BENEFIT BYLINES

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Fiduciary Liability Insurance vs. ERISA Fidelity Bonds – What's the Difference?

ERISA Fidelity Bonds

Section 412 of ERISA mandates that every fiduciary of an employee benefit plan and every person who "handles funds or other property of such a plan" be bonded. The purpose of an ERISA bond is to provide protection to the plan (and plan participants) against financial loss by reason of acts of fraud or dishonesty on the part of plan officials, directly or in association with others. It does not provide protection for fiduciary breaches such as making imprudent investment decisions.

The minimum required amount of the bond is 10 percent of the plan's assets as of the beginning of each plan year. Unless the plan holds company stock, the maximum required bond amount is $500,000. Plans may purchase more protection than the required minimum or maximum, and many do. Premiums for ERISA bonds are generally modest. Bonds are often purchased on a 3 year pre-paid basis which reduces insurer administrative expenses and keeps down premiums. Those premiums can be paid by either the Employer (as plan sponsor) or from the assets of the plan.

Fiduciary Liability Insurance

Whereas a Fidelity Bond protects the assets of the plan, Fiduciary Liability Insurance protects the plan sponsor, trustees and other plan fiduciaries from financial loss in the event they are sued by plan participants or the Department of Labor alleging fiduciary breach. Fiduciary breaches involving the imprudent investment of plan assets tend to receive the most publicity, but breaches can also include the improper denial of benefits and a variety of administrative errors or omissions.

Under ERISA, Plan fiduciaries can be held personally liable for breaching or failing to carry out their fiduciary responsibilities. Further, fiduciary breaches need not be intentional. Plan fiduciaries can be held liable for acts or omissions involving poor judgment or simply not carrying out their duties in a prudent and responsible manner. *(Continued on Page 4)*

Misclassifying Workers Can Be Expensive

The proper classification of individuals as independent contractors or employees has been an important issue for many decades. If individuals are classified as independent contractors and it is determined later that they are really employees, it can result in substantial costs to the employer for back payroll taxes, penalties and legal fees. It is also an important issue for employers who sponsor tax-qualified retirement plans because failure to include eligible employees can result in unintended funding costs. While this issue is not new, improper employment status classifications have recently become an even higher priority for the Department of Labor, IRS, and many states, including Pennsylvania.

Advantages of Independent Contractor Status

Some individuals prefer to be independent contractors rather than employees because of the flexibility it provides in managing their work schedules. Being one's own boss and the potential opportunity to make more money can also be motivating factors. Employers often find it convenient and financially attractive to retain independent contractors rather than employees for one-time projects, seasonal work, or to perform functions for which there is no in-house expertise. Avoiding payroll taxes and employee benefit costs are also motivating factors.

Governmental Perspectives

The IRS has historically been concerned that classifying workers as independent contractors rather than employees may be part of a scheme designed primarily to avoid payroll taxes and other business expenses. *(Continued on Page 5)*

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The Saver's Credit – A Well Kept Secret

The Saver's Credit gives a special federal income tax break to low- and moderate-income taxpayers who are saving for retirement. Unfortunately, many eligible taxpayers do not take advantage of this tax break because they do not know it exists. A recent survey shows that less than 25% of American workers with annual household incomes under $50,000 are even aware that the Saver's Credit exists.

How much could the Saver's Credit cut from a worker's tax bill?

First, it is important to understand that this is a tax credit applied to offset taxes that would otherwise be due, not just a deduction that reduces taxable income.

The maximum Saver's (tax) Credit for an individual is 50% of the first $2,000 saved (or $1,000). The maximum credit for a married couple is 50% of the first $4,000 saved (or $2,000). The actual credit is based on the taxpayer's adjusted gross income (AGI) and tax filing status, as illustrated in the chart below:

There are, however, two important qualifiers to the above statement:

1. If an individual (or spouse) takes a taxable distribution from his or her retirement account during the two years prior to the due date for filing the federal tax return (including extensions), that distribution reduces the size of the available Saver's Credit.

2. The Saver's Credit is a 'non-refundable' tax credit. That means that this credit can reduce the tax amount owed to zero, but it can't provide a tax refund.

Other Requirements

To claim the Saver's Credit, the individual must be age 18 or older, cannot be a full-time student, and cannot be claimed as a dependent on someone else's tax return. Further, the contribution must actually be made to the applicable retirement vehicle during the tax year for which the return is being filed.

