



Workshop 12: 403(b) Update, Including Audit Activity

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Agenda

- IRS-Employee Plans 2016
- Importance of Internal Controls
- Common Audit Issues
- Revised 403(b) LRM
- Current Legislation & Court Cases
- IRS Resources on Audits



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IRS-Employee Plans-2016

- Employee Plans Exam Workplan
- IRC 403(b) Plans Workplan



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IRS-Employee Plans-403(b) Plans

- ACT Report – 403(b) Plans
 - Focused on four areas
 - Universal Availability
 - Orphan Contracts
 - Terminating a 403(b) Plan
 - EPCRS



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IRS-Employee Plans-403(b) Plans

- ACT Report – 403(b) Plans
 - General recommendations
 - Update/Improve current web-based tools
 - More outreach opportunities for sponsors
 - Formal or soft guidance
 - New legislation
 - EPCRS changes



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IRS-Employee Plans-403(b) Plans

- Exam – Document Request Consistency
 - ACT requested we look at our Information Document Requests (IDRs)
 - 403(b) Compliance Planning Group project



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IRS-Employee Plans-403(b) Plans

- Recent EPCU Project Findings
 - Universal availability still an issue
 - The larger the plan, the fewer issues
 - Top issues in small & medium plans include
 - Communications to begin/change deferrals
 - Conditioned eligibility
 - Exclusion of part-time employees



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IRS Tools

- 403(b) Page – Includes sections on
 - Establishing
 - Participating
 - Operating
 - Maintaining
 - Correcting
 - 403(b) Fix-It Guide
 - Terminating



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403(b) Plan Fix-It Guide



Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
1) Your organization isn't eligible to sponsor a 403(b) plan. (More)	Determine if your organization fits one of the eligible employer groups - public educational institutions or IRC Section 501(c)(3) charitable organizations.	Stop all contributions. Make a submission under the Voluntary Correction Program.	Understand what makes an organization eligible to sponsor a 403(b) plan and know if your organization meets one of the requirements.
2) You didn't adopt a written plan intended to satisfy the law by December 31, 2009. (More)	Check your records to see if your organization adopted a written plan intended to satisfy the final 403(b) regulations by December 31, 2009.	Put the plan operations into a written plan that complies with the final 403(b) regulations and adopt it. Make a submission under the Voluntary Correction Program.	Make sure that your 403(b) plan is in writing.



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Audit Process & Internal Controls



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Audit Process Overview

- Initial phone call
- Follow-up letter
- Information Document Request (IDR)
- Interviews
- IRS reviews IDR responses
- Discuss issues
- Closing conference
- Closing letter



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Review of Internal Controls

- Key in the IRS deciding whether to expand an audit
- If weak then the IRS must do more testing to validate operation matches the plan
- Key internal control areas:
 - Eligibility/Discrimination
 - Contributions/Limitations
 - Vesting
 - Distributions
 - Reconciliations with the vendor and or Third Party Administrator



Common 403(b) Audit Issues



Plan Document - Errors

- Failure to follow written plan
 - Problem for all plans
- 403(b) – Failure to comply with Notice 2009-3
- 403(b) of Churches & QCCO do not have written plan requirement unless they are a 403(b)(9) retirement income account (RIA)



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Written Plan – Typical Errors that Result in Failure to Follow Plan

- Payroll/HR system not matched to the document requirements
- Document is changed and no longer matches operations
 - Is there a system in place to monitor plan changes and compare to operation?
- Misunderstanding of document provision



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403(b) Discrimination – Elective Deferral Errors

- Universal Availability - Allows all employees to make deferrals unless they are excludable (does not apply to Church & QCCO)
- Exclusions:
 - If yearly SRA \leq \$200
 - Employees eligible under other deferral plans
 - Non-resident aliens
 - Students – IRC 3121(b)(10)
 - Normally work less than 20 hours per week (new 1000 hour rule in regulations)
- Each year must give effective opportunity notice



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403(b) Discrimination – Non-Elective Contribution Errors

- Failure to perform discrimination testing or errors in test data – 403(b)(12)(A)(i)
- Requirements:
 - IRC 401(a)(4) – nondiscrimination
 - IRC 401(a)(5) – permitted disparity
 - IRC 401(a)(17) – compensation limits
 - IRC 401(a)(26) – minimum participation
 - IRC 401(m) – ACP
 - IRC 410(b) – minimum coverage requirements
- Keep your testing documentation
- Church & QCCO are exempt from IRC 403(b)(12)(A)(i)



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403(b) – Contribution Errors

- Using wrong definition of compensation
- Limitation – Elective deferrals
 - Exceeding the basic limit \$18,000 – 2015
 - Improper 15 YOS catch-up
 - Ordering rule with age 50 catch-up
 - Calculation of YOS
 - Excess results in employee being taxed twice
- Limitation – IRC 415(c)
 - Plan aggregation
 - Treatment of excess



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403(b) – Contribution Errors (cont.)

