### IRS QUESTIONS AND ANSWERS - DEFINED CONTRIBUTION PLANS - 2014

**The Q&A committee solicits, screens and submits questions from ASPPA members to various government agency panels as part of the ASPPA Annual Conference and other ASPPA conferences. Members of the Q&A subcommittee generally meet with the government agency panels to screen and preview the submitted questions.**

The answers reflect the ASPPA representatives' interpretation of the IRS officials' responses, and are not direct quotes. They are intended to reflect as accurately as possible the statements made by the government representatives.

*This material does not represent the official position of the Internal Revenue Service, the Treasury Department, or any other government agency.*

<table>
<thead>
<tr>
<th>2014 Q#</th>
<th>Topic</th>
<th>Subtopic</th>
<th>Question</th>
<th>Proposed Answer</th>
<th>IRS Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Safe harbor 401(k) plan</td>
<td>Definition of compensation</td>
<td>It is discovered in early 2014 that the definition of compensation used by a safe harbor 401(k) plan for 2013 does not comply with §414(i), and it is clear that the definition is likely to be discriminatory against 2014 and subsequent plan years. The failure for 2013 is corrected via a retroactive amendment under Treas. Reg. §1.401(a)(4)-1(l)(1). How is the 2014 failure corrected from the safe harbor plan cannot be amended mid-year? Is there a limit on the number of years that an 1(l)g amendment can be used?</td>
<td>As the plan's definition of compensation cannot definitively be determined to be discriminatory until tested at the end of the year, there is technically no failure for 2014 at the time it is determined to be discriminatory for 2013. As such, the sponsor could correct the failure for 2014 using an 1(l)g amendment in the same manner as for 2013. The regulations do not impose a limitation on how frequently an 1(l)g amendment is used as long as it is adopted within the requisite timeframe and the benefits provided are meaningful, so the sponsor could use this method each year if when the definition of compensation is determined to be discriminatory. Alternatively, the sponsor could amend the plan effective January 1, 2015, to adopt a different definition of compensation.</td>
<td>If the plan is amended to change the definition of compensation during the plan year, it will lose the safe harbor treatment. This amendment changes an important feature of the plan, which affects the amount of contribution to be allocated to participants. Therefore, a mid-year amendment is not permitted.</td>
</tr>
<tr>
<td>2</td>
<td>Eligibility</td>
<td>Excluded employees</td>
<td>A 401(k) plan excludes from participation those employees who are not eligible for fringe benefits, and the plan sponsor has a written policy identifying the employees who excluded from receiving fringe benefits. PPACA now requires that those excluded employees be covered by the sponsor's health insurance plan; however, they continue to be excluded from the company's other fringe benefits pursuant to the written policy. Must those employees now be covered by the 401(k) plan?</td>
<td>This is primarily a question of legal construction. If the plan document is written in such a way as to exclude those individuals who are excluded from receiving all fringe benefits, then the fact that certain employees must now be covered under the sponsor's health insurance plan would likely mean that they no longer fall within the 401(k) plan definition of excluded employee. If, however, the 401(k) plan exclusion is written more generally, there may be grounds to interpret it as continuing to exclude the employees in question. Similar to the aftermath of the Microsoft decision (where plan terms were applied literally to the detriment of the sponsor), sponsors should consider updating the language in their plan documents in light of the PPACA requirements to ensure the language is written in such a way as to specifically accomplish the objective.</td>
<td>The Service agrees that this primary is a documentation issue. The plan terms should be given operative effect. Be careful, however, of a contingent benefit rule violation that could disqualify the 401(k) plan. For example, if the fringe benefit requires a contribution by the employee, the 401(k) plan could be interpreted as conditioning eligibility for employer contributions on whether the employee makes contributions to the fringe benefit plan.</td>
</tr>
<tr>
<td>3</td>
<td>Electronic disclosure</td>
<td>Accessibility</td>
<td>The alternative method for complying with the IRS e-delivery rules requires that participants have the effective ability to access the electronic medium. The IRS rules are not as specific as the DOL rules in this regard. What constitutes the effective ability to access? Must the participants be given access to a computer or is it enough to give them access to the website on which the notices will be posted?</td>
<td>No proposed answer.</td>
<td>To be discussed from the podium.</td>
</tr>
<tr>
<td>4</td>
<td>RMD</td>
<td>Receivable Allocations</td>
<td>A 74-year-old participant in a calendar year 401(k) plan retires in 2013. She receives a profit sharing contribution for the 2012 plan year that is not deposited until September 2013. When calculating the 2013 RMD, is this accrued contribution included in the account balance as of December 31, 2012? What if the same participant also makes a salary deferral in December 2012 but is not deposited until January 2013? Does the elapsed time between pay date and deposit date have any bearing on the answer with respect to the DOL's plan asset rule? For example, is the answer different if the pay date is December 31st and the deposit date January 2nd vs. a pay date of December 1st and a deposit date of January 31st?</td>
<td>Yes. According to the 5500-EZ Instructions, the form may be used for retirement plans covering one or more partners in a business partnership. Although the term &quot;business partnership&quot; is not defined, the Pension Protection Act of 2006 modified the term “partner” to include individuals owning more than 2% of an S corporation. For consistency purposes, a retirement plan covering only members of an LLC and their spouses, if taxed as a partnership, should be permitted to file a Form 5500-EZ.</td>
<td>The Service agrees with proposed answer. Amounts deposited on behalf of one year but deposited the next year are not required to be included for RMD purpose. Note, however, that the DOL rules regarding the timing of deposit of deferrals may be violated in this example (e.g., for a deferral in relation to a December 1 pay date being deposited on the following January 31).</td>
</tr>
<tr>
<td>5</td>
<td>Form 5500-EZ</td>
<td>Business Entity</td>
<td>An LLC taxed as a partnership has more than two owners and no non-owner employees. It sponsors a 401(k) plan that has less than $250,000 in assets. Can the plan sponsor file a Form 5500-EZ based on the LLC’s federal tax status (as a partnership) even though the entity is actually an LLC?</td>
