

Employee Plans News

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Mid-Year Plan Amendments Related to Marriages of Same Sex Couples

Safe harbor 401(k) or 401(m) plans may be amended mid-year to comply with the Supreme Court's decision in [United States v. Windsor](#) and related IRS guidance in [Revenue Ruling 2013-17](#) and [Notice 2014-19](#) ([Notice 2014-37](#)). The Windsor decision invalidated Section 3 of the 1996 Defense of Marriage Act (DOMA), which barred married same-sex couples from being treated as married under federal law.

When plan amendments are required

A plan with terms that are inconsistent with Windsor or Revenue Ruling 2013-17 must be amended to comply ([Notice 2014-19](#)). For example, a plan must be amended if it defines "spouse" by reference to section 3 of DOMA, or only as a person of the opposite sex. Similarly, a plan must also be amended if a plan sponsor chooses to reflect the outcome of Windsor for periods prior to the date Windsor was decided. Required amendments must generally be adopted by the later of December 31, 2014, or the applicable date under the IRS' general amendment guidance for qualified retirement plans, [Revenue Procedure 2007-44](#) (Q&A-8 of Notice 2014-19).

Safe harbor plan rules

A safe harbor 401(k) or 401(m) plan must generally be adopted at the beginning of a plan year and maintained throughout the full 12-month year. Plan amendments to reflect Windsor and related IRS guidance are exceptions to this general rule.

Additional resources

- [Treatment of Marriages of Same Sex Couples for Retirement Plan Purposes](#)
- [Revenue Ruling 2013-17](#) – treatment of same-sex marriage for federal tax purposes
- [FAQs](#) on treatment of same-sex marriage for retirement plans
- [401\(k\) Plans](#)

Retirement Plan Payments for Accident, Health and Disability Insurance

Final regulations ([T.D. 9665](#)) state that payments from a qualified defined contribution plan to pay a participant's:

- accident and health insurance premiums **are taxable** distributions to the participant unless a statutory exception applies (Internal Revenue Code Sections [72](#) and [402\(a\)](#)), and
- disability insurance premiums **aren't taxable** distributions if they meet certain conditions.

The regulations finalize the [2007 proposed regulations](#) and add the exception for disability insurance coverage; they are **effective** January 1, 2015, but may be applied earlier.

Accident and health insurance

The 2007 proposed regulations stated the general rule that payments from a qualified plan to pay a participant's accident or health insurance premiums are taxable distributions unless they're paid:

- from a qualified retiree health account (IRC Section [401\(h\)](#)), or
- for qualified public safety officers (IRC Section 402(l)).

Disability insurance

The final regulations include an exception for disability insurance premiums being taxed to participants if the following conditions are met:

1. Premiums for the disability insurance contract are paid directly from the plan.
2. The plan receives the benefit payments as required by the disability insurance contract.
3. Benefit payments under the **contract are paid because of an employee's inability to continue employment** with the employer because of disability.
4. The benefit payments to a participant's account aren't more than a reasonable expectation of what the participant would've received as an annual contribution during the disability period, reduced by any other contributions.

If these conditions are satisfied, the disability insurance is considered a plan investment, and the plan's premium payments and the insurance's benefit payments to the plan aren't taxable to the participant.

If the disability insurance **premiums aren't paid by the plan**, the insurance benefits paid to the plan aren't a return on a plan investment. Instead, these payments are

contributions to the plan governed by qualified plan contribution rules (generally, IRC Section [415\(c\)](#), which limits employer contributions to a defined contribution plan).

If an employer **self-insures this disability coverage** (or doesn't finance it through third party insurance), the amount paid to the plan because of the employee's disability is also considered a contribution to the plan governed by the general qualified plan contribution rules.

The final regulations add the exception for nontaxability of disability insurance based on comments we received on the 2007 proposed regulations, which:

- recommended that disability insurance designed to protect against the loss of plan contributions during a period of disability should be excluded from the general taxable distribution rule, and
- noted that the participant would be taxed on these insurance benefits when they are distributed from the plan.

