

# Is My Plan a “Qualified” Plan?

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Frequently for governmental retirement plans, confusion arises over whether they are “qualified.” In the private sector, it’s generally understood that plans are qualified if they’re in compliance with the Employee Retirement Income Security Act (ERISA). However, because government plans are subject to quite a different regulatory scheme than nongovernmental (private) plans, questions sometimes occur.

Government plans are exempt from the majority of ERISA provisions, making them subject to far fewer Internal Revenue Code (IRC) requirements than private plans; and, because their benefits aren’t protected by the Pension Benefit Guaranty Corporation (PBGC), they’re not required to pay premiums to them.

However, government plans can still be qualified as long as they comply with other provisions of the IRC (from which they aren’t exempt).

## What Makes My Plan a Qualified Plan?

To be considered a qualified government retirement plan, a plan document must contain IRC provisions required for municipalities. Often plan documents are based on private plan prototypes and contain federal regulations

applicable to private plans but not governmental ones. This can be problematic because Pennsylvania state laws and regulations often conflict with federal laws and regulations (from which municipalities are exempt).

It is also important that qualified government retirement plans satisfy IRC requirements for attaining favorable tax

status in both form and operation. Therefore, the plan document must be written in compliance with IRC requirements and those provisions must be followed in the actual plan operation. Employers should develop specific practices to insure that the plan is being administered according to plan document provisions.

## Why is it Important that My Plan is a Qualified Plan?

When a retirement plan maintains a qualified status, it is eligible for tax-deductible contributions. Plan participants benefit through the receipt of favorable tax consequences. Qualified plan status also prevents taxing employees on pension contributions, accruals and earnings. If a municipal retirement plan was “not qualified,” employees would be required to pay taxes on earned pension benefits, and both the employer and employee could be subject to FICA taxes on contributions.

## How Should I Maintain a Qualified Plan?

A well-drafted, government specific and current plan document is a sound foundation for administering and operating qualified retirement plans. A consolidated plan document can protect the employer and employees by providing a clear description of benefits and administrative procedures.

Employers need to be aware that retirement plan governing laws and regulations are frequently changing. Some of the more essential requirements necessary to

maintain your plan as qualified for federal income tax purposes under the IRC include:

- **Trust Requirement** - requires the retirement plan to include a trust, created or organized in the United States.
- **Contribution Requirement** - calls for contributions to be made to the trust, by the employer, employees or both, for the purpose of distributing the trust’s

principal and income to employees in accordance with the written plan document.

- **Exclusive Benefit Requirement** - requires the trust to be maintained for the exclusive benefit of the employees or their beneficiaries and makes it impossible for any part of the principal or income of the trust to be used for any other purpose, until the plan’s liabilities are satisfied.
- **Minimum Vesting Requirement** - provides that when a plan terminates or when contributions are completely discontinued, employees have a right to all benefits accrued to such date (as in effect prior to the enactment of ERISA).
- **Distribution Requirement** - establishes the latest date on which distributions must begin and the minimum amount of the distribution. This section is to assure that an employee’s assets cannot remain in the retirement plan indefinitely.
- **Maximum Benefit and Maximum Contribution Requirements** - provide that a retirement plan cannot maintain qualified status if it provides for benefits or contributions which exceed the limitations of Section 415 of the IRC.
- **Maximum Eligible Compensation Requirement** - sets a limit on the annual compensation that can be taken into account for purposes of contributions or benefit accruals.
- **Direct Rollover Distribution Requirement** - provides that participants must be given the right to a direct rollover of any eligible distributions made under the retirement plan. A new rule, effective as of Jan. 1, 2006, provides that lump-sum distributions in an amount between \$1,000 - \$5,000 must be rolled over into an eligible retirement plan if the participant does not elect otherwise.

It is worth noting that plan administrators must also comply with other IRC regulations not related to qualification, such as required employee notices with respect to lump-sum distributions and withholding on plan

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# Mistakes on the Form AG-385 Can Be Costly

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By now, you should have received Form AG-385 from the Department of the Auditor General to be completed for your pension plans; requested information on the form pertains to the 2005 plan year. It's important that the form be completed accurately because your municipality's 2006 state aid allocation will be calculated based on this information and factors from the Jan. 1, 2005 Act 205 reporting form.

An error on the form could be quite costly. For example, if your municipality receives state aid based on the full unit value, omitting one unformed employee from last year's AG-385 Form could've cost your municipality up to \$5,853 in state aid.

And, once state aid is lost, it can never be recovered. Conversely, if you get too much state aid because the number of employees or the total payroll was overstated, when discovered, the excess must be returned to the state (usually through the state audit process) with interest.

While the form may appear to be quite simple, mistakes are very common. Periodic changes are made to the information requested and instructions, so it is to your advantage to take a few minutes to review the instructions.

