and the tax code were imposed. Also, the text of the decision did not indicate if the loans were secured by the participants' account balances. If they were, prohibited transaction status would cause plan disqualification — see Reg. section 1.401(a)-13(d)(2)(iii).)

The Tax Court, based on the legislative history of IRC section 72(p), agreed that the unpaid *principal* amount of a plan loan not repaid within the five-year statutory repayment period measured from the date of initiation of the loan should be treated as a deemed distribution to the participant at the end of the five-year period. The fact that the initial repayment period was less than five years was irrelevant to the timing of when the deemed distribution occurred for tax purposes. The court also upheld the addition of the 10 percent early distribution penalty to the principal amount. However, the court disagreed with the IRS on the treatment of the unpaid interest accrued during and after the five-year repayment period. The court rejected the argument that the accrued interest represented an additional loan, and it held that IRC section 72(p) required Chapman and Christie to have actually *received* the interest proceeds from the plan in order for it to be taxable. The court upheld the IRS on the issues of taxable income received because of the interest paid on Chapman and Christie's behalf by their companies and the constructive receipt of dividends stemming from the overpaid interest.

Treatment of Plan Loans Under the Tax Code

Section 72(p) was added to the Internal Revenue Code as part of TEFRA. Section 72(p)(1)(A) generally treats a plan loan as a taxable distribution. It provides that —

> If during any taxable year a participant or beneficiary *receives (directly or indirectly)* any amount as a loan from a qualified plan, such amount shall be treated as having been received by such individual as a distribution under such plan [emphasis added].

An exception to this general rule is provided under IRC section 72(p)(2). According to that section, a qualified plan may make loans to participants and beneficiaries on a tax-favored basis if the loan meets the following requirements at the time of initiation and during its term:

1. The balance of all outstanding loans under all plans of the employer does not exceed the lesser of (i) $50,000, or (ii) the greater of $10,000 or half of the participant's vested accrued benefit under the plan;

2. The loan, by its terms, requires repayment within five years (unless the loan is related to the purchase or construction of a primary residence to be used by the participant); and
3. The loan is required to be amortized in substantially level payments paid at least quarterly.

The first two requirements were included in the TEFRA amendment of IRC section 72, while the third was added effective December 31, 1986, for loans made, modified, renewed, or extended after that date, as part of the Tax Reform Act of 1986.

The court in the *Chapman* case focused on the second requirement. While IRC section 72(p)(2) does not specifically address the issue, according to the TEFRA conference report, unless a loan is required to be repaid within five years it must be treated as a deemed distribution. When measuring the five-year period for these purposes, the five-year period begins on the date on which the loan is made. If a loan is granted with a repayment period of less than five years and subsequently the repayment period is extended beyond five years, the conferees expressed their intent that the balance of the loan as of the extension date be treated as distributed as of that date. In situations where a loan repayment period is less than five years, the conferees took a different approach: "If payments under a loan with a repayment period of less than 5 years are not in fact made, so that an amount remains payable at the end of five years, the amount remaining payable is treated as if distributed at the end of the 5-year period." The Tax Court reluctantly accepted this explanation, partially because Chapman and Christie did not dispute this interpretation. The court voiced its reluctance to adopt the conference committee interpretation in a footnote:

> There seems to be a gulf between the language of the statute and the legislative history. In other circumstances, we might be concerned about this disparity, which indicates legislation by conference report rather than by concise statements in the statute. *Taxpayers should not be compelled to look at legislative history to determine the tax consequences of their activities* [emphasis added].

The text of IRC section 72(p) also does not address the tax treatment of unpaid interest that has accrued either before or after the event that has caused the loan to go into default. In this apparent vacuum the court took the position that —

> We are not convinced, however, that Congress intended that interest accruing during or after the 5-year period be treated as a taxable distribution for purposes of section 72(p)(1). *Respondent's argument relies upon the fiction that the accrued interest constitutes an additional loan.* From the language of section 72(p)(1), it is apparent that, to be a taxable distribution, the loan amount must be **received** either directly or indirectly by the participant or the beneficiary. The accrued interest does not satisfy the requirement that the loan must be received to be a distribution [emphasis added].

However, the *Chapman* court either consciously ignored a statement contained in the Senate's explanation to the TEFRA amendment to IRC section 72(p) or refused, based on its comment regarding legislation by conference report, to give the Senate's views the same weight afforded the conference committee report on the five-year repayment period. The Senate's explanation specifically takes the position that "*A failure to pay loan interest when due will constitute an indirect loan* for purposes of the bill, unless under the facts and circumstances such a failure does not constitute an additional loan transaction" [emphasis added]. Although the conference report does not repeat this statement, it notes that the conference agreement generally follows the Senate amendment to IRC section 72(p).

Based on the Senate's view, it appears that each time a participant fails to make an interest payment a new loan agreement effectively is created. If the original loan is in default, the plan administrator would be obligated to deem any accrued unpaid interest to have been distributed to the participant. This could occur at several points during the history of a defaulted loan. For example, in the year the loan went into default, unpaid interest accrued prior to the default date would be added to the unpaid principal and reported accordingly. In addition, the plan administrator is obligated to continue accruing interest on the defaulted loan as an investment of the plan trust until it is either paid or offset upon the occurrence of a distributable event. Each continuing failure to pay interest would trigger a new defaulted loan, a distribution, and a reporting requirement.

The Proposed Regulations

In December 1995, the IRS released proposed Regulation section 1.72-1 in an attempt to answer certain open issues respecting loans treated as deemed distributions under IRC section 72(p). These regulations, which were issued in question-and-answer format, have not yet been finalized. The regulations envision that a plan loan will not be treated as a deemed distribution so long as the underlying loan meets the requirements of IRC section 72(p)(2) in form and in operation. These re-

quirements include the need to document the terms of the loan in a written, legally enforceable document, to satisfy the statutory repayment and level amortization schedules, and to satisfy the statutory limits on the maximum permissible amount of the loan.