- 5 year post-severance contribution
 - If using must be in the written plan
 - Must not be elective
 - If elective the problems are compounded
 - Watch treatment of vacation & sick leave
 - What happens if employee dies?
 - Watch IRC 415 limits
 - Limitation year is the calendar year for most individuals



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Other 403(b) Errors

- Timely deposit of employee contributions
- Plan loans
 - Written plan vs. contracts
 - Default/limits/aggregation/who monitors
- Hardship Distribution
- Transfers
- Distribution



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457(b) – Common Operational Problems

- No discrimination standards – “follow your plan”
- Excess annual deferrals
 - Special catch-up
- Timely deferral election
- Loans
- Unforeseeable emergency distribution
- Failure to pay FICA taxes on contributions



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457(f) – Common Problems

- Employment contracts
- 457(f) generally taxes before IRC 409A
- Inadequate substantial risk of forfeiture
- Failure to recognize a 457(f) plan
- Loss of 457(b) status
- Improper reporting of taxes



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403(b) – EPCRS Correction of Errors

- Self-Correction Program (SCP)
 - Still an option under an IRS audit
- Voluntary Correction Program
 - Not an option if under audit
- Audit CAP - if under audit and not SCP
 - Negotiated closing agreement



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457(b) – Correcting Errors

- EPCRS does not apply to 457(b) plans
 - Section 4.09 of RP 2013-12
 - Consider these requests on a provisional basis outside of EPCRS
 - No submissions that involve the form of the written 457(b) plan
- Tax-exempt 457(b) has no correction options
 - Treated as 457(f)
- IRS may do a directors closing agreement
 - Voluntary or Audit Closing Agreement
 - Much larger sanction



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457(f) – Resolving Issues

- EPCRS does not apply to 457(f) arrangements
- Not eligible for voluntary closing agreement
- Governmental and tax-exempt 457(f) arrangements receive same treatment
- IRS auditor will determine the timely reporting of:
 - Income taxation to the participant
 - Employment tax reporting by the employer



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LRM Struggles for Employers & Submitters



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LRM 17 - Participant

- LRM 17: Allows exclusion for 457(b) only for a governmental 457(b)
- Issue: The LRM is consistent with the language in Treas. Reg. 1.403(b)-5(b)(4)(ii)(A). However, this language appears to be inconsistent with the statute and previous verbal guidance from treasury stated that the statute controlled.
 - Example – The regulations require that amounts be deferred at the election of the employee. The statute only requires that the employee be a participant.
- It appears that the fact NQCCO can have a broad based 457(b) was ignored



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LRM 23

- LRM 23: “Retirement Income Account” is defined as a “defined contribution program established or maintained by a church, or a convention or association of churches, including an organization described in section 414(e)(3)(A)... to provide benefits under section 403(b) ... for its Employees or their Beneficiaries as described in section 1.403(b)-9 of the Treasury Regulations.”
- Issue: This definition is inconsistent with the statute and restricts the types of employees that may participate in a Retirement Income Account



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LRM 29

- LRM 29: The Note states that “A plan may allow for reasonable administrative procedures for plan entry” which delay the effective date of an election to participate by up to 60 days
- Issue: Many entities currently use a probationary period (consistent with other benefits) of up to 90 days, based on previous oral guidance from the IRS



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LRM 38 – New Annual Notice

- There is no requirement for this notice under IRC or the regulations for the language
- Issue: Appears to create an operational violation if the plan has this requirement and does not issue the notice even if there is no violation



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LRM 66

- LRM 66: Only governmental and QCCO employers allowed to reference collective bargaining agreement
- Issue: Tax-exempt employers, in addition to governmental and church employers, should also be able to cross-reference to the requirements of a collective bargaining agreement regarding contributions



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Current Legislation & Court Cases



