

Operating in Compliance

Understanding IRS and DOL Audit Hot-button Issues and How Plan Sponsors Can Address Them




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Enforcement Framework

<p>Focus</p> <ul style="list-style-type: none"> ◆ Fiduciary rules and participant protections <p>Impact</p> <ul style="list-style-type: none"> ◆ Fiduciaries and service providers ◆ Timely contributions 	<p>Focus</p> <ul style="list-style-type: none"> ◆ Compliance with tax rules <p>Impact</p> <ul style="list-style-type: none"> ◆ Operational compliance ◆ 401(k) questionnaire
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AGENDA

- ◆ IRS and DOL enforcement update
- ◆ IRS and DOL audit "hot buttons" and hypothetical and actual case studies
- ◆ 401(k) plan check-up
- ◆ Support network

ERISA is a highly complex area of law. The information contained in this material is strictly educational in nature and is not intended as legal advice. Clients are strongly encouraged to obtain legal advice from a qualified expert.

Employee Plans (EP) Compliance Trends and Tips

- ◆ IRS Employee Plans
- ◆ Enforcement
- ◆ Guidance: EP Examinations Trends and Tips



IRS website, 2014

<http://www.irs.gov/Retirement-Plans/EP-Compliance-Trends-and-Tips>


IRS AND DOL ENFORCEMENT UPDATE

IRS LESE Exam Projects

- ◆ Learn, Educate, Self-Correct, Enforce (LESE)
- ◆ Focused IRS examinations
 - ◆ Based on a sampling – generally about 50 plans
 - ◆ Similar characteristics that the IRS believes may reveal problems
 - ◆ Assess compliance levels for selected groups of retirement plans

401(k) Compliance Questionnaire

- Measure
 - Compliance levels
 - Risk factors
- Determine new compliance projects
 - Hardship distributions
 - Roth contributions
 - Top-heavy plans
 - Excess corrections
- Provide Questionnaire Self-Audit Tool



IRS website, 2014

http://www.irs.gov/pub/irs-tege/401k_final_report.pdf

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Missed/Unsigned Plan Documents and Amendments

IRS Actual Case Study

- Christy & Swan Profit Sharing Plan v. Commissioner of IRS (March 2011)
 - Failed to restate for Economic Growth and Tax Relief Reconciliation Act (EGTRRA)
 - Missed other interim amendments
 - Chose not to correct through IRS Employee Plans Compliance Resolution System (EPCRS)
- Consequence: retroactive disqualification (employer/ employees)
 - Tax deductions disallowed
 - Participants' plan balances are taxable

Source: *Christy & Swan Profit Sharing Plan v. Commissioner of IRS*, T.C. Memo 2001-62 (Mar. 15, 2011)

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IRS AND DOL AUDIT "HOT BUTTONS" AND CASE STUDIES

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Employee PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS)

IRS Revenue Procedure 2013-12

	Process	Fee	Types of Errors
Voluntary Correction Program (VCP)	Employer initiated, IRS submission	Reduced fee based on number of participants	Operational, document, demographic, & employer eligibility errors
Audit Closing Agreement Program (Audit CAP)	IRS initiated	Penalty based on various factors	Errors discovered under IRS audit
Self-Correction Program (SCP)	Employer initiated, no IRS involvement	No fee	Operational errors

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IRS Audit Hot Buttons

Common Plan Failures

- Failure to timely update plan documents
- Failure to operate the plan in accordance with plan terms
 - Compensation definition
 - Matching contributions
 - ADP/ACP nondiscrimination tests
 - Eligible employees
 - 402(g) deferral limit
 - Deferral deposits
 - Hardship distributions
 - Loans


Sources: 2013 IRS 401(k) Plan Checklist; Internal Revenue Manual, EP Exam Guidelines, Section 2

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Eligible Participants Excluded