<td>Yes. According to the 5500-EZ Instructions, the form may be used for retirement plans covering one or more partners in a business partnership. Although the term &quot;business partnership&quot; is not defined, the Pension Protection Act of 2006 modified the term “partner” to include individuals owning more than 2% of an S corporation. For consistency purposes, a retirement plan covering only members of an LLC and their spouses, if taxed as a partnership, should be permitted to file a Form 5500-EZ.</td>
<td>To be discussed from the podium.</td>
</tr>
<tr>
<td>Question</td>
<td>Proposed Answer</td>
<td>IRS Response</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>----------</td>
<td>----------------</td>
<td>--------------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A Plan is top-heavy. The document provides that all employees are eligible for the top-heavy minimum contribution. The Plan has one key employee who deferred 3%, so the top-heavy minimum is 3%. Of course, the nonkey employees must receive a 3% top-heavy minimum contribution and their own deferrals are not counted toward that requirement. However, can deferrals count towards the top-heavy minimum for the key employee(s), assuming the document so provides? If so, any key employee deferring more than 3% would receive no additional employer contribution, as the deferrals would fulfill the top-heavy obligation.</td>
<td>The plan document could be worded such that deferrals by key employees would be used to offset top-heavy minimum contributions; but this wording is very unusual. If the document simply specifies that key employees should receive a top-heavy minimum allocation, then a contribution, in addition to any deferred, must be made to key employees that will satisfy the top-heavy minimum requirement. There is no requirement that key employees need to get a top-heavy minimum contribution and the document can exclude key employees from the requirement.</td>
<td>The Service agrees with the proposed answer.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A plan has a EACA feature with an escalation provision (e.g., starts at 3% and increases by 1% each plan year thereafter). A participant terminates employment, but is later rehired. When the participant terminated employment, he was automatically enrolled at 4% on the escalation schedule. How does the uniformity requirement apply to the escalation provision (i.e., at what rate is the participant enrolled upon rehire)? Is the answer different if the participant is gone from employment for a full plan year, as opposed to a participant who returns to employment before having a full plan year without participation?</td>
<td>This is a facts and circumstances determination. For example, if the purchase of the land is made and the intent is to build a principal residence on that land at some future point in time, then we would suggest that the current purchase does not meet the requirement of being &quot;costs directly related to the purchase of a principal residence of the Participant.&quot; On the other hand, if the purchase of the land is coincident with a contract with a builder to build a principal residence on that land beginning soon after the purchase of the land is completed, then the facts and circumstances would seem to meet the requirements for a hardship distribution for the purpose of principal residence purchase of the Participant.</td>
<td>The Service agrees with the proposed answer.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does the purchase of land with the intent to build a primary residence qualify for hardship withdrawal under the 40(k) plan safe harbor rules? Also, would the building of the primary residence qualifies if the land purchase does not?</td>
<td>This is a facts and circumstances determination. For example, if the purchase of the land is made and the intent is to build a principal residence on that land at some future point in time, then we would suggest that the current purchase does not meet the requirement of being &quot;costs directly related to the purchase of a principal residence of the Participant.&quot; On the other hand, if the purchase of the land is coincident with a contract with a builder to build a principal residence on that land beginning soon after the purchase of the land is completed, then the facts and circumstances would seem to meet the requirements for a hardship distribution for the purpose of principal residence purchase of the Participant.</td>
<td>Texa. Reg. §1.401(k)-1(d)(3)(i) provides that hardship determinations require a demonstration of &quot;immediate and heavy financial need.&quot; Whether this standard is satisfied with a purchase of land is determined on the basis of either meeting a safe harbor -- deeming so, if it is a &quot;cost directly related to the purchase of a primary residence for the employee&quot; -- or on the basis of all relevant facts and circumstances. To be discussed further from the podium.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The sponsor of a qualified replacement plan under §4980(d) would rather not allocate earnings to the suspense account (i.e., the sponsor would prefer that earnings generated on the suspense account are allocated as current earnings to the participants in the DC plan based on their account balances). This way, earnings are not added to the amount to be allocated from the suspense account so those earnings are not converted into annual additions. Does IRC §4980(d)(2)(C)(iii) preclude this kind of allocation?</td>
<td>Earnings on the suspense account may be allocated currently each year as additional earnings to participant account balances rather than as allocations of employer contributions from the suspense account.</td>
<td>The earnings at issue are not earnings on participant's account, but on the suspense account. So, it is not reasonable to treat this as additional earnings.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assume the plan should have paid the participant in an annuity, but mistakenly paid the amount in a lump sum, which the participant rolled over to an IRA. The plan discovers the error several years later and endeavors to correct the error through VCP. Under EPCRS, the lump sum is treated by the Service as an overpayment, and you must tell the participant it was not eligible for rollover and request repayment. Generally, the lump sum that was rolled over would be treated as an &quot;excess contribution&quot; to the IRA, which means (1) the participant has to pay a 6% excise tax each year it was in the IRA and (2) when the amount is distributed from the IRA, the participant has to pay income tax on the distribution. Through VCP, the employer can request relief from the excise tax under (1), but not from the income tax exclusion under (2). Is the lump sum that is returned to the plan treated as a distribution from the IRA that is taxable to the participant? If so, in what year is it taxable?</td>
<td>If the amount is transferred back to the plan from the IRA, the amount is not taxable to the participant, and the plan can purchase an annuity for the participant with the returned funds.</td>
<td>The Service disagrees with the proposed answer. There is nothing in EPCRS that allows a plan participant or plan sponsor to completely undo this taxable event, simply by transferring the lump sum back from IRA to plan. To be discussed further from the podium.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
11 401(k) Top Heavy

A separate employers had the following plan types in 2014. In 2015 each adopts a regular 401(k).

