Transcript for 401(k)

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Moderator: Welcome to the 401(k) EP Phone Forum. At this time all participants are in a listen-only mode. As a reminder, today's conference is being recorded.I would now like to turn the conference over to your host, Mr. Mark O'Donnell.

M. O'Donnell: Hello, everyone. I'm Mark O'Donnell, Director of Customer Education and Outreach for IRS Employee Plans. Welcome to our 401(k) EP Phone Forum. Today our speakers are Monika Templeman, Director of Employee Plans Examinations; Janice Gore, Area Manager of Employees Plans Examinations in the Great Lakes area; and Roger Kuehnle, Senior Tax Law Specialist in EP Technical Guidance and Quality Assurance.

I'd like to point out a couple of things before we start. Everyone registered for this forum will receive a certificate of completion by e-mail approximately one week after the forum. You must attend the entire live forum to receive a certificate. Enrolled agents and enrolled retirement planned agents are entitled to Continuing Professional Education credit for this session. Other types of tax professionals should consult their licensing organization to see if this session qualifies for Continuing Professional or Educational credit.

You can find detailed information on 401(k) plan on our retirement plans Website at www.irs.gov/ep, that's employee plans. You can also get there by going to the main IRS Web page and clicking on Retirement Plans Community tab at the top. Look to the left hand navigation bar, click on Types of Plans, then select 401(k) Plans.

You also might want to subscribe to one of our free electronic newsletters. The link for newsletters is in the left hand navigation bar. We have two newsletters: the *Retirement News for Employers* for small employers sponsoring retirement plans, and the *Employee Plans News* for retirement plans professionals.

So without further ado here are our speakers, Monica, Janice, and Roger.

M. Templeman: Thank you very much, and it's a pleasure to be with you. I'm Monika Templeman. I'm going to be starting with the slide you'll see as slide number two. I'm going to be talking a little bit about the 401(k) operating priority that we have.

Looking at compliance in 401(k) plans really continues to be a key operating priority for us, and it will be in this fiscal year we just started in October, which is fiscal year 2011. As you may be

aware, 401(k) plans are our fastest growing market segment. Therefore they have a really huge impact on the health of the private retirement system in America.

The 401(k) questionnaire compliance check project that our Employee Plans Compliance Units, better known as EPCU, is responsible for administering was developed by an EP wide team to look at compliance issues in 401(k) plans. What's very unique about this particular questionnaire is that it is an electronic compliance check. We'll talk a little bit more about that.

The health of the 401(k) plan universe is of huge concern to us. This particular vehicle is one of the ways that we're going to be able to work with our stakeholders to better ensure the health of our 401(k) retirement plans. We think approximately half of the one million plus plans out there are in the (k) arena. What's also particularly disturbing is that we do have a huge coverage gap in America today, and for those who have a plan in retirement it's likely to be a (k) plan. So we really have to be looking at how we can be proactive in working with the benefits community to ensure that these plans are really what they're intended to be, true retirement vehicles that are qualified and at the end of the day will reap retirement benefits. That is sort of the premise of what we're doing going forward with the compliance questionnaire.

Some of the strategies for that operating priority I talked about for our FY 2011 strategies are after we get the responses back maybe not only analyzing the compliance issues, but the disconnect where there is confusion and where we need to work to clarify what the rules are and how better to comply. We'll talk about this later, but we're also going to prepare this fiscal year an interim report that will be for the benefits community as a whole so that you'll have a generic snapshot of the type of information we're seeing. Then the education and outreach needs and where we need to provide more soft and hard guidance and where our compliance programs can be more effective. That's kind of just a snapshot look at what the operating priority is.

Now let me direct you to slide number three. That's focusing on the compliance questionnaire itself and what I consider good news about it. For what we termed the lucky 1,200, which is how many questionnaires were sent out and the plan sponsors who received them. The reason we're saying it's good news and lucky 1,200 is that this is not an audit. It is a compliance check, which means that for those who received it, while we required response, it did not in any way preclude or does not preclude the use of our Voluntary Compliance Systems, our Employee Plans Compliance Resolution Systems, including, where feasible, self-correction. So self-correction and Voluntary Compliance are completely an option when you see problems.

The very, very best thing you can do with this questionnaire, if you received it, is to use it as an internal audit tool so that you can take a look at the plans, see what might be a problem with them, and fix the mistakes before the service, if we ever are looking at your individual plans, would find those. To keep your plans qualified, because remember, the faster you find and fix a mistake the less costly it is to fix in addition to any ramifications for not fixing it.

Let's take a quick look at slide number four, and at that point in time Janice is going to tell you why the project exists.

J. Gore: The information gathered from this project is going to be analyzed to get a better understating of the 401(k) plans and the behaviors in those plans. We want to look at the Web based tools that we have provided over the past few years, like the 401(k) checklist and the Fix-It Guide, and see if those tools have been working and see if there are improvements in some of the areas that we have found as problems in the past from our audit history.

So let's go to the next slide.