Hypothetical Case Study: Facts

- Employer D 401(k) plan
 - 8 participants
 - Plan operates on a calendar year basis
 - January 1 and July 1 entry dates
- Employer matching contribution
 - 50% matching contribution on deferrals up to 10%
- Employee Jack erroneously excluded
 - Should have been given the opportunity to make elective deferrals on January 1, 2013
 - Was not provided the deferral opportunity until January 1, 2014
 - Jack is a non-highly compensated employee (NHCE)
 - Jack's compensation for 2013 was \$80,000
 - The actual deferral percentage (ADP) NHCEs for 2013 was 8%



Note: The persons portrayed in this example are fictional. This material does not constitute a recommendation as to the suitability of any investment for any person or person having circumstances similar to those portrayed and a financial advisor should be consulted.

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Eligible Participants Excluded

Hypothetical Case Study: Correction

- Employer D must make a corrective contribution for the 2013 "missed deferral opportunity" and the missed matching contribution

Calculation:

\$80,000	(Jack's salary earned during period he was excluded)
x .08	(ADP of NHCEs = 8%)
\$ 6,400	(Missed Deferral)
x .50	(50% x Missed Deferral)
\$ 3,200	(Corrective deferral contribution by employer – Qualified Non-elective Contribution (QNEC))
+ 3,200	(50% match on Missed Deferral - \$6,400 x .50)
\$ 6,400*	(Full corrective contribution by Employer D)

* The corrective contribution must be adjusted for earnings through the date of the correction

- Additional IRS fees and penalties may apply
- Correction amounts add up significantly if eligible errors occur with multiple employees or over multiple years

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1. See IRS Revenue Procedure 2013-12

DOL Corrections Program

- Delinquent Filer Voluntary Compliance Program (DFVCP)**
 - Late or inaccurate Form 5500 filings
- Voluntary Fiduciary Corrections Program (VFCP)**
 - Delinquent participant contributions
 - Delinquent participant loan repayments
 - Improper payment of expenses from plan assets
 - Payment of excessive or unnecessary compensation
 - Improper handling of defaulted participant loans
 - Purchase of assets by plans from a "Party in Interest"
 - Inadequate fidelity bond
 - Failure to timely deliver participant Summary Plan Description (SPD) and notices

Eligible Participants Excluded- continued

Hypothetical Case Study: Correction

Q: Is the penalty always 50% of missed deferrals?

A: No. 50% is actually a corrective contribution requirement rather than a penalty. The 50% QNEC amount is dictated by the IRS in Rev. Proc. 2013-12, where the IRS explains the corrections options and suggests correction methodologies for certain common errors, such as the missed deferral opportunity.

Delinquent Deposits

Hypothetical Case Study: Facts


- Company A's pay periods
 - Employees paid every other Friday
 - Participant deferrals each pay period: \$25,000
 - Participant deferral contributions reasonably can be segregated from Company A's general assets by 10 business days following each pay day
- Pay period ending March 6, 2012
 - Company A should have remitted participant deferral contributions by March 20, 2012 (the Loss Date)
 - Date remitted: May 18, 2012 (the Recovery Date)
- In 2014, the plan sponsor discovers it made a late payment in 2012
- The plan sponsor decides to use the DOL Voluntary Fiduciary Corrections Program to correct the late payments

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DOL Audit Hot Buttons

Fiduciary Breaches


- Failing to
 - Operate the plan prudently and for the exclusive benefit of participants
 - Properly value plan assets or to hold plan assets in trust
 - Follow the terms of the plan
 - Properly select and monitor service providers
- Using plan assets to benefit
 - The plan administrator
 - The plan sponsor



Delinquent Deposits

Hypothetical Case Study: Correction

- Determine the corrective contribution amount (use DOL VFCP Online Calculator)
 - Lost earnings on the principal amount
 - Interest on lost earnings
- Data for Online Calculator
 - Principal Amount: \$25,000
 - Loss Date: March 20, 2012
 - Recovery Date: May 18, 2012
 - Final Payment Date: March 14, 2014
- Online Calculator repayment amount: \$127.99
 - Administration costs (service fees for calculation and allocation)



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