The specific regulatory provision governing the timing and determination of the amount of a deemed distribution caused by a failure to make an installment payment is found in Q&A 10 of the proposed regulations. Failure to make *any* scheduled loan payment when due will cause the loan to violate the IRC section 72(p)(2) requirements and will cause the loan to be deemed distributed to the participant or beneficiary under IRC section 72(p)(1) as of the date that the failure to make payment occurs. The proposal permits a plan to have a grace period; however, the grace period may not extend beyond the end of the calendar quarter following the calendar quarter in which the payment was scheduled to occur. Where a grace period is provided, violation of the requirement to make installment payments ordinarily will not occur until the last day of the grace period. The requirement respecting the repayment schedule of the loan must be met at the time the loan is initiated and must continue to be met during the term of the loan in order to avoid a deemed distribution.

If a failure to make an installment payment occurs, the amount of the deemed distribution is equal to the *entire* outstanding balance of the loan at the time of the failure to make payment. The IRS provides an example in the proposed regulation of a plan participant who takes a loan on August 1, 1998, in the amount of $20,000 at 8.75 percent to be repaid over five years in level monthly payments due at the end of each month. The participant makes payments through July 31, 1999, and then ceases to pay. The plan provides a three-month grace period. Based on the facts presented, the participant had a deemed distribution as of November 30, 1999, and the outstanding balance on that date was $17,157, including unpaid principal and unpaid accrued interest through that date. (The example notes that the maximum allowable grace period in this situation would have expired on December 31, 1999, and the adjusted outstanding balance in that situation would be increased by $125 to $17,282, representing unpaid accrued interest for the month of December.) Thus, the proposed regulations support the IRS's position that the deemed distribution includes both unpaid principal and accrued interest at least through the date of default.

> The proposed regs permit a plan to have a grace period; however, the grace period may not extend beyond the end of the calendar quarter following the calendar quarter in which the payment was scheduled to occur.

Unfortunately, the proposed regulations do not clarify whether there is an obligation to continue to accrue interest on the loan (and deem further distributions of this accrued interest) until it is either paid or offset against the participant's or beneficiary's account. This shortcoming may soon be rectified by the IRS. At the IRS-ASPA Midstates Benefits Conference held in Rosemont, Ill., in April 1997, Richard Wickersham of the IRS was quoted as saying that the IRS intends to issue further guidance on IRC section 72(p) issues. Specifically, the IRS is said to be looking into the proper approach for dealing with failures to make quarterly amortization payments, and it intends to deal with how a plan will report missed payments, decide on whether missed payments will constitute new loans, and determine whether missed payments may be offset upon the ultimate distribution of the account. This appears to indicate that IRS would be unwilling to forego the additional revenue attributable to accrued interest on defaulted loans that the Chapman decision would cause.

Conclusion

Based upon the available legislative history and the positions taken by the IRS in the proposed regulations and in the *Chapman* case, it appears very unlikely that the IRS will acquiesce in the Tax Court's decision. If the IRS refuses to acquiesce, affected individuals will be forced to litigate each case in which the IRS assesses additional taxes and penalties. Plan administrators will need to reconsider how they administer and report defaulted loans. Those already providing for deemed distributions of unpaid principal and accrued interest can rest assured that they have been administering their plans in a fashion that will not cause an IRS challenge.

Steven R. Oberndorf is senior counsel at McKay Hochman Co., employee benefits consultants in Butler, N.J.

FOCUS ON RIAS

New Registered Investment Adviser Law Makes Big Changes

by John W. Myers, MSPA

At the same time Congress was passing legislation to simplify retirement plans last year, the Investment Advisers Act of 1940 was amended as part of the National Securities Market Improvement Act of 1996. Title III — Investment Advisers Supervision Act of that legislation dramatically changes not only the regulation of investment advisers but also the market place.

Effective Date

Title III had an effective date of April 9, 1997. This delay gave the Securities and Exchange Commission six months to formulate regulations and for the various states to conform their statutes. The SEC issued proposed regulations with comments due by February 10, 1997. However, in March, the SEC asked Congress to extend the effective date by another 90 days (sound familiar!). The extension was passed on a nonpartisan basis and signed into law by President Clinton on March 29, 1997. The new effective date is July 8, 1997.

SEC Registration if Assets Under Management are $25,000,000 or More

The act eliminated federal regulation of advisers with less than $25,000,000 of assets under management. The SEC is developing a new Form ADV-T. All advisers currently registered with the SEC will use this form to indicate whether they meet the $25,000,000 requirement. If not, then SEC supervision will cease and registration will be handled exclusively by the states. The SEC has authority to increase the threshold amount as needed and to develop regulations for firms which move over and under the threshold due to market fluctuation or other circumstances.

"Assets under management" means securities portfolios for which an adviser provides continuous and regular supervisory or management services. You must have discretionary authority over the assets and your total must reasonably match what has been shown on your firm's SEC Form ADV.

States Retain Responsibility for Certain Functions

States will continue to license, register, or otherwise qualify any **investment adviser representative** (the person who works for your firm that provides investment advice to your clients) even though the SEC has responsibility for your firm. Thus all exams, fingerprinting, annual notices, bonding, and so on, will continue to be handled by your state of domicile and you will continue to pay fees for such services. SEC regulations call for an audit of your firm if you require prepayment of fees of more than $500 per client and more than six months in advance. State audit requirements do not apply to an SEC-regulated firm.

Less than $25,000,000 — State Regulation Remains As Is

If you come under state regulation, your operation will be the same as it currently is except you do not file with the SEC. States generally require a firm to have audited financial statements so that non-SEC regulated firms will still have that burden and its related expense. States are required to treat your firm no worse

Case Study

Setting Up an RIA

by Neal J. Bransford

As a third-party administrator for 401(k) plans, we are always looking for ways to create value-added service for our clients. Today there are a number of so-called *"mutual fund supermarkets"* that can help provide all the necessary ingredients to provide what we call *the Ideal 401(k) Plan*[SM].

