Swerdlin & Company

The Swerdlin Quarterly

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3rd Quarter 2010 | Volume 16, Issue 3

Hardship Withdrawals and Plan Loans–Necessary Evils?

Many 401(k) plans allow participants to take hardship withdrawals and loans from their plans. Plan sponsors generally believe these features encourage participation since participants can access their funds.

Although the purpose of a retirement plan is to save money for the future, life happens! Participants sometimes find themselves in need of extra cash for some unforeseen event. Therefore, the government allows plan sponsors to include hardship withdrawal and loan provisions in their retirement plans.

Hardship withdrawals can only be taken for very specific reasons and require documentation to prove the need. These withdrawals are limited to the amount required to satisfy the specific need plus any taxes or penalties that might be due on the withdrawal. They are taxable in the year distributed and may also be subject to a 10% penalty if the participant is under age 59½.

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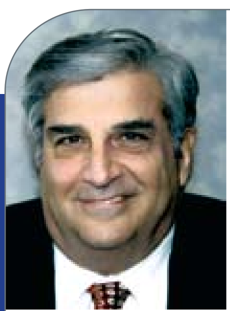
Swerdlin & Company
Actuaries and
Employee Benefit Consultants
770.396.6601
www.swerdlin.net



Dorn's Corner

This quarter I want to talk about a scientific theory called "Gaia Theory" or the "Gaia Hypothesis," and how a recent movie and TV series embed this theory into their story.

So what is this Gaia theory? The name comes from the Greek goddess of the Earth, named Gaia. In short, the theory assumes that our earth is a living organism rather than a lifeless rock with some life on its surface. Sir James Lovelock, a British atmospheric scientist and chemist, was consulting with our space agency, NASA, in the 1960's to address the question, "How do we determine whether or not life exists on Mars?" This leads to the more basic question: how do we define the line between life and non-life?

In his research for NASA about defining life, Lovelock created the Gaia hypothesis; that our earth itself is a living being.

Until recently, we had no reason to imagine our planet as an organism. Peter Russell in his book, *The Global Brain*, compares fleas that live on an elephant with us earthlings living on our planet. "They chart its terrain… study its chemistry, plot its temperature changes — arriving at a reasonable perception of where they live. Then one

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Hardship Withdrawals and Plan Loans–Necessary Evils?

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To avoid taxes and penalties, many plan sponsors also offer loans from the plan. When loans are offered in addition to hardship withdrawals, the law requires the participant to take a loan first. However, if the participant can prove that making loan payments will create an additional hardship, the participant can skip the loan and take the hardship.

Although loans are popular and preferable to hardship withdrawals, they are not beneficial to the participant's long-term investment goals. Most participants don't understand that borrowing from their plan will ultimately reduce their retirement benefits.

With the steady increase in the number of loans, now is a good time to look at the benefits and costs of taking a loan.

Benefits of taking a loan from a retirement account:

1. Few restrictions on taking a loan – no credit check.
2. Lower interest rates than many commercial loans.
3. Convenience – can often apply online or over the phone.
4. Tax and penalty free when fully paid back to the plan.

Costs of taking a loan from a retirement account:

1. Fees – some plans charge setup and maintenance fees.
2. Taxes – the loan is made from before-tax money and is paid back with after-tax money. When the participant terminates, the entire distribution is taxed so the loan payments will be taxed twice.
3. Penalties – if the loan is not repaid when the participant terminates, the outstanding balance becomes taxable and, if the participant is under age 59½, a 10% penalty is also incurred.
4. Loss of future income – the participant feels he is not losing income because the interest paid on the loan is going back into his account. However, since the account balance is reduced by the loan, the long-term investment return may also be reduced.

Some plans allow a participant to have two loans at the same time, and we are often asked to explain how we calculate the amount available for a second loan. Below is an example:

Sample Calculation for Second Loan

Account balance (excluding outstanding loan)	$10,000
Current loan balance	5,400
Total balance for calculation	15,400
50% of total balance	7,700
Less current loan balance	(5,400)
Amount available	$2,300

It is never a good idea for a participant to take money from his account before retirement but, if it is necessary, taking a loan is the lesser of the two evils. The loan is generally not subject to taxes and penalties, and gets paid back into his account.