1) Employer A had a Form 5305 model SEP that was terminated in 2014 (some accounts were
rolled over to the 401(k) plan).
2) Employer B had a Form 5304 model SIMPLE IRA that was terminated in 2014 (some
accounts were rolled over into the 401(k) plan).
3) Employer C had a SIMPLE 401(k) plan that was amended effective 1/1/2015 into a regular
401(k) plan.

Analysis for A:

§416 regs specifically include SEPs – conceptually they are similar to PS plans. §416 regs
specifically include SEPs – conceptually they are similar to PS plans. The SEP and tested 401(k)
never were adopted together. 
Any amounts rolled into the 401(k) plan – are relevant
for top-heavy testing purposes.
Any amounts rolled into the 401(k) plan – are relevant
for top-heavy testing purposes.

Analysis for B:

§416(g)(4) provides that SIMPLE IRAs are not top-heavy plans, but it does not say that
SIMPLE IRA contributions are disregarded to determine if another plan is top-heavy.
The analysis is therefore the same as for A.

Analysis for C:

A SIMPLE 401(k) is a qualified plan; no special top-heavy rules apply. 2015 top-heavy status is
based on the 12/31/14 account balances (including distribution add-backs).

The IRS agrees with the proposed answer for Employers A and C. Employer B will be discussed
from the podium.

12 Safe harbor 401(k) plan

Plan A is a calendar year 401(k) Plan that provides the basic safe harbor match. The Plan holds
“regular” matching contributions from prior plan years that are subject to a vesting schedule. The
Plan is top-heavy and at least one key employee receives total allocations of more than 3% of 415
Compensation.

For the 2015 plan year, only deferrals and safe harbor matching contributions are to be made.
There are $3,500 forfeitures of regular matching contributions waiting to be used. They cannot
be used to reduce the safe harbor match under IRS policy. If the forfeitures are allocated, the plan
will fail to be exempt from the top heavy rules, and a top-heavy minimum will be required. The
top-heavy minimum (after using the safe harbor match to offset the top-heavy minimum, as is
permitted) is about $90,000. The safe harbor match is only $45,000. Is the plan forced to reallocate the $3,500, giving rise to an additional contribution obligation of
$90,000?

No, the plan should be permitted to use the forfeitures to fund part of the safe harbor contribution.

The "combined" IRC §415 compensation is to be used in the determination of each company’s
HCEs.

The "combined" IRC §415 compensation is to be used in the determination of each company’s
HCEs.

The IRS disagrees with the proposed answer. The 415(h) requirement (applicable only to parent-
subsidiary groups) provides that, for section 415 testing, two entities otherwise treated as unrelated
are deemed to be a parent-subsidiary controlled group if the connecting ownership is 50% or more.
This rule is for 415 testing purposes only, and not for all of the other uses of section 415
compensation (i.e., HCE determinations, top heavy testing, etc.)

13 Compensation IRC §415

IRC §415(h) provides that, for purposes of applying §§ 414(h) and (c) to §415, a 50% ownership
threshold is used instead of the generally applicable 80% threshold. Assume that a company is in
a joint venture. The company owns 50% of the joint venture company. Obviously, compensation for
IRC §415 purposes is combined, and the annual additions are combined for individuals who
participate in a plan of the "parent" and the joint venture company for purposes of testing whether
the limitations of IRC §415(c) are exceeded.

As a result, if an employer’s §415 compensation includes amounts paid from 50-80% owned
affiliates, there is no basis for excluding these amounts for purposes of identifying HCEs under
Code §414(g).