R. Kuehnle: I drew slide number five. As you can see, it's the front page of our checklist. I'd just like to bring your attention to some of the helpful items available on irs.gov, as Mark mentioned at the top of the hour. On irs.gov you can go the Retirement Plans Community section, there's a tab, or just type a topic in the search box and you'll pretty soon get to anything you could desire for 401(k) plans and other plans.

The main page of the checklist, which is slide five, just has the top ten items that we think most plans should be concerned about. If you hit the link in each of these items you'll be sent to a more detailed explanation of that item. I deal with 401(k) plans a lot since I got here in '87, and as Monika said they're the most common type of employer-sponsored plan. For that reason Congress is continually tinkering with them, and so they're getting harder and harder. There are more rules and grandfather rules, and it's very difficult to work with them over all these years.

I mean just from my perspective when we put out the guidance, or soft guidance as we call it, or we try to put it in terms that everybody could understand there is not common terms. 401(k) is about the only common term there is, and even that we call it CODA, Cash or Deferred Arrangement. Elective deferrals some people call them salary deferrals, employee contributions, salary reduction contributions. It can be very complicated; it's really difficult to understand reading a document that two or three terms may refer to the same item.

Fortunately, though, for employers that want a plain vanilla 401(k) with no bells or whistles there are many vendors out there that can offer a pre-approved document, like a prototype 401(k) plan, along with administration services for a reasonable price. If you want more exotic features the price increases, obviously.

If you want to turn to slide number six now this is the Fix-It Guide. It's similar to the checklist. It's a little more involved, a little more complicated, and has more items, 12 items are on the Fix-It Guide. It's a little more involved than the checklist. It's designed for plans that may have a problem or do have a problem, and it shows the various options for correcting the problem, usually through EPVCS, which is the Employee Plans Voluntary Compliance System. Then there are all sorts of acronyms: VCP, SCP, and all that.

If you go to the Website, there are checklists and Fix-It Guides are available for other kinds of plans, too: SEPs, Simples, and other plans that small employers may have. That's the end of slide six.

J. Gore: On to slide seven: About the 401(k) compliance check questionnaire. In May of this year the Employee Plans Compliance Unit, as Monika mentioned, sent out 1,200 letters to plan sponsors of all sizes asking them to complete our 401(k) compliance check questionnaire. The letter included instructions on how to go to a secure Website and enter the information electronically. The plan sponsors were given 90 days to complete the questionnaire, and if they had questions or needed assistance they also had the name and phone number of a person in EPCU to contact.

After 60 days those who had not already completed the questionnaire were sent a follow-up letter to remind them that the questionnaire would be due in approximately 30 days. Like Monika mentioned, the questionnaire is not an audit, but our letters did indicate that we would follow-up with those who did not provide the information requested.

So we're going to move on to slide eight.

M. Templeman: Now I alluded to this initially, but if you received the questionnaire you should have visited the EPCU Website. At that Web page you would be able to print a copy of the questionnaire and the glossary of terms. Just be aware that if you printed the copy, it would look a lot longer than it did in its electronic form. In the electronic form it was a lot more user friendly, but you would have the questions. Then you'd be able to read the frequently asked questions to get a better feel of this kind of a project, complete the questionnaire within 90 days from the date of the cover letter, and then you had a contact person. If you needed an extension you would be able to explain why and obtain an extension. If you needed clarification of anything those individuals, John Wright and Margaret Bisburgh, are available to answer your questions.

What if you didn't receive the questionnaire? I alluded to the fact on slide nine that this would be a wonderful internal audit tool. Well you can do the exact same thing. If you didn't get the questionnaire it is on the EPCU Web page. You can go ahead and print out that questionnaire, read the frequently asked questions, print out the glossary of terms as well so you're clear on what's being asked, and use it as a self-audit tool to be able to find and fix questions.

In conjunction with that Fix-It Guide that Roger pointed out, it is a really wonderful tool to make sure that you have internal controls in place, that if you have problems you service them quickly, that you can fix it using our self-correction process or Voluntary Compliance. It's a very non-Draconian way to get plans into compliance. Really that's the mutual goal that we have—to keep qualified plans qualified. I would really, really encourage anyone who did not receive the

questionnaire but is interested in what we are interested in, which is the overall compliance of your plan in areas that we feel might be problematic and you should take a look at, to use that questionnaire as a tool to keep your plan in compliance.

Let's take a quick look at the next slide, which would be slide number 10, which is basically a snapshot of the home page at irs.gov for the EP home page. You have the Retirement Plans Navigator, which is a really wonderful tool for being able to choose what you need in our product. You have your Fix-It Guide, which we talked about to find, fix, and avoid common mistakes. You have the Employee Plans Programs and Specialty Areas. What's very, very nice about our Web page is we list top problems in each of our market segment groups.

So if you want to see—and we'll talk about this a little bit on this phone forum as well—the kinds of errors and issues that we've been seeing in our audit or voluntary compliance dealings with 401(k) plans, or any other kind of plan that you may sponsor or belong to, that kind of information is available on our Website. We also have a site map that gives you the information by topic. So do check it out, and our Website address is www.irs.gov/ep and you can get into any of our wonderful features on that Web page.

