

# Retirement News for Employers

Helping Business Owners with Retirement Plans

Internal Revenue Service

Tax Exempt and Government Entities

Volume 2, Summer 2005

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## All The News That Fits

The [Retirement Plans Community web page](#) has a new look and now has more information designed for members of the small business community.

We've gone to a "newsier" three-tiered approach on our landing page. The new look features breaking news items like the new rules on benefit and contribution limits and other new guidance.

Our page now also features more information written just for business owners. Just go to our [web page](#) and click on "Plan Sponsor/Employer" under the "Information For" heading on the left side of the page.

We know that when it comes to retirement, a business owner's needs and interests are different from those of benefits professionals.

Here are just a few examples of the type of information available on the Plan Sponsor/Employer section:

- A collection of one-page Checklists for IRA-based plans, such as SEPs, SARSEPs and SIMPLE IRAs, that will help give you a better idea of whether your plan is meeting some of the important retirement plan rules.
- An archive of our popular "The Fix Is In: Common Plan Mistakes" column – you no longer have to go to the *Retirement News for Employers* archive. Instead, just click on "How Do I..." and then select "Fix a Plan Mistake."
- Retirement Tips for Employers features advice on choosing and operating a retirement plan and it also has lots of links to plain-language publications that the IRS has on retirement plans.

And, of course, there's much more.

Next on our "To Do" list is creating more content on retirement for employees and plan participants. We'll have information on receiving distributions from retirement plans, tips on retirement planning and, you guessed it, lots more – and all of it designed just for employees and plan participants.

Let us know what you think of our redesign by emailing us at [RetirementPlanComments@irs.gov](mailto:RetirementPlanComments@irs.gov). ■



## Product Profile – *SIMPLE IRA Plans for Small Businesses* Publication

Have you considered establishing a SIMPLE IRA plan for your small business? Does your small business already sponsor a SIMPLE IRA plan? Either way, you may have questions about some of the rules and requirements of a SIMPLE IRA plan.

The IRS and U.S. Department of Labor's Employee Benefits Security Administration (EBSA) have jointly issued a publication to provide answers to your questions. *SIMPLE IRA Plans for Small Businesses* ([Publication 4334](#)) is a plain-language publication that provides you with basic information dealing with establishing and operating SIMPLE IRA plans, such as:

- 
- Choosing a financial institution
  - Adopting a written plan
  - Enrolling employees
  - Employee contributions
  - Employer contributions
  - Depositing and investing contributions
  - Communicating with employees
  - Reporting to the government
  - Distributions

The publication provides an example of how a SIMPLE IRA plan works. In addition, it discusses the EBSA and IRS correction programs to help SIMPLE IRA plan sponsors correct plan errors, protect participants and keep the plan's tax benefits. Finally, the publication provides additional resources for your use if you need more in-depth information.

The publication, as well as additional information on SIMPLE IRA plans, can be found on the IRS and EBSA websites, [www.irs.gov/ep](http://www.irs.gov/ep) and [www.dol.gov/ebsa](http://www.dol.gov/ebsa). Copies of the publication can be ordered by calling either (800) 829-3676 (IRS) or (866) 444-3272 (EBSA). Both numbers are toll-free. ■

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### *While We're on the Subject...*

Speaking of SIMPLE IRA plans, here's some more information on these valuable retirement plans:

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- As we reported in the [Winter 2005 Edition](#) of the *Retirement News for Employers*, Employee Plans started a new examination program of SIMPLE IRA plans. Early examination results show a substantial number of SIMPLE IRA plans have not been amended for the changes required by the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). SIMPLE IRA plans needed to be amended for EGTRRA by adopting the March 2002 revision of IRS model Forms [5304-SIMPLE](#) or [5305-SIMPLE](#) by December 31, 2002 or the approved EGTRRA plan of the prototype plan sponsor by the required due date for prototype plans. Failure to do so has caused these plans to be considered non-amenders. If you think this applies to your plan, you may want to seek the advice of your financial institution or a benefits professional.

- EP has developed another tool for your use to assist you in reviewing the operational requirements of your SIMPLE IRA plan. The SIMPLE IRA Checklist ([Publication 4284](#)) is a one-page list of 10 questions highlighting some of the basic requirements for operating the plan. It is available in paper and online versions. It provides a quick review to see if some basic requirements in operating a SIMPLE IRA plan have been met. However, it does not cover all plan requirements and it should not be used as a complete plan review.
- The [Retirement Plans Community web page](#) has additional information on choosing, establishing, operating and terminating a SIMPLE IRA plan. The SIMPLE IRA Resource Library includes Frequently Asked Questions on SIMPLE IRA Plans. Check out these resources by selecting “Plan Sponsor/Employer,” then “Types of Retirement Plans,” and clicking on “SIMPLE IRA.”

