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CUEd In:

The Law and Business of Employee Benefits for Credit Union Executives

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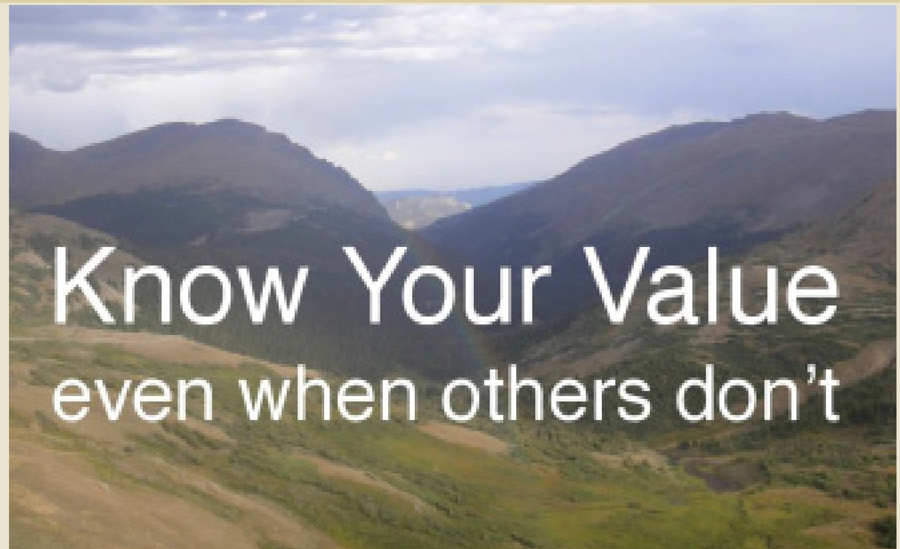

This issue marks the beginning of the 3rd year of CUEd In, our guide to the law and business of employee benefits for credit union executives.

In this issue, we take a look at recent guidance released by the U.S. Department of Labor which may impact federal credit unions' use of an outside corporation to administer their 401(k) plans. To demonstrate the circumstances in which federal credit unions may be affected, we take a look at Advisory Opinion 2012-04A with the facts modified so as to specifically include credit unions. In addition, we give you a quick update on pending Treasury regulations interpreting Section 83 of the Internal Revenue Code, which pertains to the tax treatment of certain compensation in the form of property.

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Advisory Opinion 2012-04A: Do You Know Who the Responsible Fiduciary Is?

On May 25, 2012, the U.S. Department of Labor ("Department") released Advisory Opinion 2012-04A in response to a request for guidance regarding the applicability of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") to a retirement savings program operated by a limited-purpose corporation designed to operate the plan for the employees of unrelated employers. Specifically, the Department was asked whether such a program could constitute a single "employee pension benefit plan" within the meaning of ERISA Section 3(2).

This Advisory Opinion is especially applicable to federal credit unions, as many engage similar corporations to administer 401(k) benefits for their employees. As a result, let's take a look at the Department's discussion in this Advisory Opinion, with the facts modified to include federal credit unions.

Background Regarding the Plan

The Corporation established the Advantage 401(k) Plan (the "Plan") to be a single "multiple employer" 401(k) profit-sharing plan covering employees of various federal credit unions and other employers that adopted the Plan by executing a participation agreement. Over 500 unreleated federal credit unions and other, non-credit union employers from across the country contracted with the Corporation and adopted the Plan for over 9,800 of their combined employees. These credit unions and other employers engaged the Corporation with the anticipation that the Corporation would assume their fiduciary duties under ERISA and take care of the complete management of their employees' 401(k) benefits as part of the aggregated Plan.

The Corporation signed the Plan's required annual Department audit (Form 5500) as the "plan sponsor" and acted as the "named fiduciary" for the Plan.

Pursuant to the participation agreements, the credit unions and other employers delegated to the corporation the "full responsibility of Plan Administrator" which included resolving beneficiary disputes, interpreting plan terms, completing audited financial statements, and appointing investment advisors and investment managers.

In addition, the credit unions and other employers represented that they "independently exercised their fiduciary judgment in selecting the Plan and the initial investment contracts and funds offered to participants." The credit unions and other employers also acknowledged that they maintained the fiduciary obligation to review the delegation of authority and the Corporation's performance insofar as the Plan covers their own employees. As part of the arrangement, fees were paid to the Corporation in exchange for the administrative services, and the fees were deducted directly from the assets of the Plan.

What ERISA Says

Section 3(2) of ERISA defines the term "employee pension benefit plan" to include: "[A]ny plan, fund, or program . . . established or maintained by an employer or employee organization, or by both, to the extent that . . . plan, fund, or program . . . provides retirement income to employees, or results in a deferral of income by employees for periods extending to the termination of covered employment or beyond . . . ."

The term "employer" is defined in Section 3(5) of ERISA to mean "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity." Further, the term "employee organization" is defined in Section 3(4) of ERISA, in pertinent part, to include "any labor union or any organization of any kind . . . in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning an employee benefit plan, or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose in whole or in part, of establishing such a plan."