We also value your feedback. I know Mark O'Donnell, who is our Director of Customer Education and Outreach, who opened our phone forum is always looking for feedback about how we can better serve you through our Website.

M. O'Donnell: That's right.

M. Templeman: I will now turn it over to Janice to talk about the questionnaire findings.

J. Gore: Slide 11: During the next year we will be analyzing the responses to the questionnaire and using the results to develop strategies to address any issues or trends identified in 401(k) plans. These strategies will include any needed enhancements to our Website tools, including the Fix-It Guide; improving our case selection process and incorporating any trends and potential issues identified; identifying where additional guidance is needed; and evaluating the need for improvements to the Employee Plans Compliance Resolution System, or our Revenue Procedure 2008-50. We'll be trying to do a lot of things with using the responses and the results of the questionnaire.

If you go to slide 12, we are going to be issuing a final report to share the information gathered from this questionnaire. As Monika mentioned, there will be an interim report towards the middle of this fiscal year. Then the final report will be posted to the Retirement Plans Community Web page early in fiscal '12, hopefully around October or November of next year.

I'm going to turn it over to Roger for slide 13.

R. Kuehnle: I'm here for slide 13. This just describes the 10 categories on the questionnaire, and it's divided into these 10 sections. The first is wrongly named demographics. It asks for basic plan information about the plan: its name, such as the kind of 401(k) plan it is. 401(k) is actually a feature of another basic type of plan, such as a profit sharing plan, a pre-ERISA money purchase, stock bonus, other kinds of plans like that. It asks for that sort of information, whether it's a pre-approved plan, like a prototype or a volume …, and whether the employer has other plans and what kind of plans they are.

Then section two, 401(k) participation, asks for demographic information such as the total number of employees that the employer has, the number covered under the plan, how many make deferrals, and how many get matches under the plan if the plan has matches. Most plans do actually have matches.

The section three asks for the dollar amount of elected deferrals and catch-ups and any conditions that are attached to getting matching contributions or non-elective contributions. Catch-ups, of course, are additional elective deferrals above the $16,500 level it is this year. An extra $5,500 can be made if you're age 50 or over by the end of your calendar year. Well I guess it's your tax year, so it's mostly your calendar year.

Section four is called top heavy and non-discrimination rules. Top-heavy rules are non-discrimination rules, really, and it looks at the top heavy where the plan is and what … contribution it makes because of it being top heavy, and also the ADP and ACP tests. They're the common test that applies to 401(k) plans with matching contributions. It stands for the Actual Deferral Percentage test and the Actual Contribution Percentage test. It just measures how much deferrals on average the non-highs make compared to the highs and how much matchings the non-highs get compared to the high, and the percentages can't be disproportionate by too much.

This section also looks at the correction methods used to pass the ADP and ACP tests. But it also notes that some of the 401(k) plans are not subject to top heavy or the ADP/ACP tests. That would include Simple 401(k), what are called Safe Harbor 401(k) plans, and new this year what we call DB(k) plans, which is the combination of a 401(k) plan and a Defined Benefit plan. You could have had them in place as of the beginning of 2010, and as far as I know nobody has any yet.

Section five: Distributions and plan loans, explore the types of distributions that are available under the plan, such as hardship distributions, cash outs, various corrective distributions if you have access deferrals or access annual additions in the 415. Whether and to what extent plan loans are available to employees, and within the plan loans who gets them, how long it takes to pay back, and the interest rates charged, and that sort of thing to help us know what's going on out there. The information we find, of course, is if we find that nobody does a certain thing then

obviously Mark O'Donnell's department wouldn't be putting out a lot of outreach efforts in that area.

The next section other plan operations. It mainly focused on plan investments where losses have been sustained recently, if you're like me everybody has, but also whether there have been losses due to fraud, not just from market factors. Also this section looks at the extent employer stock is used as an investment for employees.

Section seven: Automatic contribution arrangements, is a bit of a new thing. They once were known as negative elections, but that term has fell out of favor now. There are different kinds of automatic contribution arrangements. They could always have been in plans, but now they're in the statute as well. The plan is now required to permit all these arrangements. I mean a lot do have them to encourage participation by a lot of non-highs. It's the inertia issue that it's too much work to fill out a deferral form, but if somebody does it for you then it's too much work to cancel it. That's the theory behind these automatic contribution arrangements.

The next section designated Roth features. That's a fairly new feature. It tracks Roth IRAs, named after Senator Roth who is no longer with us. But they're expanding a lot lately, I think they're called front-loaded IRAs in 401(k) because you pay the tax up front and if you get a qualified distribution from either a Roth IRA or a designated Roth account in a 401(k) or 403(b) plan there is no tax on the earnings or the contributions that you put in. So they're becoming more popular nowadays.

The next section IRS Voluntary Compliance Programs: It seeks to gauge employer's familiarity with EPCRS and the Fix-It Guide, and it also asks for comments on ways that you think could improve our products.