In putting the ingredients together, we made a commitment to provide daily valuation and voice response services. In our opinion, if you cannot provide these two services, you will not be "invited to the dance" — they are expected in today's marketplace. The other key ingredient was the establishment of our *registered investment advisory* firm.

We contacted a number of other firms similar to ours who had already established an RIA. We found that most engaged the services of an organization that helped them gather the information necessary to file the Form ADV and other registration requirements with the Securities and Exchange Commission. They also provide guidance regarding various federal regulations (including the SEC's), how files should be maintained within the office, what needs to be disclosed to clients, how different states govern RIAs, and so on. Needless to say, we engaged the services of one of these organizations and continue to use them as a valuable resource.

When putting together the Form ADV there are a number of things to consider. Following are some of the steps we went through:

1. Determine your primary focus (*i.e.*, self-directed 401(k) plans).

2. Pinpoint what services you are going to provide:

   (a) Investment selection process — as part of this, determine the criteria you are going to use (*i.e.*, performance within peer group, modern portfolio statistics, management tenure, expense ratio, etc.);

   (b) Ongoing monitoring — once you choose the funds, what measurement and related criteria are you going to

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than your home state if you desire to be registered in more than one state. No special requirements (record keeping, bonding, net capital requirements, *etc.*) can be imposed if you want to do business in another state which has stricter requirements.

National De Minimis Rule

If you do not have an office in a state, you can have fewer than six (*i.e.*, five) clients in a state before you must comply with any state requirements.

Place of Business

The act does not define "place of business." The SEC defined it in the draft regulations to mean any "place or office from which the investment adviser representative regularly provides advisory services or otherwise solicits, meets with, or communicates to clients." According to the regulations, a place of business may include a hotel room, temporarily rented office space, or even the home of the client if the adviser representative regularly provides advisory services or solicits, meets with, or otherwise communicates to the client at that location. If no specific place or office is used, the place of business would be defined as your client's residence.

Sen. Phil Gramm (R-Texas) has expressed his concern with this definition. In his view, it is contrary to congressional intent as well as the plain language of the act which seeks to "eliminate where possible multiple

use? (Note: This typically requires an investment in software);

(c) Investment policy statement — the selection and monitoring process should then be put in writing and;

(d) Other — for instance, do you cover the cost of conducting employee meetings, communication material, and so on, under your advisory agreement?

3. Obtain the necessary licenses (such as a Series 7, 63, or 65) required to provide RIA services. (Note: There are a number of organizations to assist you in obtaining these as well as other professional designations.)
4. Determine what fees you are going to charge (*i.e.*, a declining percentage as the assets grow).

One other key item we had to address was *"selling away"* with our broker-dealer. Our broker-dealer has the responsibility of making sure we are in compliance.

With our RIA firm in place, we can provide the value-added services the market demands. We can offer the daily valuation environment, voice response, no-load, no-transaction-fee mutual funds from multiple fund families with same- or next-day settlements, a written investment policy, and formal quarterly monitoring. Our RIA services provide the documentation and support for the selection, retention, or replacement of the chosen funds and, thus, serves to reduce the client's fiduciary liability.

Neal J. Bransford is vice president of Retirement Plan Investments Inc., a registered investment advisor, and an officer of Bransford Retirement Plan Services Inc., a third-party administrator for qualified retirement plans.

State supervision of securities market professionals." The law provides for limited supervision of investment adviser representatives by the state where the representative has a "place of business." Sen. Gramm does not think of a restaurant, an automobile, an airport lobby, a phone booth, or your client's residence as a place of business.

Special ERISA Plan Rule

Prior to this act, all investment advisers were registered under the Investment Advisers Act of 1940. Now some advisers will be regulated exclusively by the states and not under the '40 act. ERISA section 3(38)(B) defines "investment manager" as an adviser under the Investment Advisers Act of 1940. This language has been amended by inserting "or under the laws of any state" after "1940." This allows a state-only registered investment adviser to continue to provide services to an ERISA plan. However, this amendment has a **sunset** provision: It expires two years after the effective date of the act (now extended to July 8, 1999).

State Statutes

State statutes will have to be amended to conform to the act. Arkansas was the first state to take such action and the Securities Department indicates that it is being used as a model by the other states. It may take some time before conforming legislation is available in many states due to their scheduled session dates. You will need to find out what problems, if any, this will pose to your operation in the interim.

Conclusion

We have a different playing field. In some respects it is more level and compliance is easier. In other areas it will be more burdensome. The need to register in a state which had no de minimis provision has been eliminated. However, the draft regulation contains an unreasonable definition of place of business. A small investment advisory firm subject to state regulation will have to terminate its business relationship with any qualified plan clients when the sunset provision takes effect.

John W. Myers, MSPA, is president of Myers Loveless Brandsgaard Inc., a registered investment adviser. Benefit Resource Group, an operating subsidiary, administers qualified retirement plans.

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Notice 97-2 Provides 401(k) Guidance for 1997

tions on how the rules can be written to prevent the inappropriate double counting of the QNECs and QMACs in both years.

Election To Use Current-Year Data For 1997

A second question that arose with respect to 401(k) testing in 1997 that was addressed by Notice 97-2 relates to the procedures for implementing an election to use current-year data in the 1997 ADP or ACP tests. As previously noted, the new law permits a plan sponsor the option of electing to use the current-year data approach that had been mandatory under prior law. However, the legislative history to SBJPA indicates that if an employer makes this election, it can only be changed as permitted by the IRS.

There has been some question as to what limitations the IRS might impose on a plan sponsor who in 1997 elects to use the current-year data approach, but in 1998 wishes to begin using the prior-year approach. Based upon the guidance provided by Notice 97-2, apparently there will be no restrictions, at least with respect to the 1998 plan year.

