

Retirement News for Employers

April 2, 2015 Edition

Plan sponsors

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IRAs

[IRS Tax Tip](#) – still time to contribute to an IRA for 2014

[IRA limits](#) – for contributions and deductions

Updated

[SEP Plan Fix-It Guide](#)

[Publication 3998](#) (12-2014), *Choosing a Retirement Solution for Your Small Business*

[Publication 4284](#) (2-2015), *SIMPLE IRA Plan Checklist*

[Publication 4285](#) (2-2015), *SEP Plan Checklist*

[Publication 4286](#) (2-2015), *SARSEP Checklist*

[Publication 4334](#) (10-2014), *SIMPLE IRA Plans for Small Businesses*

Excluding Eligible Employees from Your 403(b) Plan - Fixing Common Plan Mistakes

The issue:

The universal availability rule requires that all employees must be allowed to make salary deferrals (including Roth contributions, if allowed under the plan) to a 403(b) plan unless the 403(b) plan specifically excludes them and they fall into one of five categories:

1. non-resident aliens
2. students performing services described in Internal Revenue Code Section 3121(b)(10)
3. employees eligible to make elective deferrals to the same employer's 401(k), 457(b) or other 403(b) plan
4. employees who normally work fewer than 20 hours per week
5. employees who contribute \$200 or less annually

Employer matching and nonelective contributions aren't subject to the universal availability rule, which is only for salary deferrals.

Under the universal availability rule, employees must be given an "effective opportunity" to make a deferral. Determining whether employees have this opportunity depends on the facts and circumstances. Generally, plan sponsors meet this requirement if employees have an opportunity to make or change a deferral election at least once a year.

The problem:

Hospital Z's 403(b) plan permits all eligible employees, except those working less than 20 hours a week, to make salary deferrals. The plan doesn't include matching contributions. Since 2009, part-time nurses haven't been told about the plan and none of them has made any salary deferrals.

On July 1, 2013, during an annual review of the plan's records, it's discovered that many of the part-time nurses regularly work more than 20 hours a week (and work 1,000 or more hours annually).

Fixing the mistake:

To fix the universal availability failure, Hospital Z must make a contribution that generally represents each excluded employee's lost ability to make salary deferrals to the 403(b) plan, called the "lost opportunity cost." This lost opportunity cost is 50% of the salary deferral the employee could have made to the 403(b) plan.

[Revenue Procedure 2013-12](#) Appendix A.05(6) allows employers to deem the lost salary deferral amount to be the greater of:

- 3% of compensation, or
- the maximum deferral percentage for which the plan sponsor provides a matching contribution rate at least as favorable as 100% of the elective deferral made by the employee.

Using the safe harbor correction, Hospital Z must contribute 1.5% (3% of compensation x 50%) of each nurse's compensation for each year they were excluded. They must adjust the contributions for any lost earnings through the date of correction.

Hospital Z can use other correction methods to fix this mistake. Any alternative correction method not described in Appendix A or B of Revenue Procedure 2013-12 must satisfy the correction principles in Revenue Procedure 2013-12, section 6.

Correction programs available:

Regardless of which correction program is used, the plan sponsor corrects the mistake the same way – by making a contribution with earnings for the excluded nurses.

Self-Correction Program

To self-correct this plan mistake, Hospital Z must have practices and procedures in place designed to facilitate compliance. Also, the failure must be [insignificant](#) because significant plan mistakes must be self-corrected within 2 years. In this case, the earliest plan year the mistake occurred was 2009. The plan sponsor had until the last day of the 2011 plan year to self-correct this mistake.

Voluntary Correction Program

If the Hospital didn't have proper practices and procedures, the failure is determined to be significant or Hospital Z wants IRS approval of its corrections methods, it can file a submission under the Voluntary Correction Program.

Audit Closing Agreement Program

Under Audit CAP, Hospital Z and the IRS enter into a closing agreement outlining the corrective action and negotiate a sanction based on the [maximum payment amount](#).

Making sure it doesn't happen again

You should develop a system to determine whether employees are eligible to participate in the plan. Employees can't be excluded because they are categorized as part-time. Develop a method to determine whether any employee is expected to work fewer than 20 hours a week and regularly check the employee's actual hours worked.

In addition to monitoring the allowable exclusions, ensure that all employees are notified of their right to participate. For example, if some categories of employees have significantly lower participation than others, it may signal that you haven't properly notified those groups of their right to participate. At the very least, you may need to reach out to those employees to inform them of their right to participate in the plan.

It's Not Too Late for a Tax Break - Start a SEP Retirement Plan for 2014

If you own a business, you still have time to set up a [Simplified Employee Pension](#) (SEP) plan for 2014. If you set up and fund your SEP by the due date of your 2014 business return (including extensions), you can still take a deduction for 2014.