The final section asks who administers the plan and who is responsible for updating it. That's the end of slide 13.

M. Templeman: We're going to go to slide 14, which is going to talk about the beginning of the first five of the top ten 401(k) errors. Primarily what we're seeing when we're looking at plans through the examination process, but we also see these same errors when people come in through our Voluntary Compliance Programwhere they find an error and come in to fix it through EPCRS, our Employee Plans Compliance Resolution System.

Let me backtrack for a second to comment on something that Roger mentioned. When he was talking about features on the questionnaire, like the designated Roth features, those are pop-up sections on the questionnaire, so if you received the questionnaire and didn't have a Roth it wouldn't pop up. If it's Safe Harbor if it didn't apply it wouldn't pop up. So one of the things we did in the questionnaire design was not everybody had to answer all questions. We only made those things applicable to your plan.

I just wanted to clarify that. But if you're using it, haven't received the questionnaire and are using it as an internal audit control tool, look at all the sections because that will help. Those that are applicable to your plan definitely you should make sure that you have issues that are resolved if you find errors.

So let's now look at the kind of errors that we are seeing. The most prevalent error that we see pretty much across plans, but we definitely see it in 401(k) plans, are document failures. Document failures are plans primarily that have not been timely amended to comply with all the laws prior to the plan or a plan merger could happen. You could have form defects, such as lack of required amendments or executed amendments. There are a host of things that can go wrong, but let me spend a little bit of time on this since document failures are such a big issue and really can cause you a tremendous amount of problems in the qualification of the plan.

What we're seeing that's very prevalent is, aside from plans not being timely updated, and you know the rules changes constantly in the employee plans law and so things do not stay stagnant and the plans have to be updated for current law, but one of the problems we're also seeing are working copies in place that have never been signed. So you have a restated or an amended document, but that document hasn't really been executed, and if it hasn't been signed than it's not officially adopted. So that has been problematic.

In an audit situation if you need to prove up that an amendment has actually been adopted, aside from the executed document you will need to have some concrete proof; board minutes of the actual resolution to adopt the amendment and anything else you can do to prove that it was timely adopted. Knowing that you properly updated your plan is not always a simple process. Certain plans must be individually amended for each change, while others may have a prototype document that is amended.

But really one of the things that is a tip to maintain the plan is to maintain contact at least on a yearly basis with the company that sold the plan, this is for the plan sponsor. If the plan company sends the plan sponsor a set of amendments to formally adopt make certain that they are timely executed, that the documents are actually signed. Keep those signed and dated copies of the plan documents in any amendments for the records, because that is a requirement in order to have a qualified plan the form of the plan has to be correct and timely.

If the plan has applied for a determination letter, and that's to assure that the plan was in correct form, again you want to be able to maintain and keep all those copies. Keep your original plan documents, subsequent amendments and restatements, and all adoption agreements, any opinion letter or advisory letter from the IRS, determination letters issued, or board of director resolutions administered similar records related to the plan. So not only do you need to do this timely, but it's a very good idea to have some kind of concrete evidence that you've done that, because this could be very problematic if that issue is raised. So that is very important.

Now another problem that we are definitely seeing is the definition of compensation. That is something that we are really concerned about because not only is the incorrect definition of compensation for various purposes is an issue in about 50% plus of our examinations of plans. So having that problem where you have a wrong definition of compensation used for a specific purpose can really cause a lot of problems. We have issues with stock option exercises or early sales where stock purchase plans can result in W-2 income and income that may be incorrectly ignored in calculating your deferral percentages, and we were talking about the ADP test.

But one of the problems with definition of compensation, and as I mentioned there, that when it gets complicated and there are multiple definitions there could be definitions that may exclude bonuses, commissions, overtime, fringe benefits, and it could be included where sometimes they've been included, sometimes they've been excluded or vice versa, and the confusion really can cause a lot of problems. Also because the plan my use different definitions of compensation for different purposes it's really important that the proper definition is applied when dealing with deferrals and allocations.

So a plan's definition of compensation has to satisfy applicable rules for determining the amount of the contribution. The amount of compensation taken into account under the plan cannot exceed $245,000 in 2010 and is subject to cost of living adjustment for later years. So really very, very important that there is a good understanding, because this is something that we are seeing.

How to avoid the mistake is another issue I'd like to touch on quickly, and that is that you can perform an annual review of your plan's operation. One of the things you're going to hear from us a lot in a lot of our outreach is the importance of internal controls and vigilance in reviewing your plan and making sure that you find mistakes quickly. Again, the checklist and Fix-It Guide are wonderful tools to help you do that.

If you amend your plan document communicate those changes to everyone involved in the plan's operation. Make sure you properly train the persons in charge of determining compensation to understand the plan documents. For plan sponsors it's very important they know what their third-party administrators have agreed to provide and that they rely on that information. If possible, simplify that definition of compensation. When you use the same definition for multiple purposes it really simplifies things and helps to avoid errors. I just spent a little extra time on that because that is a prevalent problem, and the more complicated and the more number of definitions the more problematic we tend to see this issue.

