PENSION TRENDS

BY INDEPENDENT ACTUARIES, INC.

IndependentActuaries.com

Volume XX, Issue III

August 2019

Top 10 Failures in the IRS' Voluntary Correction Program

In our March 2011 Newsletter we provided commentary on the ten most commonly cited plan administration failures found when the IRS conducts an audit of a 401(k) plan. Below is an updated list of the top ten failures found in the IRS' Voluntary Correction Program (VCP) and includes our insights to avoid these common failures.

The updated top ten list includes more of the same items from 2011 than it does new items. This fact just goes to show that administering a 401(k) plan is not a good do-it-yourself project. It may seem easy when you've been handling the plan's administration for years and "nothing has changed", but if the administration has not been done correctly in the past, then doing it the same way you've always done it will not guarantee that there aren't any failures.

1. Failure to amend the plan for tax law changes by the end of the period required by the law.

Every five to six years the IRS requires plan sponsors to restate their plan document. Currently the most common error is by employers that failed to adopt their pre-approved document by April 30, 2010 or April 30, 2016, or by employers that failed to update their individually designed document by the end of their applicable remedial amendment cycle.

We would suggest taking the responsibility off of the plan sponsor and retain the assistance of a third-party administrator (TPA) or legal counsel. They will have the expertise to know what amendments and restatements are required, and the timing of such actions.

2. Failure to follow the plan's definition of compensation for determining contributions.

It is not uncommon for plans to include or exclude certain types of compensation, such as 401(k) deferrals, bonuses, commissions, or overtime. A plan document may define compensation as 415 Compensation, while contributions are calculated based on W-2 Compensation. These variables could result in the wrong contribution amounts for employees, cause a failed compliance test that was thought to pass under the wrong definition of compensation, or be determined to be a discriminatory compensation definition under IRC 414(s). In general, these are all failures to follow the terms of the Plan, which was on the 2011 list, and can be a qualification issue for the Plan. As mentioned above, working with a third-party administrator, and checking the plan provisions should minimize the risk of using the wrong definition of compensation.

3. Failure to include eligible employees in the plan or the failure to exclude ineligible employees from the plan.

Including an ineligible employee may result in the employer making additional contributions that were unnecessary. Excluding an eligible employee may cause a 410(b) failure. If the employer is a member of a controlled group, all employees of the controlled group may potentially be eligible for benefits. It's important to know who is covered or excluded under the terms of the Plan, when they are covered, and what information they need once they are eligible.

To subscribe to our Pension Trends newsletter, visit IndependentActuaries.com and submit your email address. Or you can send an email to KristenMeredith@indact.com

To read previous issues of Pension Trends, visit our Pension Trends Archive at:

IndependentActuaries.com/resources/general-resources/pension-trends-newsletter/pension-trends-archive/

Author Profile:

This article was adapted from our March 2011 Pension Trends Newsletter originally authored by Alan J. Stonewall, FSPA, EA, MAAA.

It has been updated by Jeffry Lamb, EA, MAAA, and Shawna Floistad, QPA.

© 2019 by Independent Actuaries, Inc.
All Rights Reserved

INDEPENDENT ACTUARIES, INC.

4500 Kruse Way, Suite 200
Lake Oswego, OR 97035
Phone: 503.520.0848
Fax: 503.520.1147
IndependentActuaries.com

email:
info@indact.com

4. Plan loans that don't comply with IRC 72(p).

If a plan allows loans, there are a number of IRC limitations and guidelines the loan must follow in addition to stipulations defined in the plan document. If the terms of the loan do not follow the terms of the Plan, this is a potential qualification issue. If a plan fails to collect loan payments, or a participant fails to pay back the loan, the loan is considered in default, which should result in the participant being taxed and makes plan administration more complicated and costly. In general, we don't necessarily recommend allowing for participant loans as they more often than not go wrong quickly, but working with a TPA can help keep them on track.

5. Impermissible in-service withdrawals.

If a plan allows for in-service withdrawals, there are certain requirements, both legally and within the plan document. A participant may need to have attained a specific age or meet other specific requirements. If they are not eligible for an in-service withdrawal, this may cause a prohibited transaction and excise taxes. It is important to know at what age they are permitted, and what other requirements (such as vesting or from which account balances) must be met before approving an in-service withdrawal request.

6. Failure to satisfy IRC 401(a)(9) minimum distribution rules.

In general, a participant must begin taking required minimum distributions (RMD) each year after the later of termination of employment, or attaining age 70.5 (5% owners are required to begin after attainment of age 70.5). There is a three month extension with the first RMD, but they must be taken annually after that. If an RMD is not taken timely, there is generally an excise tax of 50% on the amount required to be taken. The excise tax may be waived in appropriate situations.

7. Employer eligibility failure.

This failure occurs when a plan is adopted by an employer that fails to meet the employer eligibility requirements for adopting such plan by law. Common situations are where a 401(k) plan is adopted by a government or a 403(b) plan is adopted by a tax-exempt entity (other than a 501(c)(3) entity or a public educational organization). This can be avoided by checking with qualified legal counsel before adopting a plan. It is important to note that unlike most operational failures, employer eligibility failures cannot be self-corrected.

8. Failed ADP/ACP nondiscrimination tests under IRC 401(k) and 401(m) not corrected in a timely manner.

If a plan does not have a 401(k) safe harbor feature, it is required to pass ADP / ACP nondiscrimination testing. A failed test needs corrective action, such as returning contributions, or making additional contributions to pass. If the appropriate corrections are not made timely, there may be an excise tax to the employer, more expensive corrections may be required, or the Plan may lose its tax-qualified status.

9. Failure to properly provide the minimum top-heavy benefit or contribution under IRC 416 to non-key employees.

In general, if the total account balance of key employees is greater than 60% of plan assets, the Plan is considered top-heavy. This can require non-key employees (or sometimes all employees depending on your plan document) to receive minimum contributions. Typically, this can be up to 3% of full year compensation for participants, or 5% if the employees also participate in a defined benefit plan of the employer.

10. Failure to satisfy the limits of IRC 415.

Under IRC 415, the most a participant can receive in contributions for plan years ending in 2019 is the lesser of $56,000 or 100% of compensation. Participants age 50 or older are allowed an additional $6,000 in catch-up contributions. It is important to note that the catch-up limit is a calendar year limit, while the IRC 415 limit is a plan year limit.

IndependentActuaries.com

Volume XX, Issue III

August 2019

To subscribe to our Pension Trends newsletter, visit IndependentActuaries.com and submit your email address. Or you can send an email to KristenMeredith@indact.com

To read previous issues of Pension Trends, visit our Pension Trends Archive at:

IndependentActuaries.com/resources/general-resources/pension-trends-newsletter/pension-trends-archive/

Author Profile:

This article was adapted from our March 2011 Pension Trends Newsletter originally authored by Alan J. Stonewall, FSPA, EA, MAAA.

It has been updated by Jeffry Lamb, EA, MAAA, and Shawna Floistad, QPA.

© 2019 by Independent Actuaries, Inc.
All Rights Reserved

INDEPENDENT ACTUARIES, INC.

4500 Kruse Way, Suite 200
Lake Oswego, OR 97035
Phone: 503.520.0848
Fax: 503.520.1147
IndependentActuaries.com

email:
info@indact.com