SIMPLE IRA Plan Questions, Simple Answers. ■

#### CONTACTING EMPLOYEE PLANS

The *Retirement News for Employers* welcomes your comments about this issue and/or your suggestions for future articles.

Send comments/suggestions to:

EP Customer Education & Outreach  
SE:T:EP:CEO  
1111 Constitution Avenue, N.W., PE-4C3  
Washington, D.C. 20224

or FAX (202) 283-9525

or E-Mail: [RetirementPlanComments@irs.gov](mailto:RetirementPlanComments@irs.gov)

For **EP Taxpayer Assistance:**

**For retirement plans technical and procedural questions:**

Please call (877) 829-5500

Or visit the EP Customer Account Services section at [www.irs.gov/ep](http://www.irs.gov/ep).

**For questions relating to retirement income, IRAs, Roth IRAs, educational IRAs, medical savings accounts and section 125 cafeteria plans:**

Please call (800) 829-1040

For further **Employee Plans Information:** Go to [www.irs.gov/ep](http://www.irs.gov/ep).

## Choosing a Tax Professional

Many business owners and individuals hire tax professionals, such as tax attorneys, certified public accountants and enrolled agents. These professionals may even represent you before the IRS.

However, did you know that you are legally responsible for your information return and its attachments (such as Form 5500, its schedules and supporting documentation)? It's true. And this includes being responsible for the data stated on your retirement plan information return.

Most tax professionals provide excellent service for their clients. After all, it's in their best interest as well as yours to follow the rules. However, there are some tax professionals who, for a variety of reasons, push the envelope too far.

So consider the following as some tips from the IRS when it comes to choosing a tax professional:

1. Be certain that your tax professional discloses all the pertinent information (i.e., assets, determination letter, participant data, etc.) on your information return.
2. Consider the following in choosing a tax professional:
  - a. Can they represent you before the IRS?
  - b. Will they be available after the information return has been filed?
  - c. Do they belong to a professional organization that provides continuing education and holds its members accountable to a code of ethics?
3. Never sign a blank information return.
4. The Better Business Bureau, State Boards of Accountancy for CPAs, State Bar Associations or State Attorney General's offices may provide information regarding tax professionals who have had legal problems in the past representing their clients.

For more tips, go to the [Retirement Plan Community web page](#), select “Plan Sponsor/Employer” under the “Information For” heading on the left side, and then click on “Retirement Tips for Employers.” ■

## Critical FewPoints...by Michael Julianelle (Director, EP Examinations)

My office is responsible for conducting audits of the operations of retirement plans by analyzing applicable books and records. If plan mistakes are identified during an examination, help to fix them may be available through our Audit Closing Agreement Program. In this and future editions of the *Retirement News for Employers*, I will share with you my office's critical areas of focus and results from our examination/enforcement work. My goal is that this information will benefit you and your employees participating in retirement plans by avoiding making some common plan mistakes or worse becoming involved in abusive transactions or schemes.

Some of my "Critical FewPoints" that are vital to the success of EP Examinations include:

- **Shutting down abusive transactions or schemes** involving retirement plans. These abuses usually involve ways to shelter all or most of the employer's business income from tax or take excessively large deductions. Right now, examinations are being performed on S Corp ESOP and 412(i) plans. Also, we are sending soft contact letters to inform plan sponsors that IRS knows these plans have the abusive potential and asking these sponsors to work with us in resolving these issues.
- **Monitoring pension funding** in conjunction with the U.S. Department of Labor and the Pension Benefit Guaranty Corporation.
- **Increasing compliance contacts** via specialized initiatives and through the Employee Plans Compliance Unit (EPCU). EPCU identifies returns for compliance activities and uses soft contact approaches to question return items, which will possibly resolve issues without a full examination.

You can access information on EP's examination/enforcement results at [www.irs.gov/ep](http://www.irs.gov/ep). Plus the web page has an Examination Process Guide which gives you a better understanding of our examination process from start to finish and includes sections on resolving issues, communications, and the appeals process. ■

### The Fix Is In: Common Plan Mistakes

In each issue of the *Retirement News for Employers* we'll present a common mistake that happens in retirement plans. We'll describe the problem, how it happened, how to fix it and how to lessen the probability of the problem happening again. This edition of the column focuses on "**Vesting Errors in Defined Contribution Plans.**"

#### The Issue

Many of you have a 401(k) plan or some other form of qualified defined contribution retirement plan. A qualified defined contribution plan must meet various requirements of the minimum vesting standards found in section 411 of the Internal Revenue Code in order to maintain its status as a qualified plan. The minimum vesting standards are designed to ensure an employee will vest, that is, be entitled to, their accrued benefit within a certain time period. An employer should think of vesting as ownership of the plan benefit by the participant. As is true with the minimum age and service requirements for eligibility purposes, the law provides some options in complying with the minimum vesting requirements. When you established your plan, you made certain plan design choices that relate to these requirements.