The IRS disagrees with the proposed answer. The 415(h) requirement (applicable only to parent-
subsidiary groups) provides that, for section 415 testing, two entities otherwise treated as unrelated
are deemed to be a parent-subsidiary controlled group if the connecting ownership is 50% or more.
This rule is for 415 testing purposes only, and not for all of the other uses of section 415
compensation (i.e., HCE determinations, top heavy testing, etc.)
<table>
<thead>
<tr>
<th>2014</th>
<th>Topic</th>
<th>Subtopic</th>
<th>Question</th>
<th>Proposed Answer</th>
<th>IRS Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>IRR</td>
<td>After-tax EE Contributions</td>
<td>What rules apply to the conversion of after-tax employee contributions into Roth via an In-Plan Roth Rollover?</td>
<td>The in-plan Roth conversion rules apply equally to all funds, including after-tax employee contributions. With the recent change in the law, it doesn't matter whether the funds are currently distributable at the time of conversion. Since a participant's benefit derived from after-tax contributions is always 100% vested, such benefits may be converted at any time, subject to any restrictions set by the plan with respect to the in-plan conversions.</td>
<td>To be discussed from the podium.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>When a conversion is elected with respect to the after-tax employee contributions, the taxable distribution is the earnings attributable to the after-tax employee contributions being converted. How the earnings portion is calculated depends on whether the plan maintains separate accounting for the after-tax contributions (referred to by the IRS as the §72(d) account or contract) because it is authorized by IRC §72(d). If the §72(d) separate accounting is used, then the earnings distributed on the after-tax contributions are the earnings in such separate account (or a proportionate share of the earnings if less than 100% of the separate account is being converted). If there is no §72(d) separate accounting, then the earnings attributable to the amount converted are determined by looking at the combined value of employee and after-tax employee contributions allocated to the employee's account. Note, however, that to the extent the employee has pre-1987 after-tax employee contributions (or a portion thereof) with no tax consequences as a result of the conversion.</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Safe harbor 401(k) plan</td>
<td>Mid-year Amendments</td>
<td>The IRS generally prohibits mid-year amendments to an ADP test safe harbor plan. How should the effective date be set for a restatement of a safe harbor plan in order to avoid a violation of this prohibition? Does the answer change if we are in the last year of the cycle (i.e., early 2016)?</td>
<td>If the plan is being restated solely to perfect interim amendments (such as PPA), then no discretionary amendments are being made to the plan and the restatement effective date is not a concern (i.e., if the plan is restated in 2014, using a retroactive effective date for the restatement is not a problem). If, as part of the restatement, discretionary changes are also being made to the plan, then these discretionary changes must generally be effective as of the first day of the following plan year. If the plan is restated in 2016 (prior to the April 30, 2016 deadline for pre-approved plans) then it would be acceptable to have a 2017 effective date for the restatement. These answers assume the plan being used contains retroactive effective dates for each of the changes in the law that were retroactively effective that are subject to the remedial amendment period.</td>
<td>The IRS disagrees with the proposed answer. The restatement document would have to be made generally effective within the applicable 401(b) period. To be discussed further from the podium.</td>
</tr>
<tr>
<td>16</td>
<td>Distributions</td>
<td>Beneficiary</td>
<td>A terminated participant died with a $15,000 account balance in a defined contribution plan. The beneficiary designation showed the spouse. The participant and the spouse were estranged at the time of the participant's death. By the time the spouse was located he had died, with no known next-of-kin. Who becomes the beneficiary? Because the spouse was the designated beneficiary and he outlived the participant, would it be the spouse's next-of-kin? What cost can the plan incur to search for the designated beneficiary's next-of-kin and who pays for that cost? Can the plan hire a private investigator at a cost of $500 to search for the next-of-kin? Is it reasonable for the participant's account to pay for the search rather than the entire plan or the plan sponsor? If no search is done or no next-of-kin found, and the plan is ultimately terminated, should the unclaimed account go into an IRA? If so, in whose name? What RMD rules apply (those for a spouse or those for an unnamed beneficiary)?</td>
<td>Taking reasonable steps to locate a missing participant or beneficiary is a fiduciary requirement. Reasonable expenses to locate the missing beneficiary may be charged to the participant's account. Should the reasonable search methods not yield any results, the account may be rolled over into an IRA in the beneficiary's name upon plan termination.</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Automatic Enrollment</td>
<td>Mid-year Amendments</td>
<td>I understand the limitation on adding a QACA arrangement mid-year to a plan due to the safe harbor portion of the plan, but why is there a restriction on adding other types of ACA arrangements during the plan year?</td>
<td>There is no restriction on adding an ACA during the plan year. The regulations under 414(w) generally require that an EACA be effective as of the beginning of the plan year. The Treasury notes, however, in the preamble to those regulations that the final regulations treat individuals who first become covered under an automatic contribution arrangement as a result of a change in employment status the same as individuals who first become eligible to make a cash or deferred election for purposes of the notice timing rules. This would permit, for example, a plan defining covered employees under the EACA as including only employees who become eligible for the plan on or after a certain date (e.g., July 1, 2015) to not have to provide any EACA notices until there are newly eligible employees. This interpretation of the final regulations was confirmed by IRS officials as reasonable at the Q&amp;A session held at the 2009 ASPPPA Annual Conference in the Washington, D.C. area. See Q&amp;A-9 of that session. However, by not including all eligible employees as covered employees, the plan would not be entitled to the 6-month correction period described in Treas. Reg. §54.4975-1(c).</td>
<td>The IRS agrees with the proposed answer.</td>
</tr>
<tr>
<td>2014 Q#</td>
<td>Topic</td>
<td>Subtopic</td>
<td>Question</td>
<td>Proposed Answer</td>
<td>IRS Response</td>
</tr>
<tr>
<td>-------</td>
<td>------</td>
<td>------</td>
<td>--------</td>
<td>----------------</td>
<td>-------------</td>
</tr>
<tr>
<td>18</td>
<td>Corrections</td>
<td>401(k) Missed Enrollment</td>