If your business uses the calendar year for its tax year, the deadline to set up and contribute to a SEP plan for 2014 depends on the type of your business organization:

- **Corporation filing Form 1120 or 1120S** - you have until March 15, 2015 (September 15, 2015, if you file for an extension).
- **Partnership filing Form 1065** - you have until April 15, 2015 (September 15, 2014, if you file for an extension).
- **Sole proprietorship reported on Schedule C of Form 1040** - you have until April 15, 2015 (October 15, 2015, if you file for an extension).

You can [set up a SEP](#) plan for little or no cost at a bank, investment firm or insurance company.

SEP plans offer high contribution and deduction limits, minimal paperwork and no annual Form 5500 filing. You can contribute to a SEP plan even if you participate in an unrelated employer's plan (for example, a 401(k) plan). Contributions to a SEP plan are subject to the [SEP contribution limits](#).

Other kinds of business-sponsored retirement plans must have been established before the end of 2014 in order for the business to get a deduction for 2014.

Additional resources

- [Small Business Retirement Plan Resources](#)
 - [Publication 560, Retirement Plans for Small Business](#)
 - [Publication 4333, SEP Retirement Plans for Small Businesses](#)
 - [SEP Plan FAQs](#)
 - [SEP Checklist](#)
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It's Up to Plan Sponsors to Track Loans, Hardship Distributions

Even if you use a third party administrator (TPA) to handle participant transactions, you're still ultimately responsible for the proper administration of your retirement plan. Make sure you're keeping up with the recordkeeping requirements.

Keep documentation for hardship distributions

The plan sponsor must obtain and keep [hardship distribution](#) records. Failure to have these records available for examination is a qualification failure that should be corrected using the Employee Plans Compliance Resolution System ([EPCRS](#)).

The plan sponsor should retain these records in paper or electronic format:

1. Documentation of the hardship request, review and approval;
2. Financial information and documentation that substantiates the employee's immediate and heavy financial need;
3. Documentation to support that the hardship distribution was properly made in accordance with the applicable plan provisions and the Internal Revenue Code; and
4. Proof of the actual distribution made and related Forms 1099-R.

It's not sufficient for plan participants to keep their own records of hardship distributions. Participants may leave employment or fail to keep copies of hardship documentation, making their records inaccessible in an IRS audit.

Also, electronic self-certification is not sufficient documentation of the nature of a participant's hardship. IRS audits show that some TPAs allow participants to electronically self-certify that they satisfy the criteria to receive a hardship distribution. While self-certification is permitted to show that a distribution was the sole way to alleviate a hardship, self-certification is not allowed to show the nature of a hardship. (See Treasury Regulation Sections 1.401(k)-1(d)(3)(iv)(C) and (D)). You must request and retain additional documentation to show the nature of the hardship.

Keep documentation on plan loans

A plan sponsor should retain these records, in paper or electronic format, for each [plan loan](#) granted to a participant:

1. Evidence of the loan application, review and approval process;
2. An executed plan loan note;
3. If applicable, documentation verifying that the loan proceeds were used to purchase or construct a primary residence;
4. Evidence of loan repayments; and
5. Evidence of collection activities associated with loans in default and the related Forms 1099-R, if applicable.

If a participant requests a loan with a repayment period in excess of five years for the purpose of purchasing or constructing a primary residence, the plan sponsor must obtain documentation of the home purchase before the loan is approved. IRS audits have found that some plan administrators impermissibly allowed participants to self-certify their eligibility for these loans.

Additional resources

- [Internal Controls Protect Your Retirement Plan](#)
 - [Retirement Topics - Plan loans](#)
 - [Retirement Plan FAQs Regarding Loans](#)
 - [Fixing Common Plan Mistakes - Participant Loans in 401\(k\) Plans](#)
 - [Fixing Common Plan Mistakes - Plan Loan Failures and Deemed Distributions](#)
 - [Retirement Plans FAQs regarding Hardship Distributions](#)
 - [Do's and Don'ts of Hardship Distributions](#)
 - [Hardship Distribution Tips from EP Exam](#)
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Plan Distributions to Foreign Persons Require Withholding

Does your U.S. retirement plan make distributions to [foreign persons](#)? If so, you must generally withhold 30% of the payment for federal income tax (IRC Section 1441(a)).

How do I document the status of a payee?

You must generally withhold 30% from a plan distribution paid to a foreign payee unless you can reliably [associate the payment with valid documentation](#) that establishes the payee is:

- a U.S. person, or
- a foreign person entitled to a rate of withholding lower than 30%.

Documentation can include Form W-9, Form W-8BEN, or other appropriate sources.

If you don't have documentation, you may be able to apply a lower withholding rate but only if you can verify that the recipient is a presumed U.S. person under the tax regulations.