Now failure to follow the plan's matching contribution provisions, failure to follow the terms of the plan document. Any failure to follow the terms of a plan is really problematic, because that's a qualification issue. Even if you're doing something more advantageous for employees in the plans … you can do still you have to follow the terms of the plan or you're not in compliance.

So very important to know what the plan says, follow the plan terms, and if you want to change those terms you need to amend them.

One of the most problematic areas we're seeing is failure to satisfy ADP/ACP testing or non-discrimination testing in 401(k) plans. Why I say it's problematic is we've put a lot of effort into outreach in this area, but we still see that that is an issue that people are grappling with. ADP/ACP testing some of the watch outs are watch out table practices, the right information needs to be sent to the plan administrator, correct plan compensation information, especially watch out for out-of-cycle checks, make sure you have a list of eligible employees who elected not to participate in the plan. Safe Harbor failures are also an issue in this arena.

Another thing for plan administrators to play very special attention to is prior year compensation, the attribution rules related to ownership when identifying 5% owners; TPAs need to assess ownership documents to identify those owners. Take care to identify family members of owners, as well as any different names. Also review the rules and definitions in the plan documents. ADP/ACP testing is something that we have, really again, seen as an issue and calculation may be performed incorrectly if they're completed by a third party without employer oversight.

Sometimes electronic data may be faulty, so test failure can occur if a … is provided to a special group of participants or if you have electronic data failure, and sometimes it's systems problems that do create a problem overall. But you need to know if a company do they do coverage testing using the whole control group information, if you have a control group, and from where did they get that information, are all groups actually counted. Again, look at our Fix-It Guide because it has wonderful tips on how to avoid this problem and find, fix, and avoid it.

But for all of the issues we discussed today, and I'd like to make a real plug that you use the Fix-It Guide as a way to see not only how to find and fix the mistakes, but also avoid them in the first place. That's a great tool, and the questionnaire is a great tool for your internal look at your plan and how compliance looks like.

So Janice, why don't you do slide 15 for the other five errors we're looking at.

J. Gore: The next common error that we see is the failure to include all eligible employees. This really is a common error; we see it a lot. Usually there's a misunderstanding of the plan's definitions of eligibility and entry dates, and sometimes there are different requirements for deferrals, for non-elective contributions, or for matching contributions. It's common to find a plan that just keeps operating the same as the prior year, carrying over the prior year's provisions without really reviewing the plan document annually to verify that this is still the same, it's still the correct method, or whether the plan language has been amended. So again, like Monika mentioned, people are not really annually looking at the plan document just to make sure that everything is the same and hasn't been changed.

Also we find the part-time employees are often not considered for eligibility. The employer assumes that they're not eligible because they're part time. Those who choose not to make deferrals are often not included in the census information provided to the plan administrator. Although it's a really tedious process if all the employees are included and all the information is provided to the administrator, like hire dates, termination dates, hours worked, accurate compensation, and any other necessary information that would really reduce the risk of excluding eligible employees. If this type of error goes on for a couple of years it can be very costly to fix when you do realize that it has happened.

The next one is the failure to limit elective deferrals to the 402(g) limits. We really do see this occasionally, and it can be a costly error. Unless the participate is eligible for catch-up contributions the excess plus earnings over the 402(g) limit needs to be withdrawn by April 15th of the year following the year the excess occurred. If they're not timely returned they're subject to additional tax. They're taxed in the year that they're contributing to the plan and in the year distributed. So they're actually taxed twice. A good way to prevent this is to put some type of system in place in the payroll department to make sure that this limit is not exceeded, though you have to also be aware that the plan might have limits that are even less than those 402(g) limits based on the plan language.

Another error we're finding quite often is still the failure to timely deposit elective deferrals. The late deposits are sometimes because of a misunderstanding about the timing requirements. The DoL rules require the employer to make the payment to the plan on the earliest date that the employer can segregate the amount from the employer's general assets with the maximum deadline of the 15th business day of the month following. For plans with less than 100 participants the DoL proposed a seven-business day Safe Harbor rule for contributions back in February of 2008, and it was finalized in January of this year. So that gives them a more solid rule to follow.

Keep in mind if the plan contains specific language stating that the deposits will be made on a certain date, for instance. There aren't a lot of them that do this but we do find them where they'll say it will be deposited weekly with payroll, then the plan would need to be operating that way or it wouldn't be following the terms of the plan. However that error could be corrected under EPCRS.

The next item is the failure to follow the plan's loan provisions and violation of 72P. It seems like every time we go out on an audit that has loans if there are a lot of loans there are going to be problems. Some of the errors we find are loans in excess of the $50,000 maximum.