2016 Adjusted Gross Income

Credit*	**Married Filing Jointly**	**Head of Household**	**All Other Filers**
50%	Up to $37,000	Up to $27,750	Up to $18,500
20%	$37,001-$40,000	$27,751-$30,000	$18,501-$20,000
10%	$40,001-$61,500	$30,001-$46,125	$20,001-$30,750
0%	more than $61,500	more than $46,125	more than $30,750

*as % of eligible contribution

Which retirement accounts qualify for the credit?

The Saver's Credit can be claimed for contributions to a 401(k), 403(b), 457 plan, a Simple IRA or a SEP IRA. Contributions to a traditional IRA or a Roth IRA are also eligible for the Saver's Credit.

Does the taxpayer receive a deduction in addition to the Saver's Credit?

Yes. It sounds too good to be true, but the Saver's Credit is in addition to, not in lieu of, the regular tax deduction applicable to pre-tax contributions made to the types of arrangements identified above. As with all taxpayers, those contributions reduce the adjusted gross income upon which taxes are paid. After the amount of overall taxes due is calculated, the Saver's Credit is then applied dollar-for-dollar to offset the otherwise applicable tax liability to determine the net amount of taxes due.

Examples

John and Mary are married and file jointly. John will contribute $1,000 to his 401(k) plan in 2016 and Mary will contribute $1,000 to an IRA. Their 2016 combined adjusted gross income is $36,000. Each of them is therefore eligible to claim a 50% credit for their contributions. Together, their credits are worth $1,000 (50% of $2,000).

Christine files as a head of household. She will contribute $1,200 to her 403(b) plan in 2016. If her 2016 adjusted gross income is $30,000, she will qualify for a $240 Saver's Credit (20% of $1,200).

How does a taxpayer claim the Saver's Credit?

To claim the credit, the taxpayer should complete IRS Form 8880 "Credit for Qualified Retirement Savings Contributions." The completed Form 8880 should then be filed with the taxpayer's tax return (Form 1040, Form 1040A or Form 1040NR, whichever applies).

Saver's Credit is a Great Deal

The opportunity to defer paying taxes on contributions and earnings is a powerful incentive for middle and upper income taxpayers to save for retirement through an IRA, 401(k) or other tax-favored vehicle. However, many lower paid workers live paycheck to paycheck, struggle to save, and are not particularly motivated by saving taxes. That being said, the Saver's Credit provides a powerful incentive for lower income workers to save. Those who qualify for the maximum credit can contribute $2,000 to an eligible retirement savings vehicle, while reducing their current tax bill by $1,000. Further, this is in addition to the regular tax savings associated with the deferral itself.

The Saver's Credit is available to those who contribute to IRAs as well as employer-sponsored arrangements. However, the opportunity to contribute in small increments by making payroll deduction contributions to an employer-sponsored plan makes it convenient and relatively painless for lower paid workers to save for retirement. This is one of the reasons why employer-sponsored 401(k) plans and similar arrangements have become so popular.

Employer Responsibilities

Some workers leave money on the table either (a) by not contributing to their employer's plan when knowledge of the Saver's Credit might be the motivating factor to do so, or (b) by contributing but failing to take advantage of the Saver's Credit when they file their personal tax returns. In both situations, better communications could lead to a more positive result. The IRS encourages employers to alert their workers to the availability of the Saver's Credit, but there is no specific federal mandate that requires them to do so. Nonetheless, with increasing focus on participant outcomes, a plan sponsor "best practice" would be to alert participants about the existence of the Saver's Credit. Even if only a small percentage of the workforce actually qualifies to take advantage of the credit, those who do will be better off financially for having done so.

Employee Saver's Credit Notice

In 2001, the IRS published a sample Saver's Credit notice that employers could send out to their employees. The Service has not updated that notice for changes in income thresholds since its initial release, but ABP has done so each year. If you would like to send the latest version of the Saver's Credit notice to your employees, you can use this link to download it from ABP's website: http://www.abp-ltd.com/Images/saverscredit-2016.pdf ▪

What You Need to Know About myRAs

If you are a business owner, executive or someone involved in HR, you may be contacted by one or more employees with requests to implement payroll deductions for a myRA. If you do not know what a myRA is, you are not alone.