How do I determine a payee's status if I don't have documentation?

If you can't reliably document the status of a retirement plan distribution recipient as a U.S. person or a foreign person entitled to lower withholding, you should apply the [presumption rules](#) in the tax regulations (Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)).

Who can I presume is a U.S. person?

A retirement plan distribution is presumed to be made to a U.S. person only if the withholding agent:

- has a record of a **Social Security number** for the payee, and
- relies on a **payee mailing address** that's
 - in the United States, or
 - in a foreign country with which the United States has an income tax treaty in effect giving its residents exemption from U.S. tax on payments of this type.

A payment that does not meet these rules is presumed to be made to a **foreign person**. See Treasury Regulation Section 1.1441-1(b)(3)(iii)(C) for the complete rule.

Examples of withholding errors

Plan sponsors and third party administrators are withholding agents and may be liable for taxes and penalties for improper withholding.

No withholding on distribution to a presumed foreign person

The Employee Plans Examinations group has seen situations in which the plan withholding agent didn't withhold federal income tax on plan distributions that constitute U.S. source income to participants residing in foreign countries, specifically when:

- The participant resides in a country with which the United States **doesn't** have an income tax treaty in effect that entitles the payee, if a resident in the treaty country, to a U.S. tax exemption on their qualified plan distributions;
- The plan sponsor didn't secure Form W-8BEN, Form W-9 or other documentation to determine the payee's status as a U.S. person; and
- The plan sponsor reported the distribution on Form 1099-R.

These participants are **presumed to be foreign persons** and their distributions should be **reported on Forms 1042-S** with 30% federal income tax withheld.

Improper withholding at a reduced rate

IRS auditors have also seen situations in which a reduced rate of federal income tax (less than 30%) was improperly withheld on qualified plan distributions that constituted U.S. source income to participants residing in foreign countries, specifically when:

- The participant resides in a country with which the United States doesn't have an income tax treaty in effect that entitles the payee, if a resident in the treaty country, to a U.S. tax exemption on their qualified plan distributions; and

- The plan sponsor didn't secure Form W-8BEN, Form W-9 or other documentation to determine the payee's status as a U.S. person or foreign person.

In this situation, the participant is presumed to be a foreign person (Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)).

A withholding agent who makes a payment to a person presumed to be a foreign person **may not reduce the 30% withholding** on it unless the beneficial owner furnishes a Form W-8BEN withholding certificate (Treas. Regs. Sections 1.1441-1(b)(3)(iii)(C) and 1.1441-1(e)(2)(i)). Because the withholding agent didn't secure Form W-8BEN from the participant in this situation, federal income tax should have been withheld at the 30% rate.

Additional resources

- [Nonresident alien withholding](#)
 - [Treasury Regulation Section 1.1441-1\(b\)\(3\)\(iii\)\(C\)](#)
 - [International Issues Affecting Retirement Plans](#)
 - [Tax Information for Plan Sponsors](#)
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DOL Corner

The Department of Labor's Employee Benefits Security Administration (DOL/EBSA) announced new guidance as featured below. You can subscribe to [DOL/EBSA's](#) home page for updates

Annual funding notice – final rule

On Feb. 2, DOL/EBSA published a [final rule](#) implementing the annual funding notice requirements under ERISA Section 101(f), as amended by the Pension Protection Act.

The rule requires the plan administrator of a defined benefit pension plan that is subject to the Pension Benefit Guaranty Corporation's (PBGC) insurance program to furnish a funding notice annually to participants, beneficiaries, labor organizations representing such participants or beneficiaries, employers obligated to make contributions to a multiemployer plan and the PBGC. The final rule contains model notices.

Among other things, the notice must show the plan's funding percentage, the assets and liabilities that determine the funding percentage, the fair market value of the plan's assets on the last day of the plan year, the plan's funding and investment policies and allocation of assets, and known events that are projected to have a material effect on the plan's funding.

An estimated 27,000 plans covering approximately 44 million participants and beneficiaries are subject to this disclosure requirement.

Annual funding notice – Field Assistance Bulletin

On Jan.14, DOL/EBSA issued [Field Assistance Bulletin \(FAB\) 2015-01](#) on the annual funding notice requirements following the Highway and Transportation Funding Act of 2014 (HAFTA).

The FAB provides guidance on compliance by plan administrators of single-employer defined benefit pension plans with the annual funding notice requirements of ERISA Section 101(f) as amended by Section 2003 of the Highway and Transportation Funding Act of 2014. The FAB includes a modified supplement to the model annual funding notice that plan administrators may use to comply.

Outreach and education

For notice of upcoming events as they are scheduled, subscribe to [DOL/EBSA's](#) website home page. DOL/EBSA conducts seminars on retirement plans and health benefits plans for small businesses.