

Action

Items

December, 2005

a newsletter for ACI's clients and their advisors

If You Haven't Heard Yet, Here are the 2006 Retirement Plan Limits

On October 14, the Internal Revenue Service announced the cost-of-living adjustments that will be applied to the dollar limits in all tax-qualified retirement plans in 2006. The limits apply to calendar year plans, and plans that have been amended for EGTRRA. If your plan has not been amended, or you have an off-calendar plan year end, contact your plan administrator to see if there are any changes to your plan.

DEFINED BENEFIT PLAN LIMITS

The limitation on the annual benefit under a defined benefit plan increases from \$170,000 to \$175,000.

DEFINED CONTRIBUTION PLAN

Individual Contributions

The limitation on contributions made on behalf of an individual to a defined contribution plan increases from \$42,000 to \$44,000. Individuals will still be limited to contributions of 100% of compensation or \$44,000, whichever is less.

401(k) Deferrals

This dollar limitation on employee deferrals into 401(k) plan increases from \$14,000 to \$15,000.

Catch-Up Contributions

For individuals age 50 and over, the catch-up contribution limit will increase from \$4,000 to \$5,000.

ANNUAL COMPENSATION LIMITS

The maximum annual compensation that may be recognized by a plan will increase from \$210,000 to \$220,000.

KEY EMPLOYEES

The dollar limitation for determining whether an employee is "Key" for officers in a top-heavy plan will increase from \$135,000 to \$140,000.

HIGHLY COMPENSATED EMPLOYEES

The dollar limitation on compensation used to determine which employees are considered highly compensated will increase from \$95,000 to \$100,000. Thus, employees who earn in excess of \$100,000 in the plan year beginning in 2006 will be considered highly compensated for the plan year beginning in 2007.

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Involuntary Termination: *Precautions and Protections*

by Hanita Hofman, President of *ThePeopleWorks*
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One of the most loathsome tasks any executive faces is the involuntary termination of an employee, no matter how well-deserved! Following is a series of questions every manager should ask themselves before embarking on the process.

If an employee is being terminated for violation of a company rule or procedure, am I absolutely certain I can prove that this rule or procedure was clearly communicated to, and understood by, the employee?

In order to avoid being caught in that trap, we recommend that every employer have a handbook (no matter how basic) and that every employee be required to sign an acknowledgement of receipt.

Could the timing of this termination be viewed as related to a protected activity in which the employee is engaged?

If the employee has recently taken action such as filing a Worker's Compensation claim, bringing a safety violation to light, announcing her pregnancy, or filing a whistleblower complaint, this termination might be viewed as retaliatory, in violation of public policy or in other ways problematic. Before taking any action, it would be advisable to check with a competent authority in the field.

Will this involuntary termination come as a surprise to the employee?

Unless the behavior is particularly egregious (i.e. sexual harassment, engaging in bribery or kickbacks) the employer has an inherent duty to provide the employee with opportunities to remedy the situation. This can take the form of disciplinary actions, warnings or candid performance evaluations. Of course, employers have more latitude with new employees still in the midst of their probationary period.

Am I sure that I have enforced the consequences for violation of rules in an even-handed and consistent manner?

Consistency is a basic presumption in the fair treatment of staff. Treating one employee differently than another causes problems in terms of issues of discrimination as well as employee relations. Having said that, how can you equalize consequences for tardiness between two employees, one of whom is an excellent long term employee with no previous incidents of tardiness and the other is a new employee who was late three times in the past two weeks? The answer is that you can't: the surrounding circumstances must be taken into consideration. When evaluating a course of action, compare the situation to equivalent situations in the past before making any determination.

When terminating an employee involuntarily (or when I have had at least 72 hours notice of a voluntary termination) do I have a final check, including all wages earned, accrued vacation and paid time off, ready to hand to the employee?

That's the law in California! It is also a requirement to provide the employee with a Notice as to Change in Relationship, which the employee signs and returns. This form is required for discharges, layoffs, leaves of absence, and changes in status from employee to independent contractor.

Do I avoid having policies that call for strict "progressive discipline"?

Any policies that delineate the steps that must be followed in terms of disciplinary action may limit an employer's right to discipline and discharge as appropriate. Different circumstances require the latitude to be treated differently. If you box yourself into the corner of having to do three verbal warnings, two written warnings and a final warning before you discharge someone, you force yourself to treat all infractions equally when in reality they are not.

Before firing an employee in the heat of the moment, do I consider putting that employee on suspension and conducting a thorough investigation?