What is a myRA?

The concept of a myRA was first presented by President Obama in his 2014 State of the Union address. It is essentially a Roth IRA intended primarily to be used by employees who are not (yet) eligible to participate in an employer-sponsored 401(k) or other savings plan. This is a government-sponsored program under which funds are invested in the same manner as the Government Securities Fund that is part of the Thrift Savings Plan offered to federal employees. All money deposited into myRAs is fully guaranteed as to principal and there are no deductions for expenses. Like traditional Roth IRAs, the myRA is funded with after-tax participant contributions. The current contribution limit is $5,500 per calendar year with another $1,000 contribution opportunity for individuals who have attained age 50 (limits are adjusted annually for cost of living increases). Employees can contribute to myRAs on their own or through payroll deductions at work. Employers are encouraged to offer payroll deduction arrangements for myRAs but are not legally required to do so. Further, employers are neither required nor permitted to contribute to myRAs on behalf of their employees.

Economic and Practical Realities

Employer-sponsored 401(k) plans have experienced tremendous growth since being introduced in the early 1980s. Nonetheless, surveys conducted by the US Census Bureau and others reveal that approximately 25-30% of US workers do not have access to a retirement plan through their place of employment. As might be expected, the participation rates for larger employers are higher and the rates for smaller employers are much lower. When one considers the fact that ERISA does not require employers to offer a retirement plan and that employees working less than 1,000 hours per year can be excluded when a plan is offered, the preceding statistics are not surprising. Nonetheless, it is unsettling from a public policy perspective to see that such a high percentage of US workers still have no opportunity to save for retirement.

In launching the myRA program, Treasury Secretary Jacob Lew expressed the hope that doing so would "create a savings habit that will grow." Materials promoting this governmental initiative emphasize that the myRA is not intended as an alternative to a traditional employer sponsored retirement plan. Evidence of that intention is the fact that when a participant's myRA account balance reaches $15,000 (or after 30 years of participation, if earlier) the account must be transferred to another retirement vehicle, presumably a regular Roth IRA.

An argument can be made that a program like this should be managed and invested through the private sector rather than the federal government. Unfortunately, the small size of these accounts makes them financially unattractive to private sector firms. Based on years of experience working with small 401(k) plans and similar arrangements, private firms have learned how challenging it can be to service small accounts on a profitable basis. *(Continued on Page 4)*

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What to Do

If you are an employer who receives a request from one or more of your employees to have amounts deducted from employee payroll and remitted to the myRA plan, you will need to evaluate the administrative work effort associated with that request in relation to the convenience to your employee(s). As noted above, you are not legally required to respond affirmatively to any such request. As a practical matter, if you are an employer reading this newsletter, interest in myRAs would likely only come from part-time employees or employees who have not yet met your qualified plan's eligibility requirements. If you are an accountant or other advisor to an employer who is not quite ready to take on the responsibility of sponsoring a formal retirement plan, it might make sense to encourage that employer to offer myRA payroll deduction services as a convenient way for employees to begin saving in a disciplined manner.

Final Observations

It is important for potential myRA contributors to recognize that this is a Roth after-tax-contribution vehicle. While Roth may be a good long-term investment strategy for younger individuals, many would prefer a pre-tax contribution vehicle if given the choice. This having been said, myRAs qualify for the Federal Retirement Saver's (tax) Credit which is a really good deal *(See companion article in this newsletter).*

While the myRA website is good, there is no local financial consultant who can explain the myRA/Roth program to those employees who have an interest. It really would not be fair to expect your 401(k) plan advisor to get involved with myRA participants at zero compensation and, for liability purposes, the employer should probably limit its involvement to doing no more than deducting and remitting contributions, assuming the employer decides to get involved in the first place. ▪

Fiduciary Liability Insurance vs. ERISA Fidelity Bonds-What's the Difference–Continued from Page 1

While ERISA requires plans to purchase a fidelity bond to protect plan assets, it does not require the purchase of liability insurance to protect the fiduciaries themselves. Most retirement plan documents do include boiler plate language requiring the employer (but not the plan) to indemnify and hold harmless fiduciaries and others for liabilities and expenses in carrying out their responsibilities with respect to the plan to the extent those expenses are not covered by insurance. However, the employer's indemnification and hold harmless does not apply in the event that liabilities or expenses are the result of gross negligence or willful misconduct on the part of the fiduciaries or other individuals.

