



## **Flashpoint: Surprise! You Are (or Are Not) a Professional and You Are (or Are Not) Covered by the PBGC!**

We worked recently on an interesting matter that has rather far-reaching consequences for some sponsors of defined benefit and cash balance (collectively, DB) plans.

Our client, a financial advisor to some retirement plans and mostly individuals, and a sponsor of a DB plan for employees at his firm, was recently audited by the IRS. During the audit, the IRS examined the actuarial calculations of required and permitted contributions, and took the position that the contributions made were in excess of the deductible limit. Why? Because the plan was not covered by the PBGC and deduction rules for PBGC-covered and non-covered plans are different.

For those who don't know, the PBGC, or Pension Benefit Guaranty Corporation, is a government-owned corporation that insures benefits in DB plans when the plan assets are insufficient to pay them. Sponsors of plans covered by the PBGC are required to pay annual premiums to the PBGC for this coverage. Certain plans are exempt from PBGC coverage. The important issue with our client was the exclusion from coverage of plans sponsored by professional service employers that have 25 or fewer participants. The IRS averred in our client's situation that a financial advisor is a professional, so his plan is exempt from PBGC coverage.

### *Who Is a Professional Service Employer?*

Under PBGC rules, a professional service employer is one that is (1) owned or controlled by professional individuals, and (2) the principal business of which is the provision of professional services.

Who are professional individuals? The law provides that certain types of companies are, per se, professional organizations: physicians, dentists, chiropractors, osteopaths, optometrists, other licensed practitioners of the healing arts, lawyers, public accountants, public engineers, architects, draftsmen, actuaries, psychologists, social or physical scientists, and performing artists.

But, this is not an exclusive list, simply a list of examples. Other occupations may be professional in nature. If you are unsure as to whether your company is a professional service organization, the PBGC provides a process by which you can apply for a ruling to determine whether you are.

In truth, very few sponsors apply for these rulings. There are some published PBGC rulings that help people on the cusp of professional status determine their coverage. However, there are many categories of people who would not even think that they were professionals for this purpose. Our informal discussions with others in the industry indicated a consensus opinion that financial advisors or planners are not professionals for PBGC purposes.

*So, What Happened to the Financial Advisor?*

The third party administration (TPA) firm providing services for the plan at issue staved off the IRS's deductibility determination by offering to get a PBGC ruling on coverage. A coverage ruling was requested and, much to the surprise of the financial advisor and the TPA, the PBGC ruled that the financial advisor was a professional.

Enter FBLC: we prepared an appeal of this ruling to the PBGC, outlining factors that we believed distinguished the financial advisor from others who were considered to be professionals including:

- the advisor at issue had no college degree (having received his CFP designation many, many years ago when such a requirement did not exist);
- the advisor's CFP designation required that he pass a multiple-choice exam after a curriculum of study that was roughly equivalent to 1½ years in college;
- many of the advisor's duties (and those of his company) involved mechanical functions, such as rebalancing portfolios via a spreadsheet program and making trades that the client requested.

We also pointed to similar types of companies that had been found by the PBGC not to be professionals, such as real estate brokers, automotive service providers, general contractors, and computer network specialists.

We want to be clear here: we are not denigrating the qualifications or the value of financial advisors. However, when you compare the course of study, the licensing process, and the public perception, it is hard (we thought) to argue that people in this occupation are "professionals" in the classical sense, such as a doctor or lawyer.

Much to our surprise, the PBGC again ruled in response to our appeal that the investment advisor was a professional.

*But, Here's What Really Concerns Us ...*

By far, the greater shock was the method of analysis that the PBGC undertook. In discussing its determination, the PBGC considered significant objective and *subjective* elements. The PBGC's statement of what constituted a professional concentrated on the occupation, itself, and the duties fulfilled by someone in such occupation, such as whether the occupation:

Require[s] knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education and from an apprenticeship or from training in the performance of routine, mental, manual or physical processes. The rendering of professional services generally

requires the consistent exercise of discretion and judgment in its performance and would be predominantly intellectual in character.

This criteria is very objective, but the actual factors the PBGC noted in this case included both the services performed by this specific company and the expertise required by this particular business owner to perform them. These factors included:

- The years of experience our client had;
- The type of clientele being served, particularly the affluence of the advisor's clients;
- The fact that being an advisor entails a fiduciary position – what the PBGC called “an element of public trust”;
- The presence of government licensing requirements;
- The presence of continuing education requirements;
- The organizations with which our client is affiliated;
- How our client represented himself on his website; and
- The way the industry presented itself to the public, including television commercials touting the professionalism of financial advisors.