Under the transitional relief provided by the IRS, a plan that uses the current-year approach for 1997 will be permitted to use the prior-year data approach for the 1998 plan year without receiving any further approval from the IRS. Consequently, 1997 will be a "free election" year in which the testing approach followed by the sponsor will not result in any limitations being placed on what might be done in the future. Additionally, Notice 97-2 provides that no plan amendment or formal election by the plan sponsor is required to be made in 1996 or 1997 in order to use the current-year data approach for the 1997 plan year. The notice indicates that the IRS intends to issue future guidance regarding the conditions under which employers who elect to use the current-year data for 1998 or a later plan year may switch to using prior-year data for subsequent years.

1997 Testing Should Be Done Both Ways

The effect of this guidance on the 1997 ADP and ACP tests is substantial. Most plan sponsors will probably want to run the tests both ways in 1997 and use whichever approach gives the best result. In other words, the 1997 limit for the highly compensated employee group should be determined based on the 1996 plan year data. Then, at the close of the 1997 plan year, if one or both tests fail based on the 1996 data, the tests should be redone using the current-year data from 1997. If the current-year approach provides a higher limit, then it would appear from Notice 97-2 that the plan sponsor would be permitted to take advantage of the higher limit without any formal action or plan amendment.

It is important to remember that there could be significant differences between the average deferral and contribution rates of the non-highly compensated employees in 1996 as compared to 1997. One reason for this difference is the normal variations that occur from year to year. However, another perhaps more likely reason as to why there could be significant differences between 1996 and 1997 is that the plan will be using markedly different definitions of who is a non-highly compensated employee in 1996 versus 1997. This is because the prior-year data from 1996 will be determined by using the old definition of highly compensated employee and the 1997 average will be calculated using the new definition that takes effect this year. Whether this change in the way the non-highly compensated employee group is determined helps or hurts any particular plan sponsor in ADP or ACP testing will vary based on the specific demographics of the particular employer's work force. In any case, those who work with 401(k) plans should be prepared to calculate their 1997 limits using both approaches that are permitted under Notice 97-2.

Corrective Distributions to HCEs

Notice 97-2 addresses another change in the 401(k) rules that takes effect this year relating to the corrective options that may be used when a plan fails either the 401(k) or 401(m) tests. One of the more popular correction techniques has been to distribute the excess amounts to affected highly compensated employees. However, this option may not be as popular in the future because of the changes made by SBJPA.

Under the old rules (which remain in effect for the 1996 plan year), corrective distributions are made to the highly compensated employee(s) who had the highest deferral or contribution rate, when measured as a percentage of pay. The effect of this rule has been that the relatively lower-paid highly compensated employees are usually the individuals that receive corrective distributions. This is because the higher-paid highly com-

pensated employees are limited by the dollar cap on elective contributions, which is presently set at $9,500. Obviously, a person making $150,000 who contributes $9,500 will have a smaller deferral rate, as a percentage of pay, than a person making $75,000 who contributes $7,500 to the plan. As a result, the old rules would require corrective distributions to first be made to the lower-paid highly compensated employee.

The HCEs who have contributed the highest dollar amount of elective deferrals will receive corrective distributions. However, the amount to be returned will be based upon the amounts that would have been returned to the HCEs who had the highest deferral rates.

New Law Approach A Surprise To Many

Under the new law, the corrective distribution methodology will change. The exact manner in which the new rule is to be applied has surprised many plan sponsors. For the 1997 plan year, the actual dollar amount of the corrective distribution will be determined in exactly the same manner as under the old rules. In other words, the maximum limit for the year will be applied to the highly compensated group's average deferral rate. Assuming the limit was exceeded, the total dollar amount to be returned would be determined by assuming an adjustment was to be made to the deferrals of the highly compensated employees who had the highest deferral rate. This hypothetical adjustment would be done just as it has been done in the past. In other words, the adjustment would be made by beginning with the highly compensated employee who had the highest rate of deferrals. That person would have his or her deferral rate lowered until either the test was satisfied or the next highest deferral rate for an HCE was reached. If the latter, these two highly compensated employees would have their rates lowered simultaneously until the test was passed or the HCE with the third highest rate of deferral was reached and the process continued.

Once the total dollar amount of the corrective distribution is calculated, SBJPA provides that the actual distribution of the excess amounts will be made to the highly compensated employees who had the largest contributions, measured on the basis of the dollar amount contributed. In other words, the highly compensated employees who have contributed the highest dollar amount of elective deferrals will receive corrective distributions. However, the amount to be returned will be based upon the amounts that would have been returned to the highly compensated employees who had the highest deferral rates. The result of this approach is that, in many cases, individuals will be forced to take corrective distributions not because of their own actions, but instead because of what other, lower-paid highly compensated employees contributed. This may be difficult to explain to the person who is going to get the corrective distribution.

Example

To illustrate how this will work, let's look at an example. Assume we have HCE 1, who contributes $9,000 of his $150,000 salary and hence has a deferral rate of 6 percent. HCE 2 contributes $7,500 of his $75,000 salary and hence has a deferral rate equal to 10 percent. Let's further assume that the limit for the HCE group for the year was 7.5 percent and because our HCE average deferral rate was 8 percent, we failed. Under the new law, the corrective distribution amount would be calculated in just the same way as under the old law. Since HCE 2 had the highest deferral rate, we would assume that we are lowering that individual's deferral rate by 1 percent since, by doing so, we would now pass the test with an average HCE deferral rate equal to 7.5 percent. One percent of HCE 2's deferrals equals $750. Under the new law, this $750 must be returned not to HCE 2, but instead it must be returned to HCE 1 because HCE 1 had the highest dollar amount of elective contributions. This is true even though the amount of the corrective distribution was determined by reference to HCE 2 because he or she had the highest deferral rate. (***Note:*** The earnings allocable to the excess amount must also be distributed. The earnings generated by HCE 1's account would be the measuring rod for this calculation.)