Your Swerdlin Representative can answer questions you may have about loans and hardship withdrawals. ■

Schedule SSA Gets a Makeover

Beginning with the 2009 plan year, Schedule SSA will no longer be filed with Form 5500. Because of privacy issues associated with the public access to the new electronic filing of Form 5500, Schedule SSA is no longer a required attachment.

Schedule SSA is being redesigned by the IRS and will be released at some future date as Form 8955-SSA. This form will be filed in hard copy format with the IRS and not the DOL.

Until the IRS completes Form 8955-SSA and provides guidance on it, plan sponsors are not required to file. The IRS expects to release the form and guidance in 2011 and will provide a special due date for the 2009 filing.

Please be aware that the special filing date for this form in no way affects the filing date for Form 5500 or Form 5500SF. ■

Leased Employees

A leased employee is employed by a leasing firm (often called a "Professional Employee Organization" or PEO). The PEO leases employees to companies for extended periods of time. They handle all payroll taxes and other human resource functions for these employees.

Many benefit plans exclude leased employees. So, what effect does this have on your plan? First, let's review the definition of a leased employee:

1. The employer must pay a fee to the PEO for the services of the employee.
2. The employee must provide services to the employer on a substantially full-time basis for at least a year.
3. The employer must have primary control or direction over the person's services.
4. The person must be on the leasing organization's payroll.

As always, there are exceptions — the leased employees are not treated as your employees if:

- they are less than 20% of your non-highly compensated work force; and
- they are immediately covered under the PEO's money purchase pension plan with a 10% contribution rate and 100% immediate vesting.

Generally, the leased employee is treated as an employee of the employer for all testing purposes — participation, coverage, vesting, limitations on contributions, compensation, top heavy, highly compensated determination and deduction limits. Even if your plan excludes leased employees, they must be considered for testing purposes. If the plan fails any of these compliance tests, you may be required to make a contribution to the leased employees.

If you hire the leased employee away from the PEO, for purposes of plan entry and vesting, he must be given credit for years of service while he worked for your company as a leased employee.

Determining if an individual is a leased employee is not always clear and simple. All of these employees must be reported on the census so they can be considered for compliance testing. If you have questions about a person's status, please contact your Swerdlin Representative or the plan's attorney. ■

Health Care Reform: Cafeteria Plans

The new Health Care Reform legislation has had a significant impact on the administration of cafeteria plans offering a Flexible Spending Account (FSA). As a result of the new laws, amendments must be made to the Cafeteria Plan Document, Summary Plan Description and enrollment materials. These changes make communication between the Plan Sponsor and participants more important than ever.

For expenses incurred in taxable years beginning on or after January 1, 2011, there will be no reimbursement by FSAs for over-the-counter (OTC) medication (except insulin), without a prescription from a doctor. However, items that are not considered medication (e.g., bandages, blood-pressure monitors, crutches, etc.) should not be affected. We are waiting for further guidance on what constitutes a medication for purposes of the restriction. This will impact cafeteria plans that are subject to the "grace period" (maximum period 2½ months after year end) since OTC claims incurred during the grace period will not be reimbursed.

The new law affects the use of debit cards for purchase of OTC medication on or after January 1, 2011. Debit cards can no longer be used to purchase these items. Merchants must reprogram their systems to reject purchases of such items after December 31, 2010, and reclassify previously eligible OTC medication as dual purpose items. Procedures must also be revised to require documentation for OTC prescribed medication.

For taxable years beginning on or after January 1, 2013, FSA salary reductions will be limited to $2,500 each year. This cap is a flat amount and applies on a per-participant basis. Non-elective employer contributions to an FSA are not subject to this $2,500 cap.

For years beginning on or after January 1, 2011, a simple cafeteria plan is available to employers who, on the average, have 100 or fewer employees. The simple cafeteria plan requires a safe harbor contribution which might allow more key employees to participate. However, the cost of the safe harbor contribution may outweigh the benefits of this plan design.

