LUSE GORMAN

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LEGAL UPDATES AND NEWS

IRS Finally Says Federal Credit Unions Can Sponsor Code Section 457(b) and 457(f) Deferred Compensation Plans

On November 8, 2011, the Internal Revenue Service ("IRS") finally broke more than six years of silence and released an "advanced notice of proposed rulemaking" which specifically states that federal credit unions (FCUs) are "eligible employers" that can sponsor non-qualified deferred compensation plans under Sections 457(b) and 457(f) of the Internal Revenue Code of 1986, as amended (the "Code"). Because the IRS's reasoning has somewhat changed (even though the end result remains the same), FCUs may want to take action now to ensure that their 457(b) and 457(f) plans comply with ERISA, the federal pension law.

IRS Notice 2005-58 addressed certain income tax issues with respect to such plans maintained by FCUs. Under Notice 2005-58, a plan in effect on August 15, 2005 that is maintained by a FCU and that is intended to be an eligible non-qualified deferred compensation plan of a non-governmental tax-exempt employer would not fail to be an eligible plan under Code Section 457(b) or 457(f) solely because the employer is a FCU, provided that certain conditions are satisfied (including the condition that the FCU plan has not claimed to be a governmental plan for purposes of Code Section 414(d) and ERISA Section 3(32)). The rule in the Notice only applies until future final guidance is issued under Code Section 414(d). ***Accordingly, upon adoption of these regulations as final regulations, FCUs can be eligible employers within the meaning of Code Section 457(e)(1)(B) on the basis that the FCUs are non-governmental tax-exempt organizations. If the FCU claimed to be a "governmental plan" that was exempt from ERISA, action is needed now to comply with ERISA.***

What has changed? If FCUs took the position that their 457(b) and 457(f) plans were exempt from ERISA because "governmental plans" are exempt from ERISA, the FCU would need to bring their 457(b) and 457(f) plans into compliance with ERISA. Hopefully, these plans can qualify as "top hat" plans under ERISA, which are exempt from many of ERISA's requirements.

An ERISA "top hat plan" is a pension plan that is established and maintained for a "select group of management or highly compensated employees." In the past few years, several federal courts have ruled on the parameters of how deep into an organization a "top hat" plan can be offered. The risk is that if too many people (or the wrong people) are covered by the plan, then all of the ERISA rules would apply to the plan – including minimum participation, vesting, holding assets in trust, filing an annual Form 5500, etc. Therefore, FCUs should review the participants in their 457(b) plan and 457(f) plan to determine if the plans qualify as "top hat plans" under ERISA.

If the 457(b) plan or 457(f) plan qualifies as a "top hat" plan, then the FCU must file a one-page "top hat notice" with the U.S. Department of Labor ("DOL") for each plan, which identifies the plan as a top hat plan. Failing to timely file the top hat notice means that the plan is subject to all ERISA requirements, including filing an annual Form 5500. The top hat notice must be filed no later than 120 days after the plan first becomes subject to ERISA. Which begs the question – when did the FCU's 457(b) or 457(f) plan become subject to ERISA? The IRS proposed guidance appears to take the view that these plans have always been subject to ERISA. Hopefully, the DOL will publish relief for FCUs to come into compliance with the ERISA rules, based on the IRS's final regulations that clearly confirm that these plans are subject to ERISA.

Why did the IRS conclude that FCUs are not governmental plans? The proposed regulations include an example that specifically addresses why the IRS believes FCUs are not "governmental entities" within the meaning of Code Section 414(d). Specifically, the IRS stated that FCUs are member-owned, and that the board of directors of a FCU is elected by the FCU's own members. The board of directors of a FCU is not responsible to the United States, except to the limited extent set forth in the Federal Credit Union Act and regulated by the National Credit Union Administration ("NCUA"). Based on this tenuous connection to the federal government and general lack of federal oversight and involvement in the FCU's activities (even by NCUA), the IRS concluded that FCUs are not "instrumentalities" of the federal government for purposes of the tax rules that apply to both qualified and non-qualified retirement plans.

What should FCUs do now? Fortunately, because these rules are not yet final, FCUs have some time to come into compliance with ERISA for their 457(b) plans and 457(f) plans. The DOL has a "Delinquent Filer Voluntary Compliance" ("DFVC") Program for late filing of top hat notices or late Form 5500s (if the plan does not qualify as a "top hat" plan). If the DFVC Program late filing is voluntarily submitted before the DOL discovers the violation, the FCU would obtain relief from the significant ERISA penalties that could otherwise apply. For example, failure to file a Form 5500 for an ERISA plan carries a maximum penalty of up to $1,100 per day. Assuming a top hat notice or Form 5500 was never filed for the FCU's 457(b) plans or 457(f) plans which were established years ago, the penalty exposure is significant. Remember, that a 457(b) plan or 457(f) plan must actually qualify as a "top hat" plan to be able to use the one-page "top hat notice" filing. We would be happy to discuss with you whether your plans comply with recent court decisions and ERISA requirements and to assist with any DFVC Program filings for late filings. This is truly the case where an ounce of prevention is worth a pound of cure.

For more information regarding this Alert, please contact one of the following attorneys of our firm. We are available to meet with you and can provide management and the board with the information necessary to bring your 457(b) plans or 457(f) plans into compliance with ERISA.

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