After the corrective distribution, HCE 1 would be left with an elective contribution of $8,250 for the year. If the ADP test was to be applied to these revised elective contribution amounts (after the corrective distribution had been made), it would appear that the plan still fails the test. However, Notice 97-2 indicates that the test does not need to be applied

again after the corrective distribution is made. Instead, the plan would be deemed to have passed the test without having to recalculate the HCE average once again.

Adverse Impact On Higher-Paid HCEs

This change in the corrective distribution methodology will almost certainly adversely impact the higher-paid highly compensated employees. Since they usually have a relatively lower deferral rate, when measured as a percentage of compensation, the higher-paid highly compensated employees have been spared in the past from having to receive corrective distributions when the ADP or ACP test was failed. Now these individuals will be the first employees to receive a corrective distribution.

As a result of this change made by SBJPA, it is likely the 401(k) safe harbor contribution formulas will be even more popular when they become available beginning with the 1999 plan year. By providing for a safe harbor contribution, ADP and ACP testing can be avoided entirely. Another approach that should be considered as a way to lessen the impact of this change in the law would be to include a plan provision which limits the elective deferrals of highly compensated employees to no more than 6 percent of compensation. By setting the limit at 6 percent, highly compensated employees who make at least $158,333 in 1997 would still have the opportunity to defer the entire IRC 402(g) limit of $9,500. On the other hand, the 6 percent limit would prevent lower-paid highly compensated employees from deferring at higher rates, which in turn should lessen the chance of failing the test in the first place. Even if the plan does fail the ADP test, the amount to be returned would in all likelihood be reduced.

A plan limit on the maximum deferral rate for each HCE has now become an important plan design consideration. Otherwise, lower-paid highly-compensated employees will have little reason to cut back their contribution rate since if either test is failed, it is likely that somebody else would get the brunt of the corrective distributions.

The Treasury Department and IRS should be commended for releasing the guidance contained in Notice 97-2 as quickly as they did. Now pension professionals can look forward to further refinements in the rules when proposed regulations are released, probably later this year.

Craig P. Hoffman, Esq., APM, is vice president and general counsel for Corbel, a leading provider of plan document and software services to the employee benefits industry. Hoffman also serves on ASPA's board of directors.

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Employees or Independent Contractors?

such as a utility, to require independent contractors to wear uniforms and carry company identification. Similarly, the prevalence of "flex-time" arrangements and telecommuting by employees has reduced the effectiveness of these factors in determining employee status.

Court decisions, while using the 20 factors, have also recognized the importance of other factors not on the list, such as the intent of the parties. The new guidelines expressly acknowledge this.

One way of determining the intent of the parties is by looking at whether the employer provides the employee with employment benefits, such as health insurance or paid vacation. The guidelines note "The evidence is strongest if the worker is provided with employee benefits under a tax-qualified retirement plan, IRC section 403(b) annuity, or cafeteria plan, for, by statute, these employee benefits can ONLY be provided to employees." [Worker Classification Training Memorandum, page 2-23; emphasis in original.]

The IRS wrote its new guidelines primarily for employment tax examiners, but for the pension practitioner, this issue is strangely circular. The inclusion of a worker in the plan can help show that the worker is an employee, which, in turn, can help show that it was proper to include him or her in the plan.

Perhaps no segment of the business community is feeling as threatened by this issue as the employee leasing industry. Staffing firms take over a business's employees and then lease them back to the business. These arrangements have become increasingly popular since the passage of the IRC section 414(n) employee leasing rules in 1982. Recent court decisions and audit activity have caused leasing organizations to question whether they are truly the employer of the workers on their payroll. If they are not, if these workers are truly the common-law employees of the recipient organizations for

which they are performing services and from which they are receiving direction, then a 401(k) or other retirement plan set up by the leasing organization may be disqualified for violating the exclusive benefit rule.

In fact, looking at the published 20 factors or the new guidelines, many staffing situations have this problem. For example, I recently analyzed the two-inch thick handbook of one national leasing firm. There was plenty of paperwork to show that the workers were the employees of the leasing organization. However, once the paperwork was stripped aside, it became obvious that all relevant decisions, including, hiring, firing, training, and so on, were made by the recipient, and not by the leasing organization.

The committee reports to SBJPA suggest that a leasing organization may be treated as the common law employer, even if many of the indicia of employer status rest with the recipient organization. In fact, after 1996, workers cannot be leased employees of the recipient unless they are under the recipient's primary direction and control. However, the committee reports clarify that ultimate control still must rest with the leasing organization for it to be a valid leasing arrangement. Otherwise, the worker is simply an employee of the recipient, and the leasing organization is simply a bookkeeping service.

This has made leasing organizations nervous, to say the least, in setting up qualified plans. Many are resorting to cosponsoring plans with the recipient organizations they serve, reasoning that one of them, either the leasing organization or the recipient, must be the employer, and hence the exclusive benefit rule will be satisfied. However, this still leaves open the question of how to test such a plan for nondiscrimination. If the leasing organization is the employer, coverage and benefits testing should be performed on an aggregate basis, while if the recipient is the employer, it must be performed separately for each recipient.

Two different GAC subcommittees are trying to deal with the worker classification issue. A special ad hoc committee is preparing recommendations for dealing with this issue for employee plans. Until now, most of the IRS attention has been focused on employment tax concerns. In fact, the IRS has devised a classification settlement program to help resolve these questions and ameliorate employer penalties. However, this program has done nothing to address qualified plan questions. While the IRS has been working on plan issues, to date nothing has been announced. The ad hoc GAC employee classification subcommittee is working on recommendations for all facets of this problem, including waiving prior contributions, removing contributions improperly made for independent contractors, and using plan language to minimize employer exposure.

The GAC legislation committee is also working on this issue, specifically as it impacts leasing organizations. They are proposing that people working under leasing organizations be treated as employees of those organizations for qualified plan purposes, much as full-time life insurance salespersons are treated as employees of the companies for whom they work under IRC section 7701(a)(20). This proposal would not affect the status of these workers for employment tax purposes or for purposes of the recipient's plan under section 414(n); it would simply insure that a leasing organization can adopt a qualified plan for the people on its payroll.