It has been the Department's long-standing view that, even in the absence of an employee organization, a single "multiple employer" plan may exist where a "cognizable group or association of employers, acting in the interest of its employer members, establishes a benefit program for the employees of member employers and exercises control of the amendment process, plan termination, and other similar functions on behalf of those members with respect to a trust established under the program." The Department has explained that relevant factors in determining whether a purported plan sponsor is a "bona fide group or association of employers" include: how many members are solicited; who is entitled to participate and who actually participates in the association; the process by which the association was formed, the purposes for which it was formed, and what, if any, were the preexisting relationships of its members; the powers, rights, and privileges of employer members that exist by reason of their status as employers; and who actually controls and directs the activities and operations of the benefit program.

The Department's Take on the Plan

The Department first noted that the Corporation was clearly not the "employer" or an "employee organization" with respect to the participants in the Plan, who are employees of the various credit unions and other employers. At the same time, the Department found that the Plan was not a "multiple employer plan" because there was an absence of any common nexus between the credit union and other employers or any other genuine organizational relationship that was unrelated to the Plan. Along these lines, the Department pointed out that there was nothing indicating that the credit unions and other employers participating in the Plan were a controlled group of corporations, a group of trades or businesses under common control, or otherwise had any substantial common ownership, control, or organizational connections.

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The Department further explained that, rather than acting in the interest of an employer with respect to the Plan, the Corporation was acting more as a service provider, analogous to a third party administrator or investment advisor. Therefore, the Department concluded that the Corporation could not be considered an "employer" for purposes of ERISA that is capable of sponsoring the Plan as a single "multiple employer plan."

What This Means

For purposes of ERISA, the Department views a program such as this to constitute a group of separate ERISA "plans" sponsored by the participating credit unions and other employers, with the Corporation merely serving as a service provider. As a result, each individual credit union and other employer within the Plan would have to file its own Form 5500 and comply with all of ERISA's filing and disclosure requirements as specifically applicable to each plan individually.

Therefore, before entering into a program which purports to be a "multiple-employer" 401(k) plan, a credit union should assess whether there is commonality between it and the other employers in the plan. If there is not, or if the information cannot be determined, the credit union may still wish to enter the arrangement for administrative ease, but must realize that it will nonetheless retain responsibility for the plan (including the attendant filings and disclosures) as if the "sponsor" of the arrangement was merely a third party administrator and/or investment advisor.

In light of this, the relationship between the credit union and the plan "sponsor" must be carefully detailed. The credit union must be aware of what services it is getting, whether these services satisfy its duties under ERISA with respect to its plan, and whether the fees charged for these services are commensurate with the benefit received.

IRS Proposed Rules Regarding "Substantial Risk of Forfeiture"

On May 29, 2012, the Internal Revenue Service ("IRS") proposed rules to further clarify the meaning of "substantial risk of forfeiture" in the context of Section 83 of the Internal Revenue Code ("Code") in order to address points of confusion. This inquiry is relevant in determining when the value of certain deferred compensation in the form of property (such as a company vehicle or other property) is deemed includable in an employee's gross income for income tax purposes.

In general, under Section 83(a) of the Code, the fair market value of property transferred in connection with the performance of services (less any amount paid by the transferee) is includable in the transferee's gross income for tax purposes in the first taxable year in which the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture. Section 83(c) of the Code provides that the rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual. The regulations underlying these Code provisions currently state that whether a risk is "substantial" or not depends upon the facts and circumstances, and there is such a risk when rights in property that are transferred are conditioned upon the future performance (or refraining from performance) of substantial services by any person, or the occurrence of a condition related to a purpose of the transfer and such condition is not satisfied.

The IRS noted that some confusion has arisen in this context as to whether conditions other than a service condition or condition related to the purpose of the transfer may also give rise of a substantial risk of forfeiture. In addition, the IRS explained, confusion existed whether, in determining whether a substantial risk of forfeiture exists, the likelihood that a condition related to the purpose of the transfer will occur must be considered.

The proposed regulations seek to resolve this confusion. First, the proposed regulations would amend the existing regulations to provide that a substantial risk of forfeiture exists only where the property rights are conditioned upon the future performance (or refraining from performance) of substantial services, or the occurrence of a condition related to a purpose of the transfer and such condition is not satisfied.

Second, the proposed regulations would clarify that, in determining whether a substantial risk of forfeiture exists based on a condition related to the purpose of the transfer, both the likelihood that the forfeiture event will occur and the likelihood that the forfeiture will be enforced must be considered. In proposing this amendment, the IRS noted that it does not believe that Congress intended that a condition that would prevent the receipt of property that in all likelihood will not occur was intended to defer the taxation of the property.

Before the proposed regulations can become effective, they are subject to a comment period during which individuals can comment on the proposal, suggest changes, and request a hearing on the matter. Accordingly, the proposed regulations are also subject to IRS-revision before being released in final form. As of now, the target effective date of the proposed regulations is early 2013.

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