Another thing we find is the treatment of outstanding loan balances when a participant terminates employment and the account balance is distributed. We also find plan documents that actually specify a limit to the number of loans that a participant can have, for instance they might say no more than three outstanding loans at one time, and the agent will find loans to participants in

violation of these provisions. We also see loans with terms longer than five years and the loan is found not to be for the purchase of a primary residence. We have found that plans allow loans to their participants, but the plan document does not allow loans in its language, and that also can be a retroactive amendment under EPCRS.

The last one is the failure to follow the plan's terms regarding hardship distributions. We do find a lot of errors regarding the application of the hardship rules. There should be some procedures in place to follow to review the hardship applications. Many plans are allowing participants to apply for a hardship electronically, and the participant may not understand the rules.

A distribution should only be made on account of immediate and heavy financial need and should only be for the amount necessary to satisfy that need. It can't be treated as necessary to satisfy an immediate and heavy need if it is in excess of the amount needed or if it can be satisfied from other sources that are reasonably available. Also records should be kept of all the information used to determine the eligibility for the hardship for the participants. We often find that hardship distributions are made to participants where the plan will allow for loans and the participant does not have a loan outstanding, so the financial need could have been satisfied by a loan rather than a hardship.

Again, like with loans, we find plans that do not allow for hardships that are allowing hardship distributions. So this again can be corrected by a retroactive amendment, actually under SCP under our …, and then they would amend the plan to allow for a hardship distributions.

So that concludes the 10 most common errors that we're finding on examination. The next slide is slide number 16. It's just a reminder of the internal controls and how important they are to make sure that your plan is in compliance. Using this compliance check questionnaire as a tool is a really good suggestion, especially right now since a lot of the information we gather from this questionnaire will be used to define some of our projects and enforcement activities during the next years.

M. Templeman: Janice, I was going to add two additional failures that we're seeing in 401(k) arena, and I will do that. Then, as Janice said, the self audit tool we can't stress that enough because it really is a very, very important way of keeping your plan in compliance and making sure that if you find a mistake you find it very quickly so that you do not end up with a situation where you have a compounded problem because you did not fix a mistake and then it becomes extremely costly to fix.

Then, of course, if we come and do visit you with an examination and you haven't fixed it what Janice was talking about, SCP, is the Self Correction Program. That program allows you to find an error, you have to have practices and procedures in place, and then you fix it and you don't have to report to the service or pay a fee. The Voluntary Compliance is a set compliance fee that

is very, very reasonable. We try to keep the qualified plans qualified, but if it's an examination situation … agreement is much more expensive. So being proactive really, really helps.

Failure to satisfy limits of IRC 415 is another issue that we're seeing across plans. Small companies with highly compensated individuals one of the problems there is not counting contributions to all related defined contribution plans. Sometimes someone has multiple plans, you can have a (k) plan, be in another plan, and you can have a problem with the limits of contribution. We're also seeing problems with controls groups in this area or excess deductions taken, exceeding 415 limits from participants that are participating in plans with more than one employer or the employer is making annual additions to multiple plans and exceeding, as Janice said, the 402(g) limits when participants are participating in more than one plan that offers elective deferrals. So that is another problem.

We're also seeing with employers some issues on partial terminations. Participants affected by the portion of the plan that undergoes the partial termination has the same rights as those during a regular termination, which means that they have a right to be fully vested. That's one of the issues we're seeing as well. What's behind it we're not sure, but it is something that is in the top issue list.

At this point we are going to address some of the questions that were pre-submitted to us. I'm going to take the first two questions. Then Roger, who is our real technical expert in this arena, is going to be tackling other questions that have come in.

The two questions that I'm going to deal with the first one is, "Will the IRS be sending out an additional questionnaire or questionnaires, and if so who is the targeted recipients?"

Well while we can always do questionnaire projects, and the questionnaire project is a very good vehicle, we like the electronic questionnaire project particularly because it's less burdensome. We do not at this moment have a targeted questionnaire project that has been formulated.

The other follow-on question that we had in the same vein is, "Do you have a second set of this 401(k) questionnaire?"

That was not the game plan right now. Not that we couldn't do a follow-on, but right now the game plan is to take all the responses from the questionnaires, analyze them. We're working with our research and with Customer Education and Research and our Employee Plans Compliance Unit, and be able to have a better understanding of the issues that are problematic and where we need better outreach. How we can enhance our Fix It Guide? How we can better service you? How we can have more targeted guidance, both the soft guidance and whether we need to add anything to the guidance plans, and Voluntary Compliance? How we can enhance those processes, and our compliance and enforcement processes as well? When we see issues

and trends how do we deal with them. It validates some of what we're seeing whether we need to do some follow-on compliance projects through the EPCU.

So while I do not see for the next fiscal year necessarily an additional questionnaire I do see some compliance check projects in the EPCU that will spin off of things that we see, and things that we're already seeing that we're validating that we need to address. With the compliance checks it's the most user friendly way to address it, because remember we said if there's a compliance check and we send out a letter the plan sponsor is not under audit at that point in time, and self-correction and Voluntary Compliance are still very valuable options.

The follow-on question along with that was, "Have plans that responded to the questionnaire been audited as a result of those answers?"