If ASPA members have comments on these issues, please direct them to Derrin Watson, by fax to (805) 683-4334, or by e-mail to mom@pixpc.com.

A tax lawyer from the Santa Barbara area, S. Derrin Watson, APM, is managing sysop of the Pension Information Exchange computer bulletin board and author of its interface software, WatsOpDoc. Watson is a frequent speaker at ASPA meetings and serves on the ASPA Government Affairs Committee as chair of the Internal Communications Committee

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SAFE Plan Legislation

benefit retirement plan providing small-business employees meaningful retirement benefits.

Retirement plan coverage for small-business employees continues to be inadequate. Eighty percent of workers employed by small businesses with fewer than 100 employees have absolutely no retirement plan coverage. The administrative burdens and high costs associated with qualified retirement plans make it extremely difficult for small business to maintain such plans. In addition, small-business employees who are baby boomers and who have not previously been covered under retirement plans will not be able to save enough under the newly enacted SIMPLE plan or a 401(k) plan to provide an adequate retirement income. Small business needs a retirement plan which is easier to administer and which will provide small-business employees, including baby boomers, a sufficient retirement benefit. The

SAFE plan will provide all small-business employees with a secure, fully portable, defined retirement benefit they can count on, without choking small businesses with complex rules and regulations that small businesses cannot afford.

Fully Funded and Secure Retirement Benefit

- SAFE plan retirement benefits will be totally secure because they will be funded either through an individual retirement annuity (SAFE Annuity) issued by regulated financial institutions or through a trust (SAFE Trust) whose investments will be restricted to registered investment securities or insurance company products.

The SAFE plan will provide all small-business employees with a secure, fully portable, defined retirement benefit they can count on, without choking small businesses with complex rules and regulations that small businesses cannot afford.

- SAFE plans will always have to be fully funded so that there will be no shortfall in case of plan termination.
- SAFE plans will be required to use specified conservative actuarial assumptions (for example, a 5 percent interest rate assumption) to ensure the minimum retirement benefit.

Minimum Defined Benefit With Possible Higher Benefit

- SAFE plans utilize the best features of both defined benefit and defined contribution plans by providing a fully funded minimum defined benefit with a higher benefit if investment returns exceed conservative expectations.
- At a minimum, employees will receive a benefit equal to 1, 2, or 3 percent of compensation for each year of service. For example, if an employee whose average salary was $40,000 has 25 years of service for an employer who elects a 3 percent benefit, the employee will retire with at least a minimum $30,000 annual benefit.
- In order to allow baby boomers to catch up with their retirement savings, employers can elect to credit benefits for up to 10 prior years of service, provided such benefits are credited to all employees eligible when the plan is adopted.
- An employee's benefit is 100 percent vested at all times.

Fully Portable Retirement Benefit

- Employees participating in the SAFE Annuity who separate from service automatically hold an individual retirement annuity that will pay them at least the benefits they have earned (and possibly a higher benefit) upon retirement.
- Employees participating in the SAFE Trust will have their retirement benefits automatically converted to a SAFE Annuity, or, if they elect, have the cash balance in their account transferred to an individual retirement account (a "regular IRA"). Either can continue to be funded under current-law rules.
- The benefit in a SAFE Annuity may be rolled over to another SAFE Annuity without restriction. However, in order to ensure adequate benefits for retirement, benefits in a SAFE Annuity and SAFE Trust will be subject to substantial distribution restrictions.

Easier to Administer

- SAFE plans will have simplified reporting requirements, including a simplified actuarial report verifying that the employer satisfied the annual funding requirement.
- SAFE plans will not be subject to complicated nondiscrimination rules or plan limitations. However, so that plan benefits are distributed fairly to all employees, SAFE plans, like SIMPLE 401(k) plans, will be subject to the current-law annual limit on employee compensation ($160,000).
- Since SAFE plans are always fully funded using conservative actuarial assumptions, expensive Pension Benefit Guaranty Corporation insurance premiums will not be necessary.

Complements the SIMPLE Plan

- SAFE plans can be used with SIMPLE plans or 401(k) plans. However, no other pension plans can be maintained if an employer maintains a SAFE plan.
- Employer eligibility, employee eligibility, and the definition of compensation are the same under the SAFE plan as under the SIMPLE plan.

ASPA's 29th Annual Conference

1997 Pension Actuaries and Consultants Conference

Learn about recent advances and challenges in retirement benefits at the 1997 Pension Actuaries and Consultants Conference, Grand Hyatt hotel, Washington, D.C.

November 2-5, 1997

Conference Mission:

Join your colleagues for this educational forum designed to keep you current on the latest in the employee benefits world. This national conference will focus on the exchange of information on the newest trends and ideas, the advancement of knowledge, and the fostering of sound principles, procedures, and practices. The conference includes lecture and workshop sessions, as well as exhibits of pension-related products. Attendees are encouraged to meet with their members of the U.S. Congress, and ASPA will assist in setting up the appointments. ASPA is striving to produce a conference that surpasses every participant's expectations.

Congratulate ASPA Award Winners

Three awards will be presented at the conference:

- Harry T. Eidson Founders Award
- Instructor of the Year Award
- Martin Rosenberg Academic Achievement Award.

Expected Attendance:

Attendance is anticipated to range between 1,100 to 1,200 participants. Register today to ensure your participation.

Who Attends?

Actuaries, consultants, administrators, benefits professionals, government agency representatives, human resource administrators, and suppliers.

Benefits:

- Come hear the latest developments in the pension industry.
- Join us for this unique opportunity to exchange information on the newest trends and ideas on a national level.
- The finest speakers from industry and government are carefully screened to provide you with the latest information.
- Earn as many as 20 CE credits.
- The variety of session types encourage your participation, including panel discussions, workshops, informal sessions, general sessions, and receptions.
- Incorporate the information you gather immediately into your day-to-day operations.