Additional resources

- [Retirement Topics - When Can a Retirement Plan Distribute Benefits?](#)
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Verifying Rollover Contributions

A retirement plan isn't required to accept rollover contributions from other plans or IRAs, but if it does, the incoming funds must:

- be [permissible rollovers](#) allowed by the plan document,
- come from a qualified plan or IRA,
- be the type of funds eligible to be rolled over, and
- be paid into the new plan no later than 60 days after the employee receives the funds from the old plan or IRA.

The plan administrator should take reasonable steps to evaluate whether these conditions are met. If the funds are coming directly from the old plan or IRA – for example, via a check made out to the new plan – then there is no 60-day requirement.

Safe harbor procedures

[Revenue Ruling 2014-9](#) describes simplified due diligence procedures for a plan administrator to confirm the sending plan or IRA's tax-qualified status and conclude that a rollover contribution is valid. These procedures are generally sufficient:

- employee certification of the source of the funds
- verification of the payment source (on the incoming rollover check or wire transfer) as the participant's IRA or former plan

- if the funds are from a plan, looking up that plan's Form 5500 filing, if any, in the Department of Labor's [EFAST2 database](#) for assurance that the plan is intended to be a qualified plan

It's not necessary to obtain a letter from the distributing plan when its qualified status can be checked using the online Department of Labor filing search.

Example (1): Alice makes a direct rollover contribution to Plan A with a check from Plan B payable to the trustee of Plan A, for the benefit of Alice. Plan A accepts all rollover contributions except after-tax or designated Roth contributions.

Plan A's administrator may reasonably conclude that Alice's rollover contribution is valid based on these factors:

1. Alice, aged 50, certifies that her Plan B distribution doesn't include after-tax contributions or amounts attributable to designated Roth contributions.
2. Plan A's administrator verifies that the rollover check was issued by Plan B payable to the trustee of Plan A. The plan administrator may reasonably conclude that the trustee of the distributing plan treated the amount as an eligible rollover distribution.
3. Plan A's administrator checks the EFAST2 database for Plan B's most recent Form 5500 filing and sees that the entry on line 8a (identifying plan characteristics) indicates the plan is intended to be a qualified plan.

Example (2): Brian, aged 60, gives Plan A's administrator a check from the trustee of his traditional IRA, payable to Plan A for the benefit of Brian. The check stub identifies the source of the funds as "IRA of Brian." Brian also certifies that the distribution includes no after-tax amounts. Based on the information on the check stub and Brian's certification, the plan administrator may conclude that Brian's rollover contribution is valid.

Will an invalid rollover contribution jeopardize my plan's qualification?

In general, a plan can accept a direct rollover contribution without jeopardizing its qualified status if the plan administrator:

1. reasonably concludes that the rollover contribution is valid, and
2. distributes any ineligible rollover contribution, with earnings, within a reasonable time of discovering the error (Treasury Regulation Section 1.401(a)(31)-1, Q&A 14).

Form 5500 filings database

A plan administrator can access the [EFAST2 database](#) maintained by the Department of Labor.

- Search for the most recently filed Form 5500 or 5500-SF for the plan making the rollover distribution.
- On the latest Form 5500 or 5500-SF for the plan, check the entry on the line for plan characteristics (line 8a on Form 5500 and line 9a for Form 5500-SF).
- Code 3C entered on this line indicates that the plan is not intended to be a qualified plan. If any other code is entered on this line, the plan administrator may reasonably conclude that the plan is qualified.

Not all plans are required to file a Form 5500 or Form 5500-SF, so sometimes this information will not be available.

It's not necessary for the distributing plan to have a determination letter from the IRS on its qualified status for a plan administrator to conclude that a rollover contribution is valid.

Eligible rollover distributions

IRAs: You can roll over all or part of any distribution from your IRA except:

- A [required minimum distribution](#) or
- A distribution of excess contributions and related earnings.

Retirement plans: You can roll over all or part of any distribution of your retirement plan account except:

- Required minimum distributions,
- [Loans](#) treated as a distribution,
- [Hardship distributions](#),
- Distributions of excess contributions and related earnings,
- A distribution that is one of a series of [substantially equal payments](#),
- Withdrawals electing out of automatic contribution arrangements,
- Distributions to pay for accident, health or life insurance,
- Dividends on employer securities, or
- S corporation allocations treated as deemed distributions.