A wise move! Circumstances that initially appear clear cut often look very different when more information and multiple perspectives are examined. By removing the employee from the premises, the situation is defused and clearer heads can prevail. In terms of whether the suspension should be paid or unpaid, be advised that it is not permissible to deduct from the wages of an exempt employee for periods shorter than one full workweek, except under very limited conditions.

Do I have an at-will statement acknowledged by the employee?

At-will statements, which usually appear in handbooks and other documents, attest to the fact that both the employee and the employer have the right to terminate the employment relationship at any time for any reason. While there are significant limitations to this right, having a signed acknowledgement form does provide some protection.

Have I reviewed the employee's file so there are no surprises?

It's not uncommon for the reasons surrounding an involuntary termination to directly contradict previous performance evaluations. Managers are notorious for overrating their employees, whether to avoid unpleasant encounters or to justify the salary increase they want to give that worker. Conflicting documentation will be difficult to defend.

Have I inadvertently turned a voluntary termination into an involuntary one —and set myself up to pay unemployment insurance benefits?

A very common scenario can have unintended and costly consequences. An employee sends in a letter of resignation, giving two weeks' notice. The employer decides they don't want that person hanging around making trouble, and tells them to leave that same day. Now the voluntary termination has become involuntary! One way to avoid such an unfortunate outcome is to pay the employee in lieu of notice: the employee receives some paid time off, and you retain the voluntary status of the termination.

In cases of voluntary separation, do I always get a written letter of resignation or signed separation report which includes the date and reason for termination?

It is a prudent practice to follow as this will help sharpen the employee's memory of the circumstances surrounding the voluntary termination in the event s/he decides to file for unemployment insurance benefits!!

Do I regularly and promptly document everything?

That includes verbal and written warnings, absenteeism and tardiness, incidents, counseling sessions, investigations, and performance evaluations. Having a paper trail is critical in the event your decision to terminate is questioned in court. Judges and juries value the printed word much more than mere recollections. Aside from the well-known fact that memories tend to diminish over time, having specific facts (dates, times, witnesses, quotes etc.) bolsters any argument.

Have I been guilty of giving a "final" warning that wasn't really final?

Rather than being viewed as a kindness on the part of the employer to give the employee another chance, the employer loses credibility with the employee involved, with the rest of the staff (who are undoubtedly watching carefully), and with the judge and/or hearing officer who may eventually review their actions. How is the employee supposed to know which final warning is really final?

ThePeopleWorks is a Human Resources consulting firm designed to help smaller businesses and non-profits minimize liability and devise workable solutions to their personnel needs. Contact us at (310) 432-4384 for information about our industry leading Compliance Review and many other services, or log on to www.thepeopleworks.com for a host of practical information you can put to use immediately.

Please note: This article is intended to provide a general overview of specific aspects of the subject matter covered. ThePeopleWorks is not a law firm and does not provide legal advice. Any individual concerns should be addressed to competent legal counsel.

An Overview of the Final 401(k) Regulations

*by Tobi Cogswell, Director, Client Services
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Final 401(k) regulations were issued December 29, 2004. They are effective with the first plan year beginning after 2005, therefore January 1, 2006 for a calendar year plan. Not every change is listed below but the ones that may have a direct effect on you or your plan are explained below.

One of the biggest changes will be the fact that "selective QNEC's" (or "bottoms up QNEC's" or "targeted QNEC's") will no longer be allowed. A QNEC (qualified non-elective contribution) is a 100% vested employer contribution that is used to "bump up" the deferral percentage for the lower paid group (NHCE), therefore allowing a

greater percentage to be deferred by the upper group (HCE). This has generally been an option to examine when you had a test failure and did not want to make refunds to certain highly paid participants.

Prior to 2006, if your plan document allowed, there was a greater amount of flexibility when determining who might receive a QNEC to help pass the ADP (actual deferral percentage) test. Beginning in 2006, QNEC's will still be allowed but to the extent that the QNEC needs to be greater than 5% of compensation, it must satisfy an extremely complex formula. It is definitely do-able, but you will find yourself having to benefit at least half of your eligible NHCE's, a more expensive arrangement than the options available in 2005.

Likewise a "selective match" (or targeted match). This is an option not used very often but it will also change effective January 1, 2006 to be no more than 5% of compensation or subject to a complex formula.

Another change will be that certain corrective distributions will be subject to "Gap Period Income". This will not apply to corrective distributions that are made because someone exceeds the maximum \$15,000 (in 2006) amount that can be deferred into a 401(k) plan, or because someone's total allocations exceed \$44,000 (in 2006). It will apply to all other corrective distributions, such as if the ADP or ACP tests fail and refunds are required to be made to certain HCE's. Gap period income is a method of determining the earnings from the last plan year end to the date of the distribution in a reasonable, consistent and non-discriminatory method. This is not something that you will have to do yourself, ACI will calculate the Gap period earnings if needed.