## Three Rules

In general, there are three rules for including an employee on Form AG-385. The employee must be:

1. An active full-time employee in the certification year (35 hours per week)
2. Employed for at least six consecutive months during the certification year
3. A participant of the pension plan

Although not apparent in the form's instructions, the Department of the Auditor General does allow for a couple of exceptions to these rules. If an employee was not actively employed for six consecutive months of the year due to a temporary work-related disability (i.e. workers' compensation) or because they were called up to active military duty, you may still be able to certify them. One condition for determining if such an employee can be reported is if he or she is continuing to accrue years of service under

the plan during the leave of absence. For any special circumstances, we recommend you contact the Department of the Auditor General directly. Be sure to make a note of the conversation in your file, including the representative you spoke with, for future reference or the next pension audit.

## Common Mistakes

The following are examples of some common Form AG-385 mistakes:

- Omitting a retired or terminated employee (a former employee can be reported even if he/she wasn't employed at the end of the year, as long as the individual was employed for six or more consecutive months during the year).
- Including a new employee who was hired after July 1 (employees hired after July 1 cannot be reported since they were employed fewer than six months in the certification year).
- Including a new employee who was hired before July 1 but who had not met the participation requirements to join the plan by Dec. 31 (if the new employee did not become a member of the plan in the certification year, he/she cannot be reported, even with six months of service).
- Including wages paid to an employee while working part-time (only wages earned while working full-time may be included).
- Reporting federal taxable wages from employees' form W-2 rather than gross pay (the federal tax code now allows for a number of deductions from taxable wages such as certain contributions to a pension plan, 457 plan or other fringe benefit plan; instead, gross wages should be reported; since reporting net pay could result in a lower state aid allocation – Note that Pennsylvania now allows a reduction of taxable wages for contributions to cafeteria plans, so even state (PA) taxable wages may not be the correct wages to report on Form AG-385).
- Addition errors or incorrect total payroll.

The actual numbers from the form used in the state aid determination are on the certification page (front page) – the number of employees and total payroll numbers. The personnel rosters that accompany the certification are usually used as supporting documentation. Individual employee information, such as birth date, hire date and contributions, is not used in the state aid calculation.

## AG-385 Form Questions and Answers

**Q. If our plan hasn't been in effect for three years, do we still have to file an AG-385 Form?**

**A.** Yes. Even though you may not be eligible for state aid this year, filing the form will get your plan "in the system" and initiate a regular recordkeeping routine. If you didn't receive a form, call the Auditor General's office at (800) 882-5073.

**Q. What can I do if I realize a mistake was made on my form after it's been filed?**

**A.** The Department of the Auditor General will normally accept amended forms through the filing deadline...and, possibly for a period of time after the deadline. However, it would be best to call first. Clearly mark the corrections on your copy of the original form, indicate on top of the certification page that the form is amended, and include the date.

**Q. We have an employee who was hired in 2005 and worked more than six months full-time, but our plan has a plan entry date of Jan. 1. Can we report him?**

**A.** No. According to the plan, he would not become a member until Jan. 1, 2006. Since he was not a member of the pension plan as of Dec. 31, 2005, he cannot be reported. (Consider eliminating entry dates and waiting periods)

**Q. The benefits in our plan are calculated using employees' base salary. Shouldn't we show only base salary on the AG-385 Form instead of W-2 pay?**

**A.** No. AG-385 Forms should list all gross wages, regardless of the type of pay used to calculate benefits. Reporting an amount that is less than gross pay will likely reduce your state aid check.

## Filing Deadline

The filing deadline is March 31, 2006. You should file your form early in case there is a question or problem with it and it is returned to you.

## Important!

If you file for Act 147 or Act 64 ad hoc cost-of-living adjustment reimbursements, you should also have received Form AG-490 (with retiree rosters) and Form AG-64. These forms must be received by the Department of the Auditor General by April 1. **There are no exceptions to this deadline. If your AG-490 or AG-64 Form is not received by April 1, your municipality will lose its reimbursement for this year.**

As always, if you have any questions on completing the AG-385 Form, AG-490 Form or AG-64 Form, or if you have any other pension questions, please call your Mockenhaupt Benefits Group consultant at (800) 405-3620. The toll-free number for the Department of the Auditor General is (800) 882-5073.

## Mockenhaupt Benefit Group's Disaster Recovery Plan Protected Client Data During Water Main Line Break Last Summer

As many of you know, last summer (*Wednesday, Aug. 17, 2005*) a 36" water main line broke under Fort Duquesne Boulevard in front of One Gateway Center – the location of Benefit Service Center companies Mockenhaupt Benefits Group (MBG) and Employee Benefit Data Services (EBDS). The broken line gushed water for over three hours. Because the break occurred near the entrance ramp to the building's underground parking garage, water flowed into the garage flooding most of the automobiles parked there for a total loss. And, many of the mechanical systems for buildings One, Two and Three Gateway Center were flooded and severely damaged. In fact, more than 20 million gallons of water flowed out of the water main. Shortly after noon that day, the Gateway Center buildings, as well as others nearby, were evacuated causing MBG and EBDS to close for the day.