<td>When a sole proprietor establishes his non-safe harbor 401(k) plan, he has no other employees. He does not understand that this is not a “his” plan and that it will cover any employees who become eligible in the future. As a result, hired employees are never enrolled in the plan. EPICRS generally requires that a contribution be made on behalf of the improperly excluded employees up to 50% of the missed deferred opportunity (which is the ADP for the similarly situated employees, HCE or NHCE). However, no NHCE participated. So, what is the correction? Is it appropriate to use a 3% rate (1.5% QNEC) as the missed deferral, the rate that would be used if the plan was a 3% safe harbor? Or is there another appropriate solution?</td>
<td>Because the deferral percentage of the NHCE group is 0%, the corrective contribution method under EPICRS is not applicable. However, before the corrective contribution is determined, the PCRS procedure requires that the plan first pass the ADP test. So, if none of the employees were given an opportunity to defer, the ADP for the eligible NHCE group is 0%, resulting in the owner's deferrals violating the ADP test. To correct this, the plan either refunds the entire deferral to the owner or the employer makes a QNEC to the NHCE accounts sufficient to pass the ADP test. If the owner's deferrals are refunded in their entirety as excess contributions, there is no further correction needed. If the plan makes a QNEC for the NHCE that enable the plan to pass the ADP test, then the violation is corrected (assuming this occurs during the plan year following the plan year of the failed test). If it is after the normal correction period, then the one-to-one correction would be required if the HCE deferrals were refunded.</td>
<td>The IRS disagrees with the proposed answer insofar as it implies that a distribution of the HCE’s account could be made and thus avoid any corrective contribution. Under EPICRS, a QNEC would have to be made, the amount depending on whether this is treated as a demographics failure or an eligible employee failure. To be discussed further from the podium.</td>
</tr>
<tr>
<td>19</td>
<td>TINs</td>
<td></td>
<td>Are Taxpayer Identification Numbers for retirement plan trusts still needed? IRC §6109 says yes and IRC §6721-6724 suggest minor penalties. But why shouldn’t the trust just use the employee’s TIN when taxes are due? Does the IRS really care or enforce the matter? Does a trust without its own TIN lose its ERISA creditor protection?</td>
<td>No proposed answer.</td>
<td>IRS announcement 84-40 provides that retirement plan trusts should - but are not required to – secure separate TINs. Tax compliance requirements (i.e., ACA reporting) might otherwise require one.</td>
</tr>
<tr>
<td>20</td>
<td>Sole Proprietor</td>
<td>401(k)</td>
<td>A sole proprietor has adopted a 401(k) plan with a profit sharing component for his company. As it is not possible to tell the difference (on the tax return) between a 401(k) deferred amount and the profit sharing contribution, what actions must he take to memorialize those two different items?</td>
<td>For the 401(k) deferral, the sole proprietor must make an election prior to year end as to the amount that will be contributed (within the maximums), subject to the actual income being there when the self-employed income is determined after the year end. The profit sharing contribution simply needs to be deposited by the appropriate time and taken as a deduction on the tax return to justify the deduction; no determination of the year’s profit sharing contribution needs to be made before the year end.</td>
<td>There are different timing requirements – albeit DOL requirements – for the different types of contributions. The other requirement that comes to mind is that there may be separate accounts for the types of deposits because of different distribution restrictions. If separate accounting is not maintained, the plan must impose the 401(k) distribution limitations on all accounts. So, internal accounting requirements may dictate what you do. As noted in the proposed answer, the sole proprietor needs to make a formal election regarding elective deferral amounts by year end, and the employer profit sharing contribution is separate from that.</td>
</tr>
<tr>
<td>21</td>
<td>Leanna</td>
<td>Corrections</td>
<td>Why are all loan issues required to go through VCP? why is there not a de minimis correction amount or a reduced VCP fee for small loan amounts? Loans are better for the participants from a “leakage” standpoint than hardship distributions, as the money is returned to the plan for use at retirement. But the penalty for a loan-related mistake can be severe. Why?</td>
<td>No proposed answer.</td>
<td>To be discussed from the podium.</td>
</tr>
<tr>
<td>22</td>
<td>Forfeitures</td>
<td>Paying fees</td>
<td>Assume the plan document allows forfeitures to pay plan expenses. Is it permitted to pay plan expenses directly from the forfeiture account? Must every participant’s account be credited a share of this expense as §415(c) allocation? If the forfeitures are allocated instead to participants’ accounts, they would be considered to be annual additions under IRC §415. By having the forfeiture account pay expenses directly, it takes these amounts out of being annual additions, leaving more “room” for additional contributions. Is this okay, or must the payment of expenses by the forfeiture account be considered to be an annual addition?</td>
<td>Paying fees from plan forfeitures is permitted if the document allows for it and the fees are of a type that is appropriately paid by the plan. If fees are paid from the forfeiture account, then they are not part of the §415(c) allocation and are not annual additions.</td>
<td>The Service agrees with the proposed answer.</td>
</tr>
<tr>
<td>23</td>
<td>Affiliated Service Group</td>
<td>Distributable event</td>
<td>Company M and Company R are members of a management-organization under 414(m)(5). R (and companies related to R) are recipients of M’s management services. M sponsors a 401(k) plan that covers the employees of M and R (R is an adopting employer). R decides to terminate the services contract, effective 7/1/14. Because there is no provision of services between M and R after that, there is no ASG. Under the 401(k) regulations and Notice 2002-4, if a subsidiary ceases to participate in a parent’s plan due to an M&amp;A transaction, the plan can pay out the subsidiary’s employees if: (a) the buyer is unrelated; (b) the buyer doesn’t take over the parent’s plan or accept a direct transfer of the subsidiary employees’ benefits; and (c) the subsidiary ceases to participate in the parent’s plan before the sale, so that there is no post-sale participation. If R withdraws from participation in the M plan on 6/30/14, can the R employees receive a distribution from the M 401(k) plan? There has been no “transaction” in the traditional sense — i.e., there is no sale of stock or assets or merger. But, there has been the termination of a relationship. Does that count?</td>
<td>The subsidiary exception in Notice 2002-4 is limited to situations where an unrelated company comes in a purchases the stock of the subsidiary of a parent company. In this example, Company M is simply severing its relationship with Company R, thereby ending the ASG relationship. The plan now becomes a multiple employer plan. As a practical alternative, R could have the assets attributable to its employees spun off from the M plan to a new separate plan maintained by R. R could then terminate and distribute the benefits provided it didn’t establish a successor DC plan within 12 months of violation of IRC §401(k)(10), or it could maintain that spun-off plan as a separate plan for its employees.</td>
<td>The Service agrees with the proposed answer.</td>
</tr>
<tr>
<td>24</td>
<td>MEP</td>
<td>Distributable event</td>
