

# THE ERISA LAW GROUP, P.A.

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## ***IMMEDIATE ERISA ALERT***

TO: CLIENTS AND COLLEAGUES

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This alert discusses post-severance payments for retirement plans and requires immediate review and action.

Internal Revenue Code § 415 provides limitations on the overall maximum contributions and benefits that are allowed under 401(k), profit sharing, pension and other qualified plans, 403(b) and 457(b) plans. The Treasury Department issued revised final regulations under § 415, which new rules are effective for plan years beginning on and after January 1, 2008. (For non-calendar plan years, the regulations are effective for years beginning on or after July 1, 2007.)

- For most all plans, the regulations are effective now.

The regulations are long and complex (54 pages of fine print), but one provision warrants your and our immediate attention. This relates to the calculation of compensation, which in turn affects several important plan provisions (listed below).

### **General Rule**

The regulations provide that compensation must be paid prior to an employee's severance from employment in order to be counted for plan purposes.

***401(k) and Other Salary Reduction Plans.*** For 401(k), 457(b) and 403(b) plans that allow employees to direct some of their pay into plans, the new rule means that amounts paid after employment terminates may not be deferred and contributed, even if it is W-2 pay, unless an exception applies (see below).

### **Important Exceptions and Special Rules**

***2½ Month Regular Pay.*** If the payments are regular compensation for services performed during the employee's regular working hours (or overtime), or are commissions, bonuses or other similar payments, that would have been paid to the employee prior to severance from employment if the employee had continued in employment, compensation paid after an employee's severance from employment must be counted as compensation if it is paid by the later of 2½ months following severance from employment or the end of the plan year during which the severance occurred.

***401(k) Plans.*** If an employee has a 401(k), 457(b) or 403(b) deferral election in place, such election must also apply to this post-employment pay.

**2½ Month Sick/Vacation/Nonqualified Plan Pay.** If payments are for unused bona fide sick, vacation or other leave that the employee could have taken if employment continued, a plan may provide that compensation for such amounts paid after an employee's severance from employment will count as plan compensation if it is paid by the later of 2½ months following severance from employment or the end of the plan year during which the severance occurred.

Also if paid during this period, a plan may provide that payments pursuant to a nonqualified unfunded deferred compensation plan will count for plan purposes if the payments would have been made to the employee at the same time if the employee continued in employment and if the payments are includible in the employee's gross income.

**Your Plan.** For plans we draft for our clients, the amendment to your plan will count these unused sick, vacation and nonqualified plan payments as compensation for plan purposes, including to reduce pay under 401(k), 403(b) and 457(b) plans. If you wish to discuss your concerns and our reason for this approach, please contact us.

**Severance Pay.** Compensation for plan purposes must not include severance pay (including under a nonqualified deferred compensation plan or parachute payments) if it is paid after severance from employment even if it is paid within the above 2 ½ month period. If it is not regular pay, the amount must be paid prior to termination of employment in order to be counted for plan purposes.

**Military Service Pay.** A plan may (for certain purposes) provide that compensation an employer pays after an employee ceases to perform services will count as compensation if the payments are made to an individual not currently performing services because of qualified military service to the extent such payments do not exceed the amount the individual would have received if the individual continued to perform services. Our plan amendment for you will count such pay for plan purposes unless you advise us otherwise. If an employee misses any work for military or National Guard service, please contact us because several different ERISA provisions apply.

**Disability Pay.** If an employee receives disability pay, contact us because special rules apply.

### **Plan Amendments**

All plans must be amended to reflect the regulations. An interim amendment must be signed and dated now to avoid a potential plan qualification failure this plan year. When a more detailed amendment is required, particularly for defined benefit plans, we will advise our clients.

For plans we draft, our clients have received or shortly will receive the necessary amendment. For employers that use vendor-produced documents, you will need to receive and execute their amendment without delay. We strongly suggest legal counsel approve the amendment prior to execution, and that you understand the amendment.

Revisions to your Summary Plan Description also likely are required.

### **Provisions Affected**

This change impacts several key plan provisions, including:

- the compensation that the plan must (and must not) consider for contribution allocation purposes (if a defined contribution plan) or accrual purposes (if a defined benefit plan),
- the compensation that must (and must not) be deferred under 401(k), 403(b) and 457(b) plans,
- the compensation that must (and must not) be considered to apply the § 415 benefit and contribution limits (the defined contribution limit for 2008 is \$46,000),
- the compensation that must (and must not) be considered for 401(k) safe harbor purposes (including to calculate either the 3% nonelective employer contribution or the required matching contribution),
- the compensation that must (and must not) be considered when calculating Code § 416 top heavy minimum benefits and contributions, and finally,
- the compensation which is used for the various nondiscrimination tests that apply to the plan (such as § 401(a)(4), ADP and ACP).

### **Contact Your Recordkeeper**

Please contact your plan recordkeeper to make sure that he or she is aware of the new regulations. Your recordkeeper also needs to receive a copy of your plan amendment in order to properly administer and apply the various tests and limitations to your plan.

If you receive communications from your recordkeeper regarding these changes, please forward it to us (or your legal counsel) for review.

### **Additional Information**

For more information or to seek clarity, contact Jeffery Mandell or John Hughes.

*This alert is intended to provide general information only and does not provide legal advice. This alert does not discuss potential exceptions to the above rules. The application of ERISA laws can be complex. For information regarding the impact of these developments under your particular facts and circumstances, please call us.*