The final regs specify that a participant must have the opportunity to make or change their deferral election at least annually. Most plans already allow participants to change at least semi-annually or even quarterly; be sure that you are communicating to your participants before each change date so they have the opportunity to make changes should they wish.

For those plans allowing safe harbor hardship withdrawals, the criteria prior to January 1, 2006 is:

- § Purchase of a primary residence
- § Prevent eviction or foreclosure
- § Certain medical expenses for self, spouse or dependent
- § Certain post-secondary educational expenses for self, spouse or dependent

New hardship safe harbors verify that funeral expenses are one of the criteria, as well as residence repairs after a casualty.

Will your plan need to be amended? It might. It might need some amendments to comply with these final regulations in advance of the next required "Amendment and Restatement" (discussed in a different article). These regulations, as well as others not explained above, are effective in 2006. There is no grace period, there is no good faith compliance period, there is no transition period. Should you have any questions regarding the Final 401(k) regulations and how they effect you please don't hesitate to contact your ACI administrator. Also, please look to future communication and Action Items newsletters for additional information.

REMINDERS

Data Request Package

For those clients who have calendar year plans you will be receiving a data request package from us shortly. This is the time of year when we ask for census information, the company questionnaire and information regarding your desired contribution. If you provide us with trust information each year we will ask for that as well. Remember that the sooner you return this to your administrator, the more flexibility you will have – in terms of ADP/ACP test correction options if required, contribution planning and so forth. We recommend that as soon as you have verified the accuracy of your census for W-2 purposes, you should send the completed data request package to us.

1099's

For those clients who do not have a daily valued arrangement with a recordkeeper or a corporate trustee, you will be required to provide 1099's to participants or former participants for all distributions that have been made during the 2005 calendar year. In order for ACI to prepare the 1099's on your behalf, we will need to have information regarding each distribution, including: name and social security number of the person receiving the distribution, their address, whether the distribution was taken as cash or rolled to an IRA or another qualified plan and the amount of Federal and State Withholding, if withheld. These 1099's and accompanying forms will be sent to you in January. The 1099's must be given to the applicable people no later than January 31, 2006. If you have not returned the completed "ACI Copy" of any distribution packages, please do so now along with a copy of the distribution checks.

ADP/ACP Testing

Calendar year 401(k) plans need to pass an ADP (actual deferral percentage) test each year in order to prove that the amount of deferrals

being made for the non Highly Compensated participants will support the deferrals being made for the Highly Compensated participants. An ACP (actual contribution percentage) test is also required for plans that have an Employer Match. Safe Harbor plans do not need to be tested; they have some communication and vesting requirements associated with them, but if you have had trouble passing the tests in prior years you may wish to explore the feasibility of Safe Harbor for 2007 and later.

If your ADP or ACP test fails, and you make the decision to refund contributions to certain Highly Compensated participants, note that refunds made prior to March 15, 2006 will be taxable to those participants as ordinary income for **2005**. If you make the refunds after March 15, 2006 they will be taxable to those participants as ordinary income for **2006**, however there will be a 10% penalty incurred by the plan sponsor.

It is imperative that you provide the completed data request package to us as soon as feasible in order to have some flexibility with your correction options in the event that the test(s) fail.

Partnership Elections

The 401(k) regulations require that a partner **must** make an election to defer prior to the close of the partner's taxable year (usually December 31). This election can be either a percentage of income or a dollar amount. A deferral election is also required if an LLC (Limited Liability Company) is electing to be taxed as a partnership. Your ACI plan administrator should be sending partnership elections to you; please execute them by the end of the year. If you have changed your business form and have not communicated that to your administrator, please contact them and ask them to provide the election forms.

ACI In the News



SPEECHES

Pat Byrnes spoke to a large group of engineers in San Francisco on October 4, 2005. The 20 year old group consists of 40 members who are all part of several large consulting engineering firms involved in design and construction of large national and international projects. His presentation was called, "*Rewarding the Right People for Doing the Right Things-Cultural Perspective*".

HAVE AN IDEA FOR AN ARTICLE?

Action Items is provided to our clients and their advisors with articles that address relevant, timely issues. If you have a particular topic that you would like us to address, a question you would like answered, or if you would like to submit an article for publication, please let us know. We welcome your feedback and input.

If you have any comments or suggestions regarding *Action Items*, please contact our marketing manager, lace.greene@acibenefits.com.



Actuarial Consultants, Inc.
would like to wish you all a happy and safe holiday season.

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