<td>Variation on previous question: Company S participates in a MEP 401(k) plan. Company S decides to terminate its participation in the plan and is not adopting another plan. Can the MEP sponsor pay out the Company S employees? FWW; several MEPs are doing this as companies shutdown — is it legal?</td>
<td>No. Mere discontinuance of participation in a MEP does not trigger a distribution event. The S employees are still employed by the company (S) that maintained the MEP for their benefit. S could have the assets under the MEP that are attributable to the accrued benefits of its employees spun off to a separate plan and then terminate that plan. Or it could maintain the spun off plan as an ongoing plan for its employees.</td>
<td>The Service agrees with the proposed answer.</td>
</tr>
<tr>
<td>2014 Q#</td>
<td>Topic</td>
<td>Subtopic</td>
<td>Question</td>
<td>Proposed Answer</td>
<td>IRS Response</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
<td>----------</td>
<td>----------</td>
<td>-----------------</td>
<td>--------------</td>
</tr>
<tr>
<td>25</td>
<td>Distributions</td>
<td>Five-year Rule</td>
<td>A defined contribution plan states that death benefits payable to a spousal beneficiary must be distributed according to the &quot;Five-Year Rule,&quot; whereby the entire death benefit must be distributed by the 12/31 of the fifth year following the participant's death. The RMD section of the plan states that the default election is the &quot;Five-Year Rule&quot; and does not even mention the &quot;Life Expectancy Rule.&quot; If the participant died before age 65, and the spousal beneficiary received the death benefit distribution in a lump sum in the fifth year following the participant's death, is the spouse permitted to roll over the distribution to an IRA (in the name of the spouse)?</td>
<td>If the plan requires that the 5-year rule be used (i.e., it does not by its terms, permit the beneficiary to take distributions over his or her life expectancy), then that is the rule that applies and no election can be made for the life expectancy rule within the plan. However, a lump sum distribution to a surviving spouse within the 5-year period CAN BE ROLLED OVER to the spouse's own IRA. This is because IRC §401(a)(9) does not require the spouse to take a RMD until the participant would have attained age 70-1/2. In this example, the participant would not yet be 70-1/2 (he died before age 65 and 5 years have passed). Therefore, notwithstanding the requirement under the plan to take the distribution, this is not a legally required minimum distribution, so it is able to be rolled over.</td>
<td>To be discussed from the podium.</td>
</tr>
<tr>
<td>26</td>
<td>Roth</td>
<td>Corrections</td>
<td>A client had several employees sign up for Roth 401(k) contributions in January 2013. The payroll clerk had no idea there was a difference between Roth and pre-tax, and reported all contributions as pre-tax to their payroll provider. How do we correct this?</td>
<td>If the plan requires that the 5-year rule be used (i.e., it does not, by its terms, permit the beneficiary to take distributions over his or her life expectancy), then that is the rule that applies and no election can be made for the life expectancy rule within the plan. However, a lump sum distribution to a surviving spouse within the 5-year period CAN BE ROLLED OVER to the spouse's own IRA. This is because IRC §401(a)(9) does not require the spouse to take a RMD until the participant would have attained age 70-1/2. In this example, the participant would not yet be 70-1/2 (he died before age 65 and 5 years have passed). Therefore, notwithstanding the requirement under the plan to take the distribution, this is not a legally required minimum distribution, so it is able to be rolled over.</td>
<td>To be discussed from the podium.</td>
</tr>
<tr>
<td>27</td>
<td>Testing</td>
<td>Profit-sharing Allocation</td>
<td>A cross-tested plan fails the nondiscrimination test, ABT and rate group tests. The plan sponsor decides to give the same pro rata compensation formula to all the cross-tested rate groups so that it meets the safe harbor allocation requirements of a pro rata compensation allocation. Does a contribution that would meet the safe harbor still need to be general-tested or cross-tested because the plan called for tiered allocations, or is the fact that the allocation would meet a safe harbor allocation means that it is per se nondiscriminatory.</td>
<td>The participants made a Roth election; the money was taken out of their paycheck and submitted to the plan. The problem is that the payroll system treated the funds as pre-tax and (presumably) reported as taxable a smaller amount than it should have. That is an error in the payroll reporting, not an error in the plan. This does not require EPCRS. The problem may be corrected as follows: 1) The Forms W-2 need to be redone for 2013 to reflect the correct taxable income. 2) The participants' tax returns need to be amended and they will owe more tax and, potentially, interest and penalties. The employee may want to help delay the costs of the interest, late filing penalties, and tax form revision, but is not required to do so. 3) The 2013 year plan records need to be corrected reflect that the payments were Roth contributions.</td>
<td>The facts are not entirely clear. However, a plan could satisfy nondiscrimination testing by using a safe harbor allocation. Having said that, unless the formula is written in the plan document, the plan is not a &quot;safe harbor plan.&quot; To be discussed further from the podium.</td>
</tr>
<tr>
<td>28</td>
<td>Distributions</td>
<td>J&amp;S</td>
<td>A 401(k) plan that has QJ&amp;S provisions is terminated. One participant cannot be found, despite diligent search efforts (including a search company). The amount due exceeds $5,000. All other participants properly elected distributions that were either paid in cash, rolled over, or provided in an annuity. The plan cannot be amended to eliminate the QJ&amp;S provisions, because there are money purchase transferred accounts from a prior plan (and the funds at issue are in the money purchase transferred account). The plan administrator contacted several firms that specialize in mandatory rollovers to see if they could provide the ability to purchase an actual annuity subject to J&amp;S rules. Why the way, the plan administrator does not know whether the participant is married. None of the firms that specialize in mandatory rollovers have any capacity to provide an annuity contract that would comply with the J&amp;S requirements if and when the participant shows up and requests his benefits; they all were willing to provide a standard deferred annuity, but the J&amp;S issues could not be included in their products. This is the only distribution remaining to finalize the termination of the plan; everyone else has been paid out. Can we just set up the regular mandatory rollover (no J&amp;S provisions) for the amount of the distribution even though it exceeds the $5,000 limit? If not, what is to be done?</td>
<td>The facts are not entirely clear. However, a plan could satisfy nondiscrimination testing by using a safe harbor allocation. Having said that, unless the formula is written in the plan document, the plan is not a &quot;safe harbor plan.&quot; To be discussed further from the podium.</td>
<td>Refer to DOL FAB 2014-1 regarding the plan administrator's obligations to try to locate the participant. To be discussed further from the podium.</td>
</tr>
</tbody>
</table>
### IRS QUESTIONS AND ANSWERS - DEFINED CONTRIBUTION PLANS - 2014