Keep reading the Swerdlin Quarterly for updates as they become available. ■

Advantages of a KSOP

Many companies have a 401(k) plan and some also have an Employee Stock Ownership Plan (ESOP). These two types of plans do not have to be separate, so why not combine them? An ESOP that is combined with a 401(k) plan is called a KSOP.

By combining the plans, the company has only one plan document to maintain, one Form 5500 to file, and one plan audit, if applicable. As a result, the cost of maintaining a KSOP is generally less than the cost of maintaining two separate plans.

Although the KSOP is one plan, the document can allow for different provisions for each plan component. For example, the timing of distributions and forms of benefit may be defined differently for the ESOP and 401(k) accounts. One document governing all plan components is helpful, because the individual or firm drafting and maintaining the plan document is aware of all the plan components and how they are interrelated.

If you have separate ESOP and 401(k) plans, many of the required compliance tests must be performed on both plans as if they were one. These tests include top-heavy analysis, annual addition limits, and the maximum deductible contribution limit. Since most of the testing must be performed on a combined basis, it is especially helpful when one Third Party Administrator (TPA) is responsible for the administration and recordkeeping of both the ESOP and 401(k) plan components.

Ideally, KSOPs are administered by one service provider. However, it is still possible to use one company to administer the ESOP and another to recordkeep the 401(k), even when there is only one plan.

Advantages of One Service Provider

- Transmit census data to only one location;
- Avoid duplication of effort;
- Avoid miscommunication between parties;
- Less chance of overlooking compliance issues;
- Only one point of contact;
- Generally less expensive; and
- Gives a clearer view of service provider responsibilities.

Swerdlin & Company is one of the few service providers in the country that is able to meet the needs of both ESOPs and 401(k) plans under one roof. We have extensive experience in administering KSOPs. If you are interested in learning more, just give us a call. ■

Divorce and Your Retirement Benefit

During a divorce, most spouses find the top three issues to be children, the house and retirement benefits. The division of retirement benefits is accomplished by a legal document called a Qualified Domestic Relations Order (QDRO), which is separate from the divorce decree. Rules on QDROs are part of the plan document.

On June 10, 2010, the Department of Labor finalized the regulations regarding QDROs. The final regulations do not change any rules already in place.

During or after a divorce has been finalized, a Domestic Relations Order (DRO) is prepared, generally by the attorney representing the spouse with the retirement benefit. It should then be reviewed by the Plan Administrator, and after approval, sent to the Court for the judge's signature. When signed, it is deemed to be qualified.

It is important to note that even after the QDRO has been approved, it can be modified by a subsequent DRO (generally before payment has been made). For example, the new DRO might increase or decrease the amount as a result of a renegotiation of the divorce settlement.

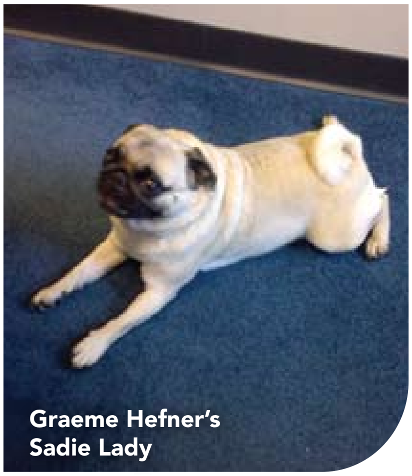
If there is a delay in determining if a DRO is qualified, the Plan Administrator must separately account for the DRO benefits for up to 18 months while a determination is made. Should the DRO not be qualified, the separated funds revert back to the participant.

We recommend you send a draft of the DRO to your Swerdlin Representative for review before it is submitted to the Court. This saves the participant time and unnecessary expense if it has to be filed again because of missing language or incorrect information. ■

Our canine friends visit the office.

Tiffany Born's pride and joy, Caesar.

Clay Isom holding Axl Rose (brother of Krull from the movie *How To Lose A Guy in 10 Days*).



Graeme Hefner's Sadie Lady

What's Happenin'

On June 23, **Adrian Farnon**, **Kathy Latour** and **Kim Hall** attended a seminar on 403(b) Plans presented by the American Society of Pension Professionals and Actuaries (ASPPA).

June 25 was **National Bring Your Dog to Work Day**. Nineteen beloved pets were brought to work by our employees for a day of fun and pampering. See some of the photos above.

