

SKY'S THE LIMIT

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THE LIST

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DEVELOPMENT

Huge project to rise in West Valley

A landowner wants to build an industrial campus on 5,000 acres near Tonopah.

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RESIDENTIAL

Tempe apartment complex proposed

Key vote approaches for five-building project on 12 acres near flagship IKEA store.

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Retirement plan mistakes happen. Here's how employers can fix them before they become costly problems

The Legal PULSE



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Qualified retirement plans, such as 401(k) plans, pension plans, profit sharing plans, etc. are a critical and popular component of Americans' savings programs and provide important tax advantages for both employers and employees. Employers can generally deduct contributions made to the plan, while employees can save for retirement on a tax-deferred basis.

However, even the best run plans can experience errors made in drafting or in operation of the plan that threaten a loss of these benefits. The most common mistakes made in writing and administering a retirement plan include:

- Failing to update plan documents when laws change
- Missing required amendments
- Excluding eligible employees from participating
- Mistakes in deferral or matching contributions
- Depositing employee 401(k) contributions late
- Plan loan failures
- Non-discrimination testing failures
- Eligibility failures

The Internal Revenue Service ("IRS") and Department of Labor ("DOL") have created correction programs that encourage voluntary compliance and allow employers to fix problems before they result in penalties, litigation, or loss of valuable tax benefits.

TWO PROGRAMS DESIGNED TO FIX RETIREMENT PLAN ERRORS

Some of most important tools

developed by the IRS and the DOL are:

- IRS Voluntary Correction Program ("VCP"), which addresses tax qualification and operational issues, such as failing to update plan documents timely or inadvertently excluding participants from plan benefits like an employer match.
- DOL Voluntary Fiduciary Correction Program ("VFCP"), which corrects failures in fiduciary compliance, such as an employer's untimely (more than a day or two after payroll payments) deposit of 401(k) deferral contributions.

Both programs replace formal negotiations, closing agreements, and expensive fines or loss of qualified status with several levels of self-effectuating correction, and with payments to the plan that hold plans and plan participants harmless from the financial impact of the errors. The programs also allow employers to avoid expensive litigation with government agencies over qualification problems and fiduciary violations.

IRS VCP: CORRECTING PLAN ADMINISTRATION AND DOCUMENTATION ERRORS

The IRS's VCP provides three levels for correcting mistakes. The simplest is self-correction, which an employer may use to correct problems that are isolated in occurrence and limited in their impact both as to the amount involved and the number of participants affected.

More difficult or long-lasting problems may require employers to file a formal VCP submission to the IRS. More egregious or repeated failures may require a formal closing agreement with the IRS, though this is becoming less common.

DOL VFCP: ADDRESSING FIDUCIARY ISSUES

The DOL's VFCP was developed to minimize litigation over inadvertent

fiduciary failures. Under VFCP, self-correction is available on a limited basis, such as for a late deposit of employee contributions that are corrected within 180 days and involve less than \$1,000 in lost earnings, or certain inadvertent operational failures related to plan loans.

More egregious violations can be addressed only through formal submissions that explain the nature of the failure, explain corrective measures taken and provide calculations of payments required to make the plan and participants whole.

WHY EARLY CORRECTION MATTERS

With a correction under either program, an employer should act promptly to carefully identify and report all plan compliance failures to prevent the IRS or DOL from raising them on audit. Employers should also determine whether a compliance failure resulted in a "prohibited transaction," which can carry significant fiduciary liability and be subject to an excise tax (15% of the amount involved if corrected before an audit, or of 100% if left uncorrected and the IRS finds the transaction in an audit). To address prohibited transactions, an employer should file Form 5330 with the IRS and pay the 15% excise tax in order to minimize the risk of a significantly higher excise tax in an audit.

Because the IRS and DOL coordinate their efforts in managing retirement plan issues, a submission to correct a violation should cover all known deficiencies. Thus, a comprehensive review of plan documents and day-to-day operations is a critical step when considering a correction submission to either agency.

IN CLOSING

Correction programs are a critical tool that the federal government offers employers to avoid expensive liability and penalties and to protect the retirement savings of their employees.

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