Hotel:

Grand Hyatt Washington

1000 H Street, N.W., Washington, D.C. 20001, phone (202) 582-1234

To make your hotel reservations, call the Grand Hyatt directly. A block of rooms has been reserved for $167 for a single or double. Just mention the American Society of Pension Actuaries to receive your special rates.

Networking

Meet your peers from all over the nation — all with a unique perspective to share.

Learning

Close to four full days of workshops and general sessions provide you with innovative ideas and keep you abreast of new developments on key issues.

Exhibits

Check out this year's showing of high-interest products, services, and emerging technologies.

Speakers

A diversity of speakers from government to industry will deliver presentations at this year's conference. You will hear updates from the Internal Revenue Service, the Department of Labor, and the Treasury Department.

Watch your mailbox!

In July, ASPA will send you the conference brochure with a list of all workshops, speakers, and exhibitors to date.

1997 Western Regional Seminar and the Successful TPA Firm Workshop

July 13, 1997
The Successful TPA Firm Workshop

July 14-16, 1997
Western Regional Seminar

The Westin Hotel Seattle

1900 5th Avenue, Seattle, WA 98101

Hotel reservations: (206) 728-1000

The Western Regional Seminar offers 20 ASPA continuing education credits and 20 credits for enrolled actuaries. And if you attend the Successful TPA Firm Workshop, that's seven more credits. (The final decision as to applicable credit rests with the Joint Board for the Enrollment of Actuaries.)

The Western Regional Seminar will highlight the recent pension simplification legislation and regulations. Some of the workshop topics include these: Document Compliance and Fiduciary Liability Issues; Family Aggregation Unraveled; Form 5500 Tips and Traps; Life Insurance in Qualified Plans; Compensation: Advanced Issues and Short Years; Pitfalls of Administering Prototypes; and much more.

On July 13, the day before the seminar, attend the first interactive workshop for the Successful TPA Firm sponsored by ASPA. This workshop is designed for panelists and attendees to share ideas that help the third-party actuarial firm to focus on areas particular to this industry. The three main issues panelists will cover include 1) How to get the most out of your marketing efforts; 2) Managing your liability and limiting your malpractice risk; and 3) Identifying your computer needs.

Join us in the Emerald City for these events to be held at the Westin Hotel Seattle, which is right next door to the Monorail and a quick ride to the Space Needle. Explore the famous Pike Place Market. Visit the Seattle Art Museum, and enjoy the glass art for which Seattle is renowned. The views of Puget Sound and the surrounding mountains are spectacular.

For more information and to receive registration forms, please call the regional seminar coordinator in the ASPA Meetings Department at (703) 516-9300.

Western Region IRS/Practitioners Benefits Conference

Biltmore Hotel, Los Angeles, September 18-19, 1997

ASPA and the Los Angeles Key District of the IRS are cosponsoring the Western Region IRS/Practitioners Benefits Conference coming this September 18-19, 1997, in Los Angeles; in addition, there are a number of cooperating sponsors. It is a great opportunity for practitioners, plan sponsors, plan administrators, and government representatives to meet and to discuss employee benefit issues, benefits regulation, litigation, enforcement efforts, and voluntary compliance initiatives.

The conference will focus on the exchange of information between regulators and practitioners, the advancement of technical knowledge, and the sharing of practical solutions to benefits questions.

To make this conference as valuable to participants as possible, registrants are encouraged to submit questions and topics for discussion with their registration forms.

Watch your mailbox. ASPA will mail the conference brochure with a list of all workshops and speakers to people located in the Western Region in early July. For more information, call the ASPA Meetings Department at (703) 516-9300.

Wanted:

ASPA Course Coordinators and Instructors!

You have learned a lot of things through ASPA — why not share your knowledge with others by volunteering to become a local course coordinator or ASPA-approved instructor?

Some of the benefits of these rewarding jobs include the opportunity to hone your technical skills, network with other pension professionals, obtain name recognition for you and your firm, and obtain continuing education credits.

Course coordinators provide a vital link between ASPA's Education Department and its students, assisting them in preparing for upcoming ASPA exams. The course coordinators not only assist in recruiting instructors but also help to obtain classroom space and set up semester-long classes in their regions. Areas where coordinators are needed include Atlanta, Denver, Baltimore, and anywhere you would like to help set up an ASPA course.

ASPA-approved instructors must hold an ASPA designation (FSPA, MSPA, CPC, QPA, or APM), have three years' consulting or administrative experience, and have demonstrated teaching ability.

In addition to the benefits already mentioned, instructors receive an instructor manual and the required textbooks. An honorarium is awarded based on the number of paying students enrolled in the course. There is no tuition charge for the instructor's coworkers or employees attending the same course.

If you or anyone you know would like to be an instructor, please contact the ASPA Education Department at (703) 516-9300.

Calendar of Events

Date	Event	ASPA CE Credit
June 20	One Day 401(k) Workshop — Philadelphia	7 credits
June 20	One Day 401(k) Workshop — Chicago	7 credits
July 13	The Successful TPA Firm Workshop — Seattle	8 credits
July 14-16	Western Regional Seminar — Seattle	20 credits
August 29	Submission deadline for 1997 PA-1 exam	10 credits
September 8	Fall semester-long courses begin	20 credits
Sept. 18-19	Western Region IRS/Practitioners Benefits Conference — Los Angeles	15 credits
October 4-7	A-3 [EA-2] class — Chicago†	20 credits
October 10-13	A-3 [EA-2] class — Washington, D.C.†	20 credits
October 25-28	A-3 [EA-2] class — Los Angeles†	20 credits
October 30-November 2	A-3 [EA-2] class — Dallas†	20 credits
November 1	Early registration deadline for ASPA examinations	
November 2-5	Pension Actuaries and Consultants Conference — Grand Hyatt hotel, Washington, D.C.	20 credits
November 10	Final registration deadline for ASPA examinations	
November 17	Jointly sponsored examination A-3 [EA-2]	
November 28	Fall semester-long courses end	
December 3	C-1, C-3, C-4, and A-4 examinations	20 credits
December 4	C-2(DC) examination	20 credits
December 5	C-2(DB) examination	20 credits

† ASPA offers these courses as an educational service for students who wish to sit for examinations which ASPA cosponsors with the Society of Actuaries and the Joint Board for the Enrollment of Actuaries. In order to preserve the integrity of the examination process, measures are taken by ASPA to prevent the course instructors from having any access to information which is not available to the general public. Accordingly, the students should understand that there is no advantage to participation in these courses by reason that they are offered by a cosponsor of the examinations.