<table>
<thead>
<tr>
<th>Page 7</th>
</tr>
</thead>
</table>

#### 29 Testing

**Profit-sharing (Allocation)**

A plan provides that each participant is in a separate allocation group and the employer may make separate discretionary contributions for each group. If the employer decides not to make a contribution for a participant, does this mean the plan must pass §410(b) using the ratio percentage test (i.e., in the fact that this participant is in his/her own allocation group tantamount to excluding this participant by name)?

In order to use the Average Benefits Test to meet §410(b), a plan must meet the reasonable classification portion of the Nondiscriminatory Classification Test (as well as the rest of the Average Benefits Test). The regs provide that the section is met if and only if, for the plan year, the plan benefits the employees who qualify under a classification established by the employer that is reasonable and is established under objective business criteria. These criteria are established by the employer, not necessarily by the plan terms. Thus, if the resulting group benefiting under the plan represents a reasonable business classification, the fact that each individual is in his own allocation group is immaterial. As a best practice, the employer may want to delineate the business classification as part of the broad resolution declaring the contribution level for each allocation group.

The Service partially agrees with this response. The fact that participants are in their own groups and that some receive no allocations does not compel use of ratio, ratio percentage, or average benefits test. If a plan wishes to use the ratio percentage test as a reasonable classification test, it must do so as indicated above, the plan must first pass the reasonable classification test under objective business criteria.

#### 30 Distributions

**POA**

Does a plan need to specifically authorize the recognition of a participant's power-of-attorney (POA)? We have a participant who was deceased and he gave a broad POA to a relative. The relative has requested a distribution from the plan, but the plan does not specifically discuss the use of a POA. Can the plan pay the benefit?

Yes. If the scope of the POA covers the handling of property of the participant, then by law, the POA is a valid representative of the participant.

#### 31 Loans

**Rollovers**

John Doe is a participant in the XYZ 401(k) Plan and has an outstanding loan when he terminates employment. Both the loan policy for the plan and John's individual loan note provide that the loan is immediately due and payable on termination of employment. John's new employer has agreed to accept a direct rollover of John's outstanding loan. Can John rollover the outstanding loan and receive payment as long as the rollover is complete and any missed payments are caught up before the end of the quarter following the quarter in which he terminated employment with XYZ?

No. As soon as John terminates employment with XYZ, the acceleration clause causes his loan to become immediately due and payable to the XYZ 401(k) Plan. If John does not repay the loan to the XYZ plan by the end of the cure period, it will be treated as a deemed distribution. To avoid the acceleration of the loan, John would need to amend its loan policy, and John would have to renegotiate his loan (because the acceleration language is included in the loan note). Both of these modifications would need to be completed before the end of the grace period under §72(p) (with the renegotiation modification being made in the plan that made the loan and the ability to renegotiate also being in the recipient plan of a rollover of the loan), and John's renegotiation of his loan would be subject to the otherwise applicable limitations, including the double-counting of the outstanding balance when determining whether his vested balances is sufficient to support the transaction. Of course, the plan would have to allow for the renegotiation of participant loans in the first place.

The Service agrees with the answer as to the fact that the acceleration clause requires repayment, possibly amendment, and renegotiation to accommodate it. To be discussed further from the podium.

#### 32 Testing

**Employer Match**

The Service agrees with the proposed answer.

#### 33 Determination Letters

**Filing Cycles**

A plan can be in Cycle B and filed for a determination letter in the Post-EGTRRA cycle by 1/31/2013. In 2014, the plan sponsor is changed, and the new sponsor has an EIN that makes the plan a Cycle E plan. Under Rev. Proc. 2007-44, the plan may elect to remain a Cycle B plan and file the determination letter immediately following Post-EGTRRA cycle (i.e., by 1/31/16). As the plan can wait to file as a Cycle E plan in the next cycle (i.e., by 1/31/21). The letter that is issued to the plan (i.e., the post-EGTRRA cycle has an expiration date of 3/31/2018. If the plan waits until 1/31/2021 to file, it will not have a determination letter in effect for 3 years. What potential effects could this have? Would the plan lose the ability to obtain IRC §7805(b) relief or any other relief (such as eligibility for self-correction under IPCRS) because it did not maintain a valid determination letter for all years?

