

THE SPARK INSTITUTE

COMPLIANCE ALERT



IRS 401(k) COMPLIANCE CHECK PROJECT

Introduction

The Internal Revenue Service (“IRS”) recently initiated a 401(k) Compliance Check Project by contacting a random sample of 1,200 employers to have them complete a detailed online questionnaire providing information about their 401(k) plans. The SPARK Institute, working with its members, has reviewed the questionnaire and is concerned that many of the questions and the available responses could have significant implications for plan sponsors and result in an audit or enforcement action. Accordingly, therefore, it is critical that plan sponsors fully understand the implications of the questionnaire and the potential consequences of their responses. Plan sponsors should be sure that their responses are complete and accurate to avoid triggering a costly enforcement action.

Following is a summary of compliance issues related to specific questions to help plan sponsors fully understand the questionnaire and to respond accurately.

Plan Compliance Implications and Consequences

The letter to plan sponsors about the questionnaire states that its purpose is “to determine (1) potential compliance issues, (2) any plan operational issues, and (3) additional education and outreach guidance that may be helpful for the IRS to provide to plan sponsors to improve compliance.” However, the FAQ provided by the IRS also states that “a compliance check is an enforcement action.” (Emphasis added.)

Plan Sponsors should note that many of the questions, particularly the multiple choice questions, include answers that are unacceptable under the law. An otherwise legally unacceptable choice should only be selected if it is the factually correct response for the plan. Plan sponsors should also ensure that such legally unacceptable choices are not inadvertently considered as acceptable ways of operating their plans in the future. Additionally, certain questions related to similar issues appear in different sections of the questionnaire so plan sponsors should be aware of the relationship between these questions and the importance of coordinating their responses.

The following questions should be reviewed carefully by plan sponsors for their compliance implications.

Questions 1b and 3b – Both of these questions ask the plan sponsor to identify the type of plan they sponsor yet Question 1b offers the option “profit-sharing plan” but does not specifically reference 401(k) plans, which are considered profit sharing plans. Question 3b, however, specifically mentions 401(k) plans, which is correct.

Question 23e – dealing with posting a safe harbor 401(k) plan notice includes the responses “posted on website” and “posted in workplace” either of which by itself will raise a compliance defect.

Question 25f – dealing with the number of loans outstanding and the amounts involved includes an option for loans of “more than \$50,000” which will raise compliance defect concerns.

Question 25g – dealing with the maximum period allowed to repay a primary residence loan includes a response of “no limit” which will raise a compliance defect.

Question 25k – dealing with the interest rate charged on participant loans includes multiple answers that may not be acceptable under the Department of Labor’s “reasonable commercial rate” standard and could raise a compliance defect.

Question 28f – dealing with the suspension of contributions after a hardship instructs an employer to enter “0” if there is no restriction, which will raise a compliance defect concern for plans that follow the safe harbor needs test for hardships.

Question 30b – dealing with cashing out terminated participants includes only one correct choice, i.e., “\$1,000.” Any other answer will result in compliance defect concerns.

Plan sponsors should note that many of the questions, particularly the multiple choice questions, include answers that are unacceptable under the law.

Question 48 – dealing with the adoption of an automatic contribution arrangement. If a plan was designated as a QACA, then the best answer under this question appears to be the fifth option, i.e., “only participants with no affirmative deferral election in place,” because a QACA must apply to any participant as of the effective date of the arrangement who does not have an affirmative deferral election in effect, as well as any future participant who fails to make an affirmative deferral election. In order to properly answer the question, a plan sponsor must fully understand the regulations and understand the meaning of an “affirmative election.” Absent an affirmative election, the first two answers available under the question (i.e., “all employees who were participants on the effective date of the automatic contribution arrangement” and “only employees who become participants after the automatic contribution arrangement was effective”) may appear to be correct responses. However, it is our understanding that they are not and that the fifth response is the best choice. Plan sponsors may be confused by this question, which may result in compliance defect concerns.

Question 49b – dealing with the automatic contribution arrangement notice includes the responses “posted on website” and “posted in workplace” either of which by itself will raise a compliance defect.

Certain Yes/No Questions - Several yes/no questions may raise significant compliance issues for plan sponsors. These include questions 18b (minimum contributions for top-heavy plans), 19g (corrective contributions for failed ADP tests), 20a (asking whether the plan is subject to ACP testing; Question 15a asks if the plan offers a match), 27 (1099-R for a defaulted loan), 28e (dealing with obtaining maximum amount of loans before a hardship), 31b (procedures for 402(g) limit monitoring), 33 (1099-R for distributions), 41 (use of rollovers to purchase employer stock or a franchise) and 49d (automatic enrollment deferral rate changes).

Conclusion

Plan sponsors should be aware that many of the choices under certain questions are unacceptable ways to operate a plan and will require corrective measures. Plan sponsors must provide complete and accurate responses but should also fully understand the nature of the questions, their responses and the implications of self disclosing a compliance defect in their plans. If you have been notified by the IRS to complete the Compliance Check Questionnaire and are concerned about your responses to any of the questions identified in this Alert you should contact your legal counsel because of the potential legal consequences that may result.

The SPARK Institute has notified the IRS of several issues and concerns regarding this project. We have also urged the IRS to provide more time to plan sponsors to respond to the questionnaire and have urged them to make their decision publicly known.

About The SPARK Institute

The SPARK Institute represents the interests of a broad based cross section of retirement plan service providers and investment managers, including record keepers, banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. Members include most of the largest firms that provide record keeping services to employer-sponsored retirement plans, ranging from one participant programs to plans that cover tens of thousands of employees. The combined membership services more than 62 million employer-sponsored plan participants.

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