



A Good Reason For Regular Compliance Audits

A recent Tax Court case* illustrates the need to keep abreast of changes in the law and to amend your plan accordingly. Failure to make sure your plan documents are in order and your plan is operating correctly could result in retroactive disqualification of the plan with harsh tax consequences.

The case involved a profit sharing plan that was not timely amended to comply with statutory changes. The plan had been inactive for a period of time, although it was not formally terminated. The IRS gave the plan sponsor the opportunity to correct the problems and pay a sanction. When the sponsor rejected the IRS's offer, the IRS retroactively revoked the plan's tax-exempt status.

In court, the plan sponsor essentially argued that the plan's inactivity rendered it terminated. But the Tax Court disagreed, noting that a formal termination requires that a termination date be set, that plan participant benefits be determined based on the termination date, and that all plan assets be distributed in accordance with the plan as soon as administratively feasible after the termination date. The court also rejected several other arguments made by the plan sponsor and upheld the IRS's retroactive disqualification of the plan. *(Continued on page 2)*

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Correcting Qualification Failures

The plan could have had a better outcome if it had taken advantage of plan correction opportunities offered by the IRS's Employee Plans Compliance Resolution System (EPCRS). The EPCRS allows employers to correct problems with their retirement plans that could cause plan disqualification.

Plan document failures result from a plan provision that violates IRS requirements or from the absence of a plan provision. In the case discussed, the failure to amend the plan to reflect a legislative change was a plan document failure.

Operational failures arise when a sponsor fails to follow plan provisions. For example, if you mistakenly exclude employees who are eligible for plan participation, that's considered an operational failure.

Demographic failures occur when non-discrimination provisions, minimum participation requirements, or minimum coverage requirements (other than operational failures) are not satisfied -- for example, where highly compensated employees are disproportionately favored.

The EPCRS Components

The EPCRS has three basic components.

The Self-Correction Program (SCP) allows the sponsor of an IRS-approved plan to identify and correct operational failures without notifying the IRS or paying any fee.

The Voluntary Correction Program (VCP) is for plan errors that are not eligible for self-correction, or it can be used if you want IRS assurance that the changes you've made to your plan are acceptable. You submit the corrections to the IRS and pay a compliance fee.

The Audit Closing Agreement Program (Audit CAP) is the opportunity the IRS offered to the plan in the Tax Court case. This program allows you to correct failures discovered when the plan or you (as the plan sponsor) are under examination by the IRS. Generally, under the Audit CAP, you would correct the failures, enter into a Closing Agreement with the IRS, and pay a sanction negotiated with the IRS.

* Christy & Swan Profit Sharing Plan v. Comm'r, TC Memo. 2011-62

"The EPCRS allows employers to correct problems . . . that could cause plan disqualification."

It's Form 5500 Time Again

Summer signals many things warmer weather, family vacation, and increased business activity for some "seasonal" businesses. It also means it's time again for sponsors of retirement plans with calendar-based plan years to file the annual Form 5500 return/report with the government.

Most retirement plans must file a Form 5500 and related schedules. These plans include 401(k) plans, profit sharing plans, and defined benefit plans, among others. A "one-participant" retirement plan may be able to use the simpler Form 5500-EZ. A plan may be considered a one-participant plan if it covers (1) only the owner of the business (or the owner and his or her spouse) or (2) only partners in a business partnership and their spouses. Certain other requirements also must be met. A few types of plans -- SIMPLE IRAs, most simplified employee pension (SEP) plans, and governmental pension plans, for example -- are exempted from filing.



Filing

Form 5500 and Form 5500-SF (Short Form Annual Return/Report of Small Employee Benefit Plan) and required schedules and attachments must be completed and filed electronically using EFAST2-approved third-party software or eFile, free filing software available on the U.S. Department of Labor's (DOL) website. Form 5500-EZ cannot be filed electronically. But some Form 5500-EZ filers may file Form 5500-SF electronically with EFAST2 rather than filing a paper copy of Form 5500-EZ with the IRS.

The deadline for filing the required forms and schedules is the last day of the seventh month after the plan year ends. Thus, for a calendar-year plan, the deadline generally is July 31. In 2011, however, July 31 is a Sunday, so the filing deadline is August 1, 2011. You can obtain an automatic 2½-month extension by filing Form 5588 (Application for Extension of Time to File Certain Employee Plan Returns) by the due date of Form 5500.

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Building a better future, together.

(Form 5500 Continued)

An incomplete filing or a filing received after the due date may result in a penalty unless you can show to the government's satisfaction that the failure was for reasonable cause. The penalties can be severe. For example, the DOL can charge a penalty of up to \$1,100 a day for each day the plan administrator fails or refuses to file a complete report. And the IRS can assess a penalty of \$25 a day (up to \$15,000).

Schedules

The instructions to Form 5500 give details about the pension benefit and financial schedules a retirement plan may have to file. Note that plans with fewer than 100 participants as of the beginning of the plan year are generally classified as small plans. The reporting requirements are somewhat simplified for a small plan.

Of note, for the 2009 plan year and later, Schedule SSA (Annual Registration Statement for Deferred Vested Participants) has been replaced with a standalone Form 8955-SSA (Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits). This form currently doesn't have to be filed electronically. However, the IRS has developed a voluntary electronic filing system for doing so.

Audited Financial Statements

Most retirement plans must include financial statements that have been examined by an independent qualified public accountant, along with the accountant's opinion concerning the statements, in their annual reports. Small plans that meet certain asset or bonding guidelines are exempted from this requirement.

Spruce Up Your Education Program

The reasons for providing employee education are pretty universal: increase plan participation, increase appreciation for the plan, and help participants invest their plan accounts. The best approach to educating different types of employees about planning and saving for retirement isn't so universal.

If your employee education program isn't as effective as you'd like it to be, why not reevaluate it and see what you can do to spruce it up? Here are some ideas.

Fine-tune Your Message

How you provide information should be tailored to specific employee groups. For example, rather than talking retirement to young, lower paid employees who are decades away from retirement, consider a broad-based financial education program. Help them see how they can afford to start saving for retirement and other financial goals.

A financial planning approach can work with other employee groups, too. A message for employees in their 30s and 40s might be how to contribute to your retirement plan while working toward competing financial goals. Employees nearing retirement want retirement-specific information. They may respond better to seminar and presentation speakers who are closer to their age rather than significantly younger. And, no matter what your message, keep it clear and simple.

Increase Access to Information

Also look at the ways you make information available to your employees. Targeted seminars and workshops with handouts can be particularly effective at reaching employees. However, some people prefer to investigate things on their own, and others like to find out more after attending a seminar or workshop. Internet access to educational information and planning tools can appeal to these employees' learning needs. Telephone help and additional printed materials may be needed, as well, if you have a significant group of employees who are not computer savvy.

“. . . consider a broad-based financial education program.”