World Actuaries Flag Serious Concerns on International Accounting Proposals

The International Forum of Actuarial Associations, which represents actuaries worldwide, has commented on proposals by the International Accounting Standards Committee for a draft revised International Accounting Standard on Employee Benefits, E54. In the submission, the IFAA says "We believe that the IASC's proposed standard fails to give adequate recognition to the nature and term of the benefit obligations. Consequently the proposed method for determining the amount of the accounting liability does not conform to actuarial principles and may, as a result, be financially misleading."

An issue in dispute is the timing of recognizing actuarial gains and losses. The IASC is proposing a "corridor" of 10 percent of the greater of assets and liabilities within which gains and losses would not be recognized but would be deferred indefinitely, but outside of which they would be fully recognized immediately. The IFAA points out that in many countries the volatility inherent in the IASC proposals will result in frequent breaches of the corridor, and hence a very uneven and distorted pattern of recognition over time. This applies particularly in the United Kingdom, where pension fund assets and liabilities can be very large in relation to corporate profits.

For further information about the IFAA submission to the IASC on E54, contact one of the following:

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Brian Wooding
Executive Director of the IFAA
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Phone (604) 929-8497
Fax: (604) 929-8597

ASPA Board of Directors

ASPA needs active involvement from every credentialed member. Our profession is run with a team approach, with each of us, QPAs, CPCs, APMs, MSPAs, and FSPAs, contributing our own strengths. ASPA needs strong people with different perspectives to lead us. Please nominate someone you think is a visionary and a hard worker for the pension industry to ASPA's board of directors by August 31, 1997. Mail nominations to—

Michael E. Callahan, FSPA, CPC
PenTec Inc.
908 South Meriden Road
Cheshire CT 066410

PIX Will Soon Do Windows

The Windows version of WOD, PIX's exclusive interface and message reader software, is in beta testing at this writing. Watch for announcements on PIX as to when this version will be available.

PIX Digest

PIX BBS support and registration information
voice : (805) 683-4334 • fax: (805) 683-0369

Rapid changes in the organization of the medical services industry continue to challenge pension practitioners. Two recent threads raise questions regarding the application of slowly evolving pension law to these new relationships.

The first thread involves physicians' practices which are purchased by nonprofit hospitals. The doctors become employees of the hospital and are now limited to $9,500 403(b) contributions, where in the past they were accustomed to $30,000 defined contribution plan allocations. What can be done?

The thread goes on to discuss some of the possibilities of setting up the doctors in their own practice, with a contract with the hospital. Does this create an affiliated service group? There is almost no guidance in the application of ASG rules to nonprofit entities, so we are left with a reasonable interpretation of the code. S. Derrin Watson, APM, PIX managing sysop and a recognized authority on entity aggregation, argues here that a reasonable interpretation is that these rules do not apply but recognizes that others could just as easily interpret that they do.

The second related thread questions a situation where a doctors' group has a separate practice entity, but their employees are provided to them through a service run by a hospital. There are at least three possible results:

1. The employees are the true employees of the doctors,
2. The employees are the true employees of the management company and the leased employees of the doctors, and
3. The doctors are in fact employees of the hospital and hence the employees are in fact employees of the hospital.

Obviously, who's the employer and who are the employees is crucial to the operation of a qualified plan. In this thread Derrin later discusses some of his conclusions based on a review of a personnel guide put out by a national leasing organization.

These threads will be combined in the file mdees2.fsg. Practitioners who work with medical professionals must be aware of these potential problems.

Family Aggregation Lives

A user asked a straightforward question, "Why keep family aggregation?" Of course it has been repealed by the Small Business Job Protection Act, but our plan documents still contain language limiting the compensation of highly compensated employee married couples. Should this language be retained, can it be retained, what amendments are required?

This thread points out that, while it is permissible to retain the compensation limitation of family aggregation, we cannot permissively retain aggregation for purposes of testing. This could have an adverse impact on cross-tested plans where large allocations where being made to younger children of HCEs, relying on aggregation with the older parents to produce a reasonable equivalent benefit accrual rate. Defined benefit plans, on the other hand, may have their contributions and funding severely disrupted by the repeal of family aggregation. Depending on the plan sponsor's ability to afford larger contributions, it may be prudent to take a "go slow" approach to eliminating the family aggregation compensation limit. You may download this thread in the file famagg3.fsg.

Where Costs Exceed Benefits

A recurring problem in our industry is the subject of the thread *de minimus distributions*. A user poses the question in the case of a plan where participants are due benefits of less than $10, while the plan will incur a fee of $35 to make the distribution. The plan sponsor wanted to allocate this charge against these payable distributions and thereby eliminate them.

Many users argued that this policy is not permitted, citing the Department of Labor's ERISA Opinion Letter 94-32A dealing with the allocation of costs incurred on behalf of a participant's qualified domestic relations order. Other users discussed situations where this type of charge is specifically written into the plan, where the plan has a favorable determination letter and has successfully survived an IRS audit.

The clear majority opinion is that these types of charges interfere with a participant's exercising his ERISA Title I rights to receive a benefit, but it is unclear to what extent a plan may be protected by a determination letter and whether the DOL will expend its limited resources regarding such small amounts. Regardless of these issues, cases where benefits are less than the costs to distribute them will continue to be a sore point with plan sponsors. Download the file demin2.fsg to read the whole discussion.