Electrical and telephone service, including voice and data communication lines, were interrupted; electricity wasn't restored until shortly after 9 a.m. on Thursday and phone lines were connected at about 4 p.m. MBG's backup process for completing mailing services was implemented Thursday through arrangements with our mailing service partner.

Despite projections that we would

be able to resume work no later than Monday morning, One Gateway Center remained closed for over a week. A limited number of employees were able to gain access to our offices for a short time on Friday enabling us to return some telephone messages received from voice mail; change our welcome messages on incoming telephone lines to explain the situation; make some adjustments to assure external connectivity to our systems for some personnel; and make some fund transfers necessary to avoid interruption of client services, such as retiree pension checks. Most of our employees were accessing our systems via remote connections to our network.

By Monday morning Aug. 22, 2005, we were collecting our incoming mail from the post office since no mail deliveries were available. Mail was processed and delivered to employees at a variety of backup locations until we were finally granted access to our offices late Wednesday afternoon Aug. 24. We immediately began the process of moving our operations back into our offices and were open for business

as usual (*although not yet normal*) on Thursday, Aug. 25, 2005.

This experience was a real-life test of our firm's Disaster Recovery Plan, which was implemented to protect our clients' employee and plan data, important documents, and provision of benefits services. We're proud to say that, except for a short interruption of phone and electronic communications, not only was a disaster averted, but most of our clients didn't even realize the incident occurred; and no files or data, whether hard copy or electronic, were damaged.

We truly appreciate the cooperation that was given to us during that difficult time. Many thanks

go out to our valued customers for their patience and understanding; to our vendors for working with us to continue to supply our needs; to our service partners and friends who provided the necessary back up facilities for our use; and to our employees for their dedication to providing the best possible service to our customers.

***"We're proud to say that, except for a short interruption of phone and electronic communications, not only was a disaster averted, but most of our clients didn't even realize the incident occurred; and no files or data, whether hard copy or electronic, were damaged."***

## GAS 45 Reminder

We announced in our Winter 2005 issue of *PEBR*, the new disclosure requirements issued by the Governmental Accounting Standards Board (GASB) in their Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions*. This new statement will require government employers to assess and report in their financial statements, the annual cost of other postemployment benefits (OPEB) like retiree medical and life insurance, as they currently do for pension benefits. The required measurements involve actuarial calculations taking into account liabilities for both current and future retirees.

Most local governments and school districts in Pennsylvania will be required to disclose the actuarial costs and liabilities under the new standard for the first time

for the fiscal year beginning January/July 1, 2009 for those with annual revenues of under \$10 million, or January/July 1, 2008 for those between \$10 and \$100 million. We are seeing more and more employers having preliminary OPEB actuarial valuations prepared and using the results as a tool in budget forecasting, negotiation of employee benefit packages and strategic planning for cost-containment measures.

With many collective bargaining agreements ending this year and negotiations taking place, employers providing OPEB to their employees should take a close look now at what price will be placed on these benefits so they have the time to make plans, if necessary, to manage the costs before the mandatory implementation date.

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distributions. Other federal laws that apply to governmental plans include the Age Discrimination in Employment Act of 1967 (ADEA) and Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA).

### What should I Do to Ensure that My Plan is a Qualified Plan?

Employers should seek the assistance of their qualified retirement plan consultant or their solicitor to ensure that their retirement plan document is in compliance with the requirements of the IRC and that the plan is being administered according to plan document provisions.

## Reminders/Deadlines for 2006

March 31: .....Act 205 reporting form filing deadline with PERC  
AG-385 form filing deadline with Auditor General

April 1: .....AG-490 (1989 *ad hoc* COLA) form filing deadline with Auditor General  
AG-64 (2002 *ad hoc* COLA) form filing deadline with Auditor General

Sept. 1 (approx.): .....Act 147 (1989 *ad hoc* COLA) reimbursement checks mailed

Sept. 30: .....2007 MMOs must be submitted to the governing body

Oct. 1 (approx.): .....State aid checks for 2006 will be mailed  
Act 64 (2002 *ad hoc* COLA) reimbursement checks mailed

Oct. 31 (approx.): .....State aid must be deposited to pension funds (30 days after receipt)

Dec. 31: .....2006 MMO deposit is due

### Legislative Update

A bill amending Act 600, Senate Bill No. 394, was approved by the governor on Dec. 22, 2005. SB 394, now Act 89 of 2005, increases the allowable cap on optional service increment benefits from \$100 overall, to \$100 per year of service over 25 years up to a maximum of \$500 for Act 600 police plans. It also grandfathers pension benefits in Act 600 plans for employees of home rule municipalities who were hired before Jan. 24, 2001 that exceed 50 percent if the excess benefit was already in effect at that time.

Check on pending pension legislation and other important news, or download prior issues of the PEER from our Web site at [www.mockenhauptbenefits.com](http://www.mockenhauptbenefits.com).

### Next issue: *Another Client Profile*

Do you have a suggestion for an article for a future newsletter? Call us at (800) 405-3620 or submit an e-mail through our Web site.

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