Cynthia Navan-Clark and **Glenda Devechio** attended the Employee Benefits Institute of America (EBIA) Advanced Cafeteria Plans Conference held in Seattle July 14-16.

Dorn Swerdlin attended the Actuarial Foundation Trustee meeting held in Chicago June 14-15.

On September 21, Swerdlin presented its second workshop on Health Care Reform legislation, focusing on the Patient Protection and Affordable Care Act (PPACA). **Ron Bachman**, FSA, MAAA, was a guest speaker at the workshop.

We welcome new employee **Scott Foreman**, who joins the Blue Team as a Pension Administrator.

Anniversaries we celebrate this quarter: **Melissa Spencer**, 18 years; **Glenda Devechio**, 15 years; **Kathy Latour**, 12 years; **Michele Gresham** and **Patti Williams**, 7 years; **Kristin Ellis**, 4 years; **Trevor Braunius**, 3 years; **Lorene Pierre**, **Rita Teague**, **Tammy Fiacco** and **Tianna Barran**, 2 years. ■

Swerdlin & Company
Actuaries and Employee Benefit Consultants
5901 Peachtree Dunwoody Road
Building B, Suite 170
Atlanta, GA 30328
phone 770.396.6601
fax 770.396.0067
email info@swerdlin.net
web www.swerdlin.net

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Dorn's Corner

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day a few of the fleas take a huge leap and look at the elephant from a distance and see that it is alive."

Another reason we haven't thought of the earth as a living being is that we don't experience its changes over time. Our time frames are very different. Russell says, "If we could speed up time appropriately, we would see the atmosphere and ocean currents swirling round the planet, circulating nutrients and carrying away waste products, much as the blood circulates nutrients and carries away waste in our own bodies."

When our astronauts saw the earth as a "blue pearl" hanging in space, their connection with mother earth caused a profound shift in their beliefs about our world. The sixth man to stand on the moon, Edgar Mitchell, is quoted as saying, "It was a beautiful, harmonious, peaceful looking planet, blue with white clouds, and one that gave you a deep sense…, of home, of being, of identity. "

The television series, Lost, generated many interpretations and websites reflecting people's thoughts. One interpretation focuses on the Gaia theory. For those of you who haven't seen the series, there is a mysterious island which seems to have a life of its own. The island self-regulates through the human inhabitants. The destructive people endanger the island and are eliminated. The "healthy" people (those who recognize the island's life) can feel a connection with the island and support its evolution. This self-regulation is a characteristic of life.

Another story can be interpreted as containing symbolism for the Gaia theory. The very successful movie, Avatar, is somewhat the opposite of the War of the Worlds. In War of the Worlds, an alien army attacks us on our home planet. In Avatar, we are the bad guys who invade an alien planet, Pandora, to exploit its natural resources. The natives of Pandora are much more connected to their home planet and the life they share with other beings. Although their outward technologies are far behind, their physical and mental capacities are far ahead of ours. We can learn lessons from this movie. On Pandora, the inhabitants connect physically and mentally with their animals to become one being. On earth, if we had more respect for and connected with our animals, who are already attuned with the mother planet, we could become better citizens of earth.

Although the Gaia theory is just that—a theory, more people including many scientists are considering this theory to be a true description of our planet. If you consider this hypothesis, your world view will shift.

In the meditation I teach, we talk about our "extended bodies." This distinction between our physical bodies and our environment is an illusion; our bodies are in constant interchange with our environment as we breathe and eat, etc. Our bodies are more like a flowing river than a fixed, solid structure; our lungs are the trees; our circulatory system the waterways. We are connected to our planet and if we know this or believe this, our attitude towards our planet will change.

Hope you had a great summer. I'll be back next quarter. ■

contributors

Swerdlin Quarterly **Committee**

Chairman:
Carol Friend

Committee Members:
Donna Martin, Dorn Swerdlin, Joanne Swerdlin, Julie Isom and Ricky Cox.

Editorial Assistance:
Dee Robbins and Mary Butina

Additional Contributors:
Adam Stone

Photos:
Adrian Farnon and Kirsty Simmons