Distributions that can be rolled over are called "eligible rollover distributions." Of course, to get a distribution from a retirement plan, you have to meet the plan's conditions for a distribution, such as termination of employment.

Additional resources

- [Rollovers of retirement plan and IRA distributions](#)
- [Rollover chart](#) – permissible retirement plan rollover transactions
- [Internal controls protect your retirement plan](#)
- [Tax information for retirement plan sponsors](#)

Disaster Relief for Retirement Plans and IRAs

In the event of a presidentially declared disaster, the IRS will postpone certain retirement plan and IRA deadlines for affected taxpayers. Most presidentially declared disasters are severe storms (such as tornadoes and hurricanes), but they may also be wildfires, flooding or earthquakes. Affected taxpayers are generally people who live in or have a business in an area directly impacted by the disaster.

Soon after a disaster is declared, the IRS will issue a news release describing the:

- type of relief (which deadlines are being postponed),
- taxpayers eligible for relief, and
- duration of the relief period.

[Revenue Procedure 2007-56, section 8](#), lists the retirement plan and IRA deadlines that the IRS may postpone because of a disaster.

The IRS may postpone all or only certain deadlines listed in Revenue Procedure 2007-56 based on when the disaster occurred and its severity as well as other factors. Unless the news release for a particular disaster limits the relief, *all* the deadlines listed in Revenue Procedure 2007-56 will be postponed.

For example, the IRS may:

- extend the 60-day period for plan participants to deposit eligible rollover distributions to another qualified plan or IRA, or
- extend the time for a qualified plan to make a required minimum distribution.

See [Tax Relief in Disaster Situations](#) for the latest disaster-related new releases and related guidance.

Puerto Rico Pension Feature Codes Misapplied by Plan Sponsors

During its Hacienda project, the Employee Plans Compliance Unit ([EPCU](#)) looked at whether plan sponsors properly classified plans covering employees who are Puerto Rico residents. Form 5500 instructions list two Puerto Rico related pension feature codes:

- **Code 3C** means a plan isn't intended to be qualified under Internal Revenue Code Sections 401, 403 or 408.
- **Code 3J** means a U.S. based plan that covers Puerto Rico residents and is qualified under both Internal Revenue Code Section 401 and Puerto Rico Code Section 1165, or is a dual qualified plan.

Project results

The responses showed that most of the sampled sponsors misunderstood the Puerto Rico related pension feature codes 3C and 3J. Plan sponsors:

- Intended their plans to qualify only under the Puerto Rico Code because they were Puerto Rico employers covering only employees in Puerto Rico.
- Incorrectly selected code 3C instead of 2C – The Plan sponsors were U.S. employers who didn't have any employees in Puerto Rico and never sponsored a plan in Puerto Rico but mistakenly selected code 3C but meant to select 2C because they had a money purchase plan.
- Incorrectly provided a Puerto Rico address – Sponsors must provide correct information because they file the return under penalties of perjury.

Background

Sponsors of plans covering employees in Puerto Rico must receive approval from the Puerto Rico taxing authority, the Hacienda. Those plan sponsors can elect to have their plans qualified:

- only under the Puerto Rico Code, in which case they would use pension feature code 3C, or
- under both the Internal Revenue Code and the Puerto Rico Code (dual qualified), in which case they would use pension feature code 3J

Project goals

EPCU designed the Hacienda project in two phases. In Phase I, they sent contact letters to plan sponsors that filed [Form 5500](#) returns showing they:

- selected code 3C in a subsequent year but not in a prior year, or
- didn't select code 3C in a subsequent year but selected it in a prior year.

EPCU wanted to learn if sponsors changed their intent for the plan to be qualified or if they simply made the mistake of selecting code 3C in one year but not another.

In Phase II, EPCU sent contact letters to plan sponsors that filed a Form 5500 return with a Puerto Rico address and who:

- didn't select code 3C or 3J, or
- selected code 3J.

EPCU wanted to learn why those plan sponsors weren't using a Puerto Rico related pension feature code or if sponsors were correctly using code 3J.

Planning tips

Now may be a good time to review your most recent Form 5500 filing to see if you selected the correct pension feature codes and completed the address portion of the return accurately.