The employer can purchase fiduciary liability insurance on behalf of all plan fiduciaries or each fiduciary can purchase his or her own coverage. Alternatively, the plan can purchase liability insurance for its fiduciaries.

If the plan is the purchaser, the policy must allow the insurer to seek recourse against a fiduciary if the fiduciary is determined to have breached his duty to the plan.

Alleged fiduciary breaches can be expensive, even if not proven to have occurred. For this reason, an important feature of any fiduciary liability policy is the payment or reimbursement of legal defense costs.

There are many issues to think about in considering the purchase of fiduciary liability insurance. The first issue is whether or not to purchase coverage at all, given that it is not mandatory. An employer reimbursement and hold harmless provision written into the plan may be a source of comfort to fiduciaries and others acting on behalf of the plan. However, the employer may be concerned about the exposure associated with self-insuring that risk. As a result, some employers purchase fiduciary liability insurance in order to transfer most or all of the risk associated with claims and related legal expenses to an insurer. Some plan fiduciaries might feel that the indemnification provision in their plan document is not adequate and therefore might be more comfortable with primary coverage being provided through a commercial insurer. If the purchase of fiduciary liability insurance is being seriously considered, specific policy issues to focus on include: *annual premium costs, the amount of coverage needed, the amount of deductible, and whether the limits of liability under the policy are reduced by attorney fees and costs incurred in defending against a claim.*

Summary and Recommendations

Sponsors of tax-qualified retirement plans have been required to purchase fidelity bonds since ERISA became law back in 1974. However, there continues to be a lack of understanding of the need for and purpose of a fidelity bond. Nonetheless, the federal mandate to purchase coverage, combined with relatively low annual premiums, has resulted in nearly 100% compliance among plan sponsors.

Most large employers who sponsor retirement programs have elected to purchase fiduciary liability insurance to protect both their plan fiduciaries and the assets of the corporation. Historically, a relatively low percentage of smaller employers have elected to purchase fiduciary liability coverage. At least part of this reluctance has been based on a perception that premiums are high and coverage is limited. This may be starting to change. In fact, some insurers offer discounts when both the fidelity bond and fiduciary liability insurance are purchased simultaneously.

As plan assets and participant counts grow, it may be appropriate to evaluate the pros and cons of purchasing fiduciary liability insurance. The time to do so may be prior to the next renewal of the plan's fidelity bond. If interested, plan sponsors should contact their property-casualty broker or insurer for more information about fiduciary liability insurance. ▪

State-Run Retirement Savings Plans

In a companion article in this edition of Benefit ByLines, we discuss myRAs - an IRA program sponsored by the Federal Government which is designed to encourage part-time workers and others who do not have access to a work-place 401(k) or similar plan to begin saving for retirement.

Under the myRA program, employers may (but are not required to) offer payroll deduction and contribution remittance services for the myRA. Taking this a step further, in each of the budgets submitted to Congress, the Administration has included "Automatic IRA" provisions which, if approved, would require employers who do not offer a traditional retirement/savings plan to offer IRA payroll deduction services for their employees.

Simultaneously, many states are looking into establishing their own IRA or more traditional retirement programs, some of which would compete against both the myRA program sponsored by the Federal Government and traditional ERISA retirement programs sponsored by private sector employers. A number of state officials have expressed concern about the relatively low percentage of workers who are covered by private retirement plans. Various studies point to coverage ratios of 55% to 85% of the workforce at least being offered some type of employer-sponsored retirement savings plan, but coverage is low in some industries and very low among part-time workers. (Employers who voluntarily establish a plan subject to ERISA are generally able to exclude employees who work less than 1,000 hours per year, and most do so.) The aforementioned federal myRA program was an attempt to create a solution to close the coverage gap but it has not really caught on.

Another dimension of this problem is that the economics are not conducive to lower income individuals voluntarily saving for retirement. Most individuals at the lower end of the income spectrum just don't have much discretionary income to save. Further, much of the growth in the traditional retirement plan marketplace has been attributable to brokers and investment advisors who have promoted retirement programs to their corporate clients and invested considerable time helping to educate workers about the importance of saving for retirement. The return on investment just isn't there with this segment of the market.