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Senator Hatch's SAFE Act

- Secure Annuities for Employee Retirement Act of 2013
(<https://www.congress.gov/113/bills/s1270/BILLS-113s1270is.pdf>)
- Introduced by Senator Orrin Hatch (R – UT) in July 2013
 - May 2015 – Sen. Hatch intends to reintroduce the bill
- Terminating 403(b) Plans
 - If a 403(b) plan has custodial accounts, those accounts are deemed to be an individual retirement plan (including Roth, if the 403(b) plan had Roth)
 - The custodial accounts would be “distributed” from the 403(b) plan due to the termination



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Senator Hatch's SAFE Act

- EPCRS shall be updated to include government-sponsored 457(b) plans
- Amounts invested in a “lifetime income investment” in a 403(b) plan or government-sponsored 457(b) plan can be distributed no earlier than 90 days before the date a “lifetime income investment” will no longer be held as an investment option in the plan
 - Must be made as a “qualified distribution” or a “qualified plan distribution annuity contract”



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Senator Hatch's SAFE Act

- A “lifetime income investment” means an investment option that is designed to provide an employee with election rights
 - That are not uniformly available to other investment options in the plan; and
 - That apply to a lifetime income feature offered under the plan
- A “lifetime income feature” means
 - A feature that guarantees a minimum level of income at least annually for at least the remainder of the life of the employee or joint lives of the employee and his/her beneficiary
 - An annuity payable on behalf of the employee under which payments are made in substantially equal periodic payments (at least annually) over the life of the employee or the joint lives of the employee and his/her beneficiary



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Senator Hatch's SAFE Act

- A “qualified distribution” means a direct trustee-to-trustee transfer to an eligible retirement plan
- A “qualified plan distribution annuity contract” means an annuity contract purchased for a participant and distributed to the participant by the plan



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US vs. Windsor

- Issued June 26, 2013
- Held that section 3 of DOMA is unconstitutional
- Consequences:
 - For all federal tax purposes, all marriages are marriages
 - States can still exclude same-gender marriages and do not have to recognize same-gender marriages from other states
 - 403(b) plans must generally recognize all marriages no later than September 16, 2013
 - Exceptions (other than rollovers by spouses):
 - Non-electing church plans
 - Government plans in states that do not recognize same-gender marriages



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Obergefell vs. Hodges

- Issued June 26, 2015
- Held that all states must permit same-gender couples to marry and must recognize same-gender marriages from other states
- Consequences:
 - Non-electing church plans can still exclude same-gender spouses from benefits (other than rollovers by spouses)
 - All other plans, including government plans, must recognize all marriages



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IRS Resources on Audits



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IRS Audit Resources

- Audit Guidelines
 - <http://www.irs.gov/Retirement-Plans/EP-Examination-Guidelines>
- Audit Process Guide
 - <http://www.irs.gov/Retirement-Plans/EP-Examination-Process-Guide>
- Employee Plans Compliance Unit (EPCU)
 - [http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-\(EPCU\)](http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-(EPCU))



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IRS Audit Resources (cont.)

- Correcting Plan Errors
 - <http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors>
 - Above link has fix-it guides
- Internal Controls
 - <http://www.irs.gov/Retirement-Plans/Policies,-Procedures-and-Internal-Controls-Self-Audit>
 - [http://www.irs.gov/Retirement-Plans/EP-Team-Audit-\(EPTA\)-Program-Internal-Control-Questionnaire](http://www.irs.gov/Retirement-Plans/EP-Team-Audit-(EPTA)-Program-Internal-Control-Questionnaire)



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IRS Audit Resources (cont.)

- 403(b) Plans
 - [http://www.irs.gov/Retirement-Plans/IRC-403\(b\)-Tax-Sheltered-Annuity-Plans](http://www.irs.gov/Retirement-Plans/IRC-403(b)-Tax-Sheltered-Annuity-Plans)
- 457(b) Plans
 - [http://www.irs.gov/Retirement-Plans/IRC-457\(b\)-Deferred-Compensation-Plans](http://www.irs.gov/Retirement-Plans/IRC-457(b)-Deferred-Compensation-Plans)
- 403(b) Pre-Approved Program
 - [http://www.irs.gov/Retirement-Plans/403\(b\)-Pre-Approved-Plans](http://www.irs.gov/Retirement-Plans/403(b)-Pre-Approved-Plans)



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Questions



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