

## **401(K) PARTICIPATION CONTINUES TO RISE**

Prior to avoiding the Year-End Fiscal Cliff, it was reported by Bank of America Merrill Lynch that employees continued to increase their participation in 401(k) plans. Statistics released for the quarter ending September 30, 2012 indicate that the number of employees starting or increasing participation in employer retirement plans almost duplicated the second quarter's performance. This consistency in the face of economic uncertainties which existed at the time, including presidential election and fiscal cliff jitters, represents a continuation of a trend that began in 2009 and shows no sign of diminishing. Also, use of an automatic increase feature for employee 401(k) deferrals has increased 42% since 2009. This is encouraging news because most financial planners acknowledge that a 3% of compensation savings rate is nowhere near adequate for the vast majority of participants. The 3% figure represents the initial minimum automatic contribution rate found in governmental rules concerning tax breaks for certain automatic enrollment plans. Instead of a 3% initial rate, many employers are designing their plans to use a 6% of compensation initial rate, with some plans eventually escalating that rate up to as much as 10% of pay. Other encouraging Bank of America statistics include the fact that 90% of automatically enrolled participants continue to remain active in their plans, compared to only 4% who opted out of plan participation following automatic enrollment.

## **401(K) PLAN CONTRIBUTION LIMITS DEFENDED**

Senators Max Baucus and Orrin Hatch of the Senate Finance Committee have spearheaded Senate passage of Concurrent Resolution 62. This resolution represents a "Sense of Congress" statement urging that the positives of current tax

deferral rules for retirement plans be thoroughly considered before they are included as one of the items to be changed to produce needed new revenue. The Resolution provides a strong message to congressional members that tax advantages available to American workers who join with their employers in saving for their eventual retirement enjoy a special status. Dale Brown, president and CEO of the Financial Services Institute, supported the resolution, praising the Senators for their efforts. Said Brown, "Any attempt to amend the Tax Code by reducing the amount employees can save each year will jeopardize the retirement security and quality of life of these workers." Brown also pointed out, "Taxes on retirement savings are deferred, not avoided."

The Senate resolution coincides with the "Save My 401(k)" program discussed in last month's Newsletter. We strongly urge you to visit [www.savemy401k.com](http://www.savemy401k.com) and voice your concern to your congressional representatives.

## **NON-RESIDENT ALIENS IN U.S. RETIREMENT PLANS**

Some companies that establish tax qualified retirement plans for their U.S. employees also employ individuals who reside in a foreign country. Often these foreign employees represent a very small percentage of the employer's workforce and the question arises as to whether they should be included in the U.S. retirement plan. Many companies, whose initial reaction may be positive on this question, often find upon closer inspection that it is more efficient and effective to exclude these "non-resident aliens" from all qualified U.S. retirement plans. The U.S. Tax Code makes it easy to exclude most of these employees; but only if they meet very specific conditions.

A U.S. qualified retirement plan may exclude "non-resident aliens" without penalty or complications.

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However, if a plan excludes “non-resident aliens,” the exclusion applies only if the excluded employee meets the following conditions: (1) the employee is not a U.S. citizen, (2) the employee is not a U.S. resident for federal tax purposes, and (3) the employee earns no income for services performed within the United States. Natural United States citizens are those born within the territorial limits of the United States (including Guam, Puerto Rico, Northern Mariana Islands, U.S. Virgin Islands, and the District of Columbia), while naturalized United States citizens are granted citizenship following application and acceptance. U.S. residents for tax purposes are described in IRS Publication 519 and generally consist of individuals who have been granted a Permanent Resident Card (“green card”) or who physically reside in the United States for specified minimum time periods (at least 183 days in the current year, or at least 31 days in the current year plus specified minimum periods during the previous two years).

The above definition does not permit the unrestricted exclusion of persons who are U.S. citizens, including persons born in Puerto Rico or another U.S. possession. It also does not permit the unrestricted exclusion of aliens who reside full or part time in the United States while performing services for their U.S. employer. Employees meeting the “non-resident alien” definition may be excluded from the U.S. retirement plan provided the formal plan document specifies their exclusion.

Employee classes, such as all Puerto Rico residents, may be excluded from qualified retirement plans at the employer’s discretion, but coverage requirements described in Code 410(b) must be met. This generally prevents an employer from excluding more than 30% of the workforce due to job class.

Puerto Rico recently finalized rules so that a U.S. company may establish a plan for its Puerto Rico

employees or modify its existing retirement plan so that the U.S. plan meets Puerto Rican requirements for tax qualification. A Puerto Rico qualified plan must be approved by the Hacienda (Puerto Rico’s Department of Treasury). Puerto Rican employees of companies that sponsor U.S. tax qualified plans that do not qualify their plans in Puerto Rico will be taxed in much the same way as their U.S. counterparts are taxed with respect to deferred compensation plans. Accrued benefits that are not subject to a substantial risk of forfeiture will be taxed immediately after they become fully vested.

## REMINDERS FOR JANUARY

- January 31, 2013 is the deadline for sending Form 1099-R to participants who received benefits in 2012.
- January 31, 2013 is also the deadline for filing individually designed (rather than pre-approved) retirement plan documents with the IRS for their review and approval if the employer’s Tax Identification Number ends in a “2” or a “7.”

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