Correct any errors you discover and amend your return, if needed. Correct your plan administrative procedures so the mistakes don't happen again. It may be helpful if at least two people review your 5500-series return before you file it.

If you're a benefits professional, make sure you talk with your clients about the differences between pension feature codes 3C and 3J.

Contact us

If you have questions about this project, [email](#) us and include "Hacienda project" in the subject line.

Additional resources

- [Form 5500](#) series and instructions
- [Form 5500-EZ](#) and instructions

Plan Sponsors Make Errors When Filing Their Final Return

During its Final Return with Assets project, the Employee Plans Compliance Unit ([EPCU](#)) found errors in the majority of the final [Form 5500-series returns](#) it reviewed. EPCU looked at plan sponsors who filed a Form 5500-series return marked "the final return/report" but listed assets at the end of the plan year to see if they had completed all the [steps in terminating](#) their plans.

Project goals

EPCU designed the Final Return with Assets project to determine:

- whether plan sponsors made an error by marking their Form 5500 as the final return/report,
- why sponsors marked their Form 5500 as the final return/report when the same return listed end of year plan assets, and
- whether there were Form 5500 processing errors that caused the return to show it was a final return/report with end of year assets.

Project results

Over 90% of the responses showed sponsors made one or more of the following errors on their Form 5500:

- Filed a Form 5500 marked the final return/report but had assets at the end of the plan year

For the final return/report box to be marked, sponsors must have distributed all plan assets.

- Filed more than one Form 5500 marked the final return/report

Only one Form 5500 should be marked as the final return/report and should be filed for a terminated plan after all plan assets are distributed.

- Distributed all plan assets after the end of the plan year but before filing the Form 5500

For example, a sponsor marked its 2011 Form 5500 as the final return/report for the plan year ending December 31, 2011. However, the plan still had assets on December 31, 2011, which it distributed in 2012 before the filing deadline for the 2011 Form 5500 (July 31, 2012). Even though the plan distributed all plan assets before the due date of its 2011 Form 5500, the distribution was made in the 2012 plan year and not in the 2011 plan year. Therefore, the sponsor shouldn't have marked its 2011 Form 5500 as the final return/report. Instead, the sponsor should have filed and marked its 2012 Form 5500 as the final return/report.

- Filed a Form 5500 for a Simplified Employee Pension (SEP) plan

Plan sponsors shouldn't file a Form 5500 for a SEP plan. Instead, the entity that maintains the SEP-IRA files a [Form 5498](#), *IRA Contribution Information*.

- Filed a Form 5500 for an IRA

Plan sponsors shouldn't file a Form 5500 for their IRA. Instead, the entity that maintains the IRA files a Form 5498, *IRA Contribution Information*.

- Didn't check the "short plan year return/report (less than 12 months)" box

Plan sponsors should mark the short plan year box when filing a return for a period of less than 12 months and show the short plan year dates just above item A in Part I. For example, if the plan assets weren't distributed until after the end of a plan year in which the plan terminated, then the plan may have a short plan year for the year they're actually distributed. For a short plan year, the return is due by the last day of the 7th month following the end of the short plan year.

Other errors

- The plan sponsor didn't file Form 1099-R for plan distributions.

Plan sponsors must file [Form 1099-R](#), *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* to report plan distributions. Form 1099-R is generally filed for each person who received \$10 or more.

- Three amended Forms 5500-EZ weren't processed or posted properly to our system.

Planning tips

Review your terminated plan to see if you have finished all the termination steps including filing:

- All current and prior Form 5500 returns
- A final Form 5500 showing zero assets

Final Forms 5500 are required even if you've been [exempt](#) from filing a Form 5500-EZ (the annual return of a one-participant retirement plan) in previous years.

You should correct any errors and amend your return. Correct your plan administrative procedures so these mistakes don't happen again. It may be helpful to ask at least two people to review your Form 5500 before you file it.

Contact us

If you have questions about this project, [email](#) us and include "Final Return with Assets" in the subject line.

Additional resources

- [Form 5500 corner](#)
- [Form 5500](#) series and instructions
- [Form 5500-EZ](#) and instructions