The plan is entitled to the remedial amendment period pursuant to Rev. Proc. 2007-44. Thus, the expiration date on the determination letter is disregarded - the expiration date has effectively been extended to 1/31/21.

The Service agrees that Section 11.03(4) of Rev. Proc. 2007-44 redetermines the applicable remedial amendment period. However, the service disagrees that the determination letter's expiration date is extended. To be discussed further from the podium.

#### 34 Sole Proprietor

**Earned income**

A sole proprietor sponsors a calendar year-end profit-sharing plan with a 5% fixed contribution. For the 2013 tax year, the proprietor did not obtain an extension of time to file the federal tax so the return due date was 4/15/2014. The 5% contribution was deposited into the plan on 5/15/2014, to the credit of the proprietor for his/her 2013 contribution. Effective 6/30/2014, the sole proprietor's earned income for 2013 calculated with or without regard to the 2013 employer contribution amount?

The contribution will not be deducted on the 2013 federal tax return, so the sole proprietor's earned income for 2013 calculated with or without regard to the 2013 employer contribution amount.

The plan is entitled to the remedial amendment period pursuant to Rev. Proc. 2007-44. Thus, the expiration date on the determination letter is disregarded - the expiration date has effectively been extended to 1/31/21.

(1) IRC 404(a)(8)(B)(i) provides that the contribution satisfies deductibility if limited to earned income "determined without regard to the deduction allowed." Note that the deduction would not be allowable without limitations, so you would determine earned income without regard to the contribution.

(2) A profit sharing plan can have a fixed contribution. See IRC 401(a)(27)(B).

#### 35 Compensation

**Earned income**

A partnership sponsors a 401(k) plan. The entity and plan year end are a calendar year end. Effective 6/30/2014, the 401(k) plan is terminated. The partnership continues to operate. How is earned income for the partners determined for the termination year?

The partnership sponsors a 401(k) plan. The entity and plan year end are a calendar year end. Effective 6/30/2014, the 401(k) plan is terminated. The partnership continues to operate. How is earned income for the partners determined for the termination year?

There is no earned income for the period for the six month period ending 6/30/14. Earned income is determined as of the end of the entity tax period.

The Service agrees with the proposed answer.

#### 36 Compensation

**Earned income**

A partnership sponsors a 401(k) plan. The entity and plan year end are 6/30. Effective 7/1/2014, the plan is amended to have a calendar year end. The entity year end does not change. Typically, when the plan year and the entity year do not match, the Forms K-1 for the entity year that ends within the plan year would be used to determine earned income for the partners. However, in this case, there will be no entity year that ends within the 7/1/2014 - 12/31/2014 plan year. How should earned income be determined for the partners for the short period?

The earnings for that period is zero, as it would be on their personal tax return for that period, the earned income as of 6/30/14 would show on the 2014 1040, and then the earnings for the 7/1/14 - 7/30/15 fiscal year will be reflected on the 2015 personal return.

The plan for earned income for the calendar year period is zero, as it would be on their personal tax return for that period, the earned income as of 6/30/14 would show on the 2014 1040, and then the earnings for the 7/1/14 - 7/30/15 fiscal year will be reflected on the 2015 personal return.

To be discussed from the podium.
<table>
<thead>
<tr>
<th>Q#</th>
<th>Topic</th>
<th>Subtopic</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>37</td>
<td>Deferrals</td>
<td>Earned income</td>
<td>Can a self-employed individual's deferral election be a formula, i.e. “My deferral for the year will be the maximum amount allowed under IRC §415(c) less the amount of any employee matching or nonelective contribution contributed by the employer (subject to the maximum deferral under §402(g))?&quot;</td>
</tr>
<tr>
<td>38</td>
<td>Top Heavy Plans</td>
<td>Minimum Contribution</td>
<td>A plan excludes commissioned employees. The plan is top-heavy for 2014 and a participant who is a non-key employee changed to a commission employee as of the first day of the 2014 plan year. Thus, the employee has an account in the plan but is now an excluded employee for 2014. Is the employee entitled to a top-heavy minimum contribution for 2014 (assuming the employee is still employed at the end of 2014)?</td>
</tr>
</tbody>
</table>

**Proposed Answer:**

Treas. Reg. §1.416-1, M-10, states that only non-key employees who are participants and who are employed at the end of the year accrue the top-heavy minimum in a DC plan. That Q&A goes on to say: “A non-key employee may not fail to receive a defined contribution minimum because either (1) the employee is excluded from participation (or accrues no benefit) merely because the employee’s compensation is less than a stated amount, or (2) the employee is excluded from participation (or accrues no benefit) merely because of a failure to make mandatory employee contributions or, in the case of a cash or deferred arrangement, elective contributions.” It comes down to how you define a participant once the person has qualified for the plan. It is clear that if you have always been in an excluded classification, then you are not entitled to participate (assuming of course the plan is able to pass coverage without covering such employees). The issue here is that this person at one time qualified for the plan because he was not in an ineligible classification, but then became ineligible. Our interpretation is that, if you later become part of an ineligible classification (other than the two circumstances in the quoted part of the reg above) you are NOT entitled to the TH minimum. See also Rev. Rul. 96-48, Holding (Issue 2).