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STEIKER, FISCHER, EDWARDS & GREENAPPLE, P.C.

CLIENT ALERT

Are You an ESOP Fiduciary?

The Enron litigation filed by the United States Department of Labor ("DOL") and other recent cases have challenged the conduct of corporate officers with responsibility for administering their company's qualified retirement plans, highlighting the potential liability of "inside" fiduciaries employed by the plan sponsor. ERISA recognizes two kinds of fiduciaries. Named fiduciaries, such as a named trustee or plan administrator, are specified in the plan documents or appointed by the company pursuant to a procedure specified in the plan. But ERISA also imposes fiduciary liability on any person who has or exercises any authority or control over the management of a plan or its assets, or who has any discretionary authority or control in the administration of the plan. These "functional" fiduciaries are responsible (and potentially liable) as ERISA fiduciaries **to the extent that** they are involved in any aspect of the plan's operations or its investments.

Suppose the plan gives the directors of a company the authority to appoint the ESOP trustee. The trustee is a named fiduciary, and the directors have no direct liability for the trustee's actions or inactions with respect to her or his responsibilities with respect to the plan. However, the DOL regulations and the reported ERISA court decisions make it clear that the power to appoint a fiduciary carries with it the fiduciary responsibilities to 1) make a prudent selection of the fiduciary, and 2) periodically review and monitor the appointed fiduciary's performance to ensure that the appointee is acting in compliance with ERISA. In addition, the DOL has taken the position that the directors also have an obligation to provide the trustee with accurate and current information, so as to enable her or him to administer the plan in the best interests of the plan participants.

Corporate officers, as well as directors, can also find themselves in a challenging position. Being an officer does not in itself make someone a fiduciary, but often executives in small companies are both officers of the company and administrators of the company's qualified plan. Although courts recognize an officer's duty to act in the interest of the company, the officer is required to act **solely** in the interest of plan participants and their beneficiaries when acting within the scope of her or his responsibilities as an ERISA fiduciary.

The law in this area will continue to change and develop as currently pending cases work their way through the Courts of Appeal and the Supreme Court. In the meantime, ERISA fiduciaries should be aware of their potential liability and proceed carefully. In some cases, it may be advisable to protect inside fiduciaries by purchasing a fiduciary liability insurance policy and/or by providing them with written indemnification agreements which spell out the company's obligations to pay for their defense in the event of litigation which challenges their actions taken as plan fiduciaries.

Please contact us with specific questions about the fiduciary responsibilities of your employees, officers or directors ▪

IRS Revenue Ruling Confirms Increased Deduction Limits for Leveraged ESOPs

Section 404(a)(3) of the Internal Revenue Code allows an employer to deduct contributions to a stock bonus or profit-sharing plan up to 25% of participants' covered compensation under the plan. Code Section 404(a)(9) allows a C corporation to make deductible contributions to a leveraged ESOP up to 25% of participants' covered compensation to repay principal of an exempt loan. Although Section 404(a)(9) states that it applies "notwithstanding" the general rule of Section 404(c)(3), some legal advisors and plan sponsors have been concerned that the IRS could take the position that a company which deducts contributions to a leveraged ESOP under Section 404(a)(9) may not be able to make additional deductible contributions to other qualified plans which, in total, exceed 25% of participants' compensation.

In a recent private letter ruling, however, the Internal Revenue Service confirmed that the Section 404(a)(9) deduction limit for leveraged ESOPs applies separately from the normal deduction rules of Section 404(a)(3). In the ruling, the IRS concluded that contributions to a leveraged ESOP of up to 25% of participants' compensation to repay loan principal are deductible under Section 404(a)(9), and that additional contributions to a 12% money purchase pension plan and a 3.5% matching contribution to a Section 401(k) plan would be separately deductible under Section 404(a)(3).

This is good news for C corporation ESOP sponsors who wish to make deductible contributions to their profit-sharing or 401(k) plans in addition to the increased ESOP contributions permitted by Code Section 404(a)(9). While the IRS ruling is not binding on other ESOP companies, as a practical matter, it strongly suggests that future IRS guidance will be favorable on the deduction issue addressed in the ruling.

Keep in mind, however, that Section 415 of the Code provides an overall limit on the "annual additions," including employer and employee contributions and forfeitures, that can be allocated to any individual participant's account in a qualified plan or combination of qualified plans in an affiliated group. Generally, this limitation is the lesser of 100% of the participant's compensation or $41,000▪

-To discuss the contents of this article further, please contact Robert Edwards in our Providence Office.

Meet Mark Kossow

Mark Kossow joined SFE&G in May 2004 as an Associate in the firm's Philadelphia office. Mark comes to us with substantial experience in the areas of U.S. income taxation of corporations and individuals, which he will draw upon in structuring corporate transactions and tax-qualified retirement plans.

Mark has counseled clients on all aspects of employee benefit matters, including qualified and nonqualified retirement plans. Mark also has significant experience in structuring and income tax planning for taxable acquisitions and tax-free reorganizations, incorporations and the formation of other business entities, and he has practiced in the areas of tax controversy, state and local taxation and tax-exempt entities.

Mark received an L.L.M. in Taxation from New York University and has a Juris Doctor from Albany Law School. He is admitted to practice law in New York and New Jersey.

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