The increased presence of both the federal and state governments in the private retirement market place is something that should concern all of us. There is a coverage gap among part-time and other lower income workers; however, when governments get involved, programs tend to expand over time. A strong argument can be made in favor of federal or state sponsored IRA arrangements where participation is voluntary on the part of both workers and their employers. However, it would not be much of a stretch to see that evolve into mandatory employer sponsorship, automatic contributions by workers, and mandatory contributions by employers.

Conclusion

There is considerable support of the goal to expanding retirement savings and worker coverage. Some in government are more than willing to accept that role. ABP will monitor this issue and will inform our readers about developments as they occur. ▪

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In recent years, the Service has also looked at the issue from another perspective: a growing underground economy where independent contractors may fail to pay employment and income taxes that are due based on their income from self-employment.

In its perceived role as a protector of workers' rights, the DOL looks at worker classification from the perspective that some individuals are improperly forced into independent contractor status by their "employers," resulting in the loss of employee rights and protections that would apply if they were properly classified.

Finally, states are increasingly taking an interest in employment classifications based on a perception that worker misclassifications have resulted in the failure to properly cover individuals under state-sponsored workers compensation and unemployment compensation programs. These misclassifications can lead to the denial of benefits to individuals who should be entitled to them. In Pennsylvania, legislation is being considered that would specifically target the construction industry for scrutiny regarding worker classification.

Classification Criteria

Whether an individual is an independent contractor or an employee is not a function of what he or she is called. Rather, the determination is based on facts and circumstances associated with the arrangement. While the IRS, DOL, and various states apply somewhat different criteria, the single most important determining factor is "who has the right to direct and control the worker?" If substantial control is exerted over a worker as to when and how the job is performed, it is likely that an employer-employee relationship exists. On the other hand, if the worker who takes on a project has personal control over how the work is completed and provides his or her own tools and supplies, it is more likely that an independent contractor relationship exists. Another important factor is the number of different relationships that exist. If an individual performs work for multiple organizations, a strong case can be made that he or she is an independent contractor. Conversely, if an individual performs work for only one entity, it will be more difficult to demonstrate that the individual is an independent contractor rather than an employee. *(Continued on Page 6)*

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Qualified Retirement Plan Issues

The proper classification of workers as independent contractors or employees is an important issue with respect to employer-sponsored 401(k) and other retirement arrangements. Individuals who perform work for an employer as independent contractors should not and cannot participate in that employer's retirement and other benefit plans. On the other hand, most full-time employees must be eligible to participate in employer-sponsored benefit programs after satisfying the applicable eligibility waiting period and entry date requirements. If a worker is classified as an independent contractor but is later determined to be an employee, the employer could be required to make employer contributions to the plan for prior periods, including deemed contributions that the employee might have made if he or she had been properly enrolled to participate. Note: The plans that ABP designs for clients typically include a provision in the base document that partially alleviates this problem. The plan provision states that individuals who were excluded by reason of being misclassified as non-employees will not retroactively become eligible, even if a subsequent determination is made that they were employees. If the plan is able to satisfy mathematical coverage tests for the plan years that these individuals were excluded, the employer is off the hook for making retirement plan contributions on their behalf for those years. On the other hand, if coverage tests cannot be satisfied because too many individuals were excluded, some level of employer contribution will be required for prior years but the magnitude of contributions may be reduced by reason of including the plan provision discussed above at part of the retirement plan document.

Recommendation

Most ABP clients will never need to deal with issues related to misclassifying workers. However, if your firm has work performed by individuals who are not classified as common law employees through the company's payroll system, it is prudent to carefully review the facts and circumstances of each arrangement with legal counsel to be sure that those individuals are properly classified. A careful up-front analysis can avoid significant expenses down the road with respect to retroactive payroll taxes and benefit plan expenses in the event that a governmental agency later determines that an employer-employee relationship existed. We recommend that you consult your accountant if there is a question regarding the status of any of your workers. ▪

Associated Benefit Planners, Ltd.

Associated Benefit Planners, Ltd. (ABP) is an independent consultant and third party administrator (TPA). We specialize in the design and administration of employer-sponsored retirement/savings plans, including 401(k) arrangements. ABP also provides plan document and compliance support for Section 125 Plans and Employee Welfare Plans, operating on a fee-for-service basis.

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