The answer is no. Those who have not responded to the questionnaire or do not fully respond or provide answers will receive follow-up, which can include an audit and will include an audit if we don't get a response in a timely way or with extensions where warranted. But as far as responding to the questionnaire that helps us to look at issues we need to look at in compliance, but that is not a direct result of receiving the questionnaire.

The questionnaire: We really value that feedback. We're going to use it in a variety of ways, but it is a requirement to respond to it. If we don't get that response we will follow-up, including the audit process.

Those are the questions I wanted to deal with. I'm going to turn it now over to Roger to deal with other pre-submitted questions.

R. Kuehnle: This is me again. I'll keep going until either AT&T or Mark cut us off here. The first question, I'll read it verbatim, it's, "I would like to discuss whether the monies in a 401(k) plan can be rolled over to a Roth IRA via trustee-to-trustee transfer?"

The simple answer is yes. There has to be what we call a distributable event, and it has to be an eligible rollover distribution. For example, if we're talking about elective deferrals a distributable event can be severance from employment, age 59 ½, or hardship. An employer doesn't have to allow all of the statuary permissible distributable events, though, in its plan. It can pick and choose some, all, or none except until you quit, I guess.

For example, many don't allow post age 59 ½ in service distribution of elective deferrals. As for hardship distributions, although 401(k) does allow them, but they cannot be rolled over anyway to anything. Hardship distributions cannot be rolled over but not to an eligible rollover distribution.

So if you quit or are over 59 ½ in a plan that allows distributions then the plan must follow the direct rollover rules, which is under 4018-31 of the Code, and transfer the money in a direct trustee-to-trustee transfer to another plan or an IRA of your choosing. So it's pretty much required if you have a distribution from the plan, but they transfer it to the plan you choose or to an IRA you choose if you're that way inclined, including a Roth IRA.

The next question somebody asks about just talk briefly about Safe Harbor 401(k) plans. We could go on for hours about these plans, in fact I spent a lot of time on the regs for Safe Harbor plans. Briefly a Safe Harbor 401(k) plan is a term we coined, it's not in the Code, of course, to describe a plan that is deemed to pass the Actual Deferral Percentage, the ADP, and the Actual Contribution Percentage non-discrimination test. Again their abbreviations are ADP and ACP; we've used them earlier in this presentation.

But technically there are several kinds of 401(k) plans that could be called Safe Harbor plans, in other words plans that are deemed to pass the ADP and ACP test. For example, there are Simple 401(k) plans that have been around for a dozen or so years, and they're under 401(k) 11. They're not a big seller. I don't think many people have Simple 401(k) plans. They're different to the Simple IRA plans, which tens of thousands of people have.

The Qualified Automatic Contribution Arrangement, or QACA, that came out a couple of years ago, that's under 401(k) 13, that's also a Safe Harbor plan. And as I mentioned earlier, beginning this year Defined Benefit, or DB (k) plans, a combination of a Defined Benefit and a CODA, Cash Or Deferred Arrangement, under 414(x).

But generally most people think of a Safe Harbor 401(k) plan as the ones that are described in 401(k) 12. They're by far the most popular, and the reason is because they don't have the run the ADP test and the ACP test. The downside is that the employer must commit up front to making certain mandatory contributions—the matching contributions, the specified minimum under the statute, or at least a 3% non-elective contribution for everybody. This was must be made clear to the participants before the beginning of the year in a notice that has the requirements specified in the regs.

Most people, employers with a Safe Harbor plan, that do go the matching route, which means they're only on the hook if employees make elective deferrals. Obviously the highs make a lot of elective deferrals and may get the full match. The match is based on, actually, the first savings plan that the government has. It's dollar for dollar for the first 3% of compensation and then it's $0.50 on the dollar for the next 2% of compensation for a total of 4%. That can be a little bit hard to administer and explain to employees, so most plans just simplify this by giving a dollar for dollar match up to 4% of comp. These mandatory contributions, where if it's matching or non-elective, they have to be immediately vested and they're subject to the same distribution restrictions or similar distribution restrictions that apply to elective deferrals.

That's just a brief overview of Safe Harbor plans. As I said, they're very popular because they don't have to run the ADP/ACP tests.

Another question is, "Are the following reasons for a distribution from a 401(k) plan to be on account of hardship the only reasons?" The list is, "Number one, certain medical expenses; number two, costs relating to the purchase of a principal residence; three, tuition and related educational fees and expenses; four, payments necessary to prevent eviction from or foreclosure on a principal residence; five, burial or funeral expenses; and six, certain expenses for the repair of damage to the employee's principal residence."

The answer here is, as it is in many cases, look at the plan. These six items that I just mentioned, also known as deemed or Safe Harbor hardship reasons, mean that the plan administrator can see fairly easily if a hardship distribution should be made. They're provided in the regulations, they've been in the regulations since there have been 401(k) regulations, and they are there to make it easier for plan administrators and their employers who want to allow in-service distributions on account of hardship.