Finally, the PBGC opined that being a financial advisor did not involve mostly repetitive or manual processes, but intellectual property, as opposed to the other covered service providers listed above. (We wonder if real estate brokers, computer folks, and automotive people think that their work is mostly manual and not intellectual.)

The PBGC's analysis begs the question: if our client was a new advisor (little experience) whose business catered to a less affluent clientele, with a less broad array of services that did not include retirement plans (so that there was not an ERISA-based fiduciary obligation), would this person fail to be a professional?

Furthermore, if a major factor is the element of public trust, where is that more present than in occupations involving food preparation, home building, and automobile maintenance?

Consider the following types of occupations and the application of this criteria:

<b>Occupation</b>	<b>Education or Training</b>	<b>Intellectual Nature of Position</b>	<b>Clientele</b>	<b>Public Trust</b>
TPA that provides non-investment 3(16) fiduciary services	No college degree needed; some industry certifications available but not required	Broad range of possible tasks (depending on type of service provided); Involves knowledge of the Tax Code and ERISA; involves exercising judgment as to the specific fiduciary services undertaken	Retirement plans and business owners	As a fiduciary, involves ERISA duties of loyalty and prudence, which engenders public trust
Non-CPA tax preparer (enrolled agent)	Passes IRS-required examinations; requires continuing education	Involves understanding the Tax Code and providing tax advice; involves the application of complex tax rules	Probably less affluent, but not necessarily	Involves payment of income taxes; potential for penalties and even criminal charges
Certified automobile mechanic	Commonly takes specialized classes in high school or college; takes training classes as part of employment relationship; some are certified by organizations, such as the Automotive Service Excellence (ASE) or the car manufacturer on whose cars the mechanic works	Involves problem identification and solving; understanding of mechanical and physics principles	No specific group – both wealthy and less wealthy clients need car repairs; could be affiliated with luxury car manufacturer	Involves public safety in transportation; also involves care of one of the client's larger capital investments
Food preparers/chefs	2- to 3-year course of study at culinary institute (although not required); subject to governmental oversight and criteria	Varies: could be following recipes or could be developing new and creative dishes; can involve knowledge of nutrition, allergy avoidance, and other medically-based issues	Commonly affluent, but not necessarily so	Involves significant health concerns
IT service provider	Commonly college degree; certification in specific course of study	Often involves designing complex computer systems and networking, integration of various hard- and software products, and training of users	Can range from very large companies to very small organizations	Client companies' dependence is substantial and a failure of the system can lead to large costs to the company; commonly involves significant capital investment by clientele

These kinds of examples can go on and on. But, what we are trying to demonstrate here is that, once a substantial subjective element is added to the analysis, what constitutes a professional

can be a hard nut to crack. Some of these occupations (and those who perform them) involve a large amount of repetition and little creativity; however, a large sector of these providers can be much more creative, intellectual in nature, and considering them not to be professional in the face of the PBGC's ruling in our case leaves us wondering how to analyze this question with regard to other clients.

### *The Bottom Line ...*

The critical part of this issue—as with many other challenges plan sponsors face in dealing with the government—is that plan sponsors need predictability. We performed a search of a Form 5500 database, looking for sponsors of DB plans that had an occupation code of either investment advisor or insurance broker, and found that 68% of the 650 plans in that category had been coded as being PBGC-covered. That is a lot of surprised folks who have been paying premiums, calculating contributions, and operating as if they were PBGC-covered. (In our informal discussions with the PBGC, its representatives expressed concern that there is a problematic level of insecurity as to coverage, commenting that it was not their intent or preference that employers be surprised by the application of the laws.)

### *What Do We Suggest?*

First, and foremost, if you are a financial advisor or insurance broker, sponsor a defined benefit plan, and have been assuming you are PBGC-covered, you should pursue getting a refund of PBGC premiums. You may also want to write a letter to the PBGC if you feel strongly that this “professional” categorization of your industry is incorrect.

Second, if you are in an industry that is on the cusp between being professional and not, it may be worthwhile to ask the PBGC for a ruling as to whether your plan is covered.

If you have been assuming that your plan is covered and it is not, you need to chat with your actuary to determine if this assumption has led to higher contributions and deductions that could be challenged on audit.

And, as always, if you have any questions about this issue, give us a call.



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