But also in the regs the plan is allowed to have a general distribution, or hardship distribution standards, whereby the plan administrator must make a case-by-case analysis to determine if a hardship is warranted. Obviously this is very costly and time consuming to a plan, so very, very few plans have the general business hardship standards. If fact, if you want a prototype plan it has to be the deemed standards, otherwise you don't get a letter.

So the bottom line is read the plan. If a plan allows general hardship standards you may be able to get one for reasons other than those six I mentioned, but most plans will have just those six I mentioned in there.

The question is, "My employer is replacing their profit sharing plan with a 401(k) plan. I am 73-years old. Do I qualify to participate?"

Well the answer is that a plan cannot exclude an employee based on age, so most likely if an employee is eligible for their profit sharing plan he or she will be eligible for the 401(k) plan. I mean that's not to say that the terms of the plan cannot be changed or the eligibility cannot be changed such that, for example, division A is only covered or division B is only covered.

But the fact of the question you're 73-years old perhaps they're thinking that they may have to start taking required minimum distributions, but that's not a barrier to participate in a plan. A lot of owners will keep working for themselves past the 70 ½ have a plan so the beginning of the year they put money in, at the end of the year they take it out, although they take out less, obviously, than they put in. But the bottom line is there's no reason that you wouldn't continue to participate in the plan and make deferrals if you want to.

We have a question on matching, and this comes up a lot. It says, "My employer matches my elective deferrals up to 6% of my salary." It says, "Because of the over 50 catch-up I have to max out early in the regular contributions," which as I said earlier is $16,500 for 2009/2010, "and then do my over 50 catch-up." Assuming the person is over 50, he can make an extra $5,500. However, this employee says, "The match stops when the catch-up starts. Because of this my employer only contributes 6% of my salary to the day my regular contributions stop and they do a reconciliation the following year and then put the remaining 6% of my salary in the 401(k). My HR department is now telling me that there is no IRS requirement to do this reconciliation and that they may stop it."

Well we often get this type of question, and in fact this is the way it happens in the Federal government's stretch savings plan. I've been caught in this trap, or nearly caught a couple of times, as in the Federal government's plan there is no true up; the deferrals are matched on a paycheck-by-paycheck basis. So if I stopped making deferrals before the last dollar was paid in the last paycheck some compensation will not be counted for calculating the match, so I could end up making more than whatever it is, 4% or 5% deferrals, and not get a matching 4% or 5% government contribution.

Anyway, in this employee's case he's deferring, based on the salary figures, 28% of his salary through October. That's a lot, but not that unusual. Then he makes catch-up contributions for the rest of the year, which are not matched, and the plan trues up after the end of the year.

The plan document controls, though. If it says the match is based on compensation for the entire plan year, even though it's contributed throughout the year, which is to the benefit of the employees actually, then a true up is required for employees making uneven deferrals throughout the year. To get the deduction for the year the employer must make the true up contribution by the due date of the extended tax return, September 15th, October 15th, whatever.

A plan may say, however, that the match is based on deferrals in compensation for each pay period and not compensation for the entire plan year. In that case no true up is required. In fact, many non-Safe Harbor plans, different rules apply for Safe Harbor plans, do not match catch-ups. The match generally is given by employers to encourage non-highs to make deferrals so they can pass the ADP test. But catch-up contributions are not counted in the ADP test, so technically there's no reason to match them; they don't care if employees make or don't make catch-up contributions. But it's definitely more difficult to administer, but it's certainly an option if the employer wants to do that they can do that.

The next one here is, "If a plan sponsor makes a contribution in error," this is an EPCRS question it looks like, "to a participant and he or she did not meet the eligibility requirements to achieve an employer contribution should the plan sponsor remove the contribution from the participants account? Also what is the DoL's view regarding the above question? Does the DoL follow the IRS, specifically Reg Part 2002-47? If the DoL audited the plan sponsor's retirement

plan it would the auditor request that the plan sponsor remove the access contribution from the participant's account?"

As I said, it's and EPCRS question, and I haven't been in this area since 1996. But I asked someone who is still in the area, and generally the amount contributed in error should be removed according to the procedures in the current EPCRS Reg Part, which is 2008-50. A retroactive amendment is available in certain circumstances, and is explained in the Reg Part 2008-50.

If the plan is under a DoL audit under the Reg Part that is not treated as under exam for EPCRS purposes. Usually if you're under exam you cannot come in voluntarily and you're foreclosed from using some of the self-correction procedures, or all of them. So the plan still has all the correction options in this case. But normally if the DoL sees a problem they refer the employer, tell the employer to go to the IRS for correction, and they will go along with our IRS procedures generally.

M. O'Donnell: Kathy, are we at time?

Moderator: Yes we are at time.

M. O'Donnell: Well let me close then. I hope everyone in the audience, thank you, Roger, Janice, and Monica, but I hope everyone in this audience found this phone forum helpful, and thanks for listening in. Good day.

Moderator: That does conclude our conference for today. We'd like to thank you for your participation and for using AT&T Teleconference Service. You may now disconnect.