An employee's rights to retirement benefits are determined through the application of a vesting schedule. A vesting schedule defines vesting in terms of percentages which are in turn determined based on the employee's number of years of service.

Generally, the plan's vesting must satisfy the legal requirements under one of two minimum schedules: "five-year cliff" vesting or "seven-year graded" vesting. Under five-year cliff vesting, employees must be 100% vested once they're credited with no more than five years of service. Prior to completing the fifth year of service, the employee's vesting percentage may be any percentage, including zero. This schedule is known as "cliff" vesting because the employee typically will jump from no vesting to 100% vesting once the employee completes the fifth year of service. Under seven-year graded vesting, employees must be 100% vested once they're credited with no more than seven years of service. Since 100% vesting can be delayed longer under this option, the law requires that a minimum vesting percentage apply to earlier years. The minimum percentages are as follows:

- Upon completion of 3 years of service – 20% vesting;
- Upon completion of 4 years of service – 40% vesting;
- Upon completion of 5 years of service – 60% vesting; and
- Upon completion of 6 years of service – 80% vesting.

**Important Note:** The forfeiture of the non-vested amount can only occur after the expiration of 5 years of little or no service or, if the plan provides, upon payment of the vested amount if a provision is made for a future buy-back of forfeited amounts. Forfeitures can be allocated to the remaining participants based on a pre-chosen formula or used to reduce future plan contributions.

## The Problem

To properly comply with the vesting rules, employers must maintain service records for all employees. Vesting schedules generally refer to "years of service" when assigning a vesting percentage. If these records are incorrect, or if a mistake is made when applying participant data to a vesting schedule, participants will receive incorrect benefit amounts upon leaving the plan. The amounts can be in excess of what is permissible or less than what was due to the participant. The failure to properly follow the vesting rules of the plan can cause the plan to lose its qualified status.

## The Fix

Employers may get relief from treatment of their plans as nonqualified through the **Employee Plans Compliance Resolution System (EPCRS)** by correcting the vesting failures. The Self-Correction Program (SCP) or Voluntary Correction Program (VCP) can be used to correct the mistakes. In order to fix the mistake under SCP, generally the mistake must be fixed within two years after the end of the plan year in which the failure occurred. Unless the failure can be classified as insignificant, VCP must be used after this time.

There is more than one way to correct vesting failures under EPCRS. One way is to use the *Contribution Correction Method*. A failure in a defined contribution plan to apply the proper vesting percentage to an employee's account balance that results in forfeiture of too large a portion of the employee's account balance may be corrected using this method. The employer makes a corrective contribution on behalf of the employee whose account balance was improperly forfeited in an amount equal to the improper

forfeiture. The corrective contribution is adjusted for earnings. If, as a result of the improper forfeiture, an amount was improperly allocated to the account balance of another employee, no reduction is made to the account balance of that employee.

### How to Subscribe to Retirement News for Employers

The *Retirement News for Employers* will be issued only through IRS e-mail. For your free subscription, please go to the [Retirement Plans Community](#) web page and subscribe online by selecting "Newsletters" under "Related Topics." All editions of the *Retirement News for Employers* will be archived at the [Retirement Plans Community](#) web page.

For your convenience, we have included Internet links to referenced materials throughout the electronic version of *Retirement News for Employers*. These links are identified on the printed version by the underlined text. The electronic version may be found at the [Retirement Plans Community](#) web page.

IRS employees contributing to this edition of the *Retirement News for Employers* are:

**Evelyn DeWald,**  
**Larry Isaacs,**  
**Michael Julianelle,**  
**Joyce Kahn,**  
**Teresita Laureano,**  
**Peter McConkey,**  
**Todd Newman,**  
**Mark O'Donnell,**  
**Nancy Payne,**  
**Keith Ruprecht,**  
**John Schmidt,**  
**Brenda Smith-Custer**  
**and Susan Taylor**

➤ **Example:** Employer E maintains a profit-sharing plan which provides that forfeitures of account balances are reallocated among the account balances of other eligible employees on the basis of compensation. During the 2003 plan year, Employee R terminated employment with Employer E and elected and received a single-sum distribution of the vested portion of his account balance. No other distributions have been made since 2003. However, an incorrect determination of Employee R's vested percentage was made resulting in Employee R receiving a distribution of less than the amount to which he was entitled under the plan. The remaining portion of Employee R's account balance was forfeited and reallocated.

**Correction:** Employer E uses the *contribution correction method* to correct the improper forfeiture. Thus, Employer E makes a contribution on behalf of Employee R equal to the incorrectly forfeited amount (adjusted for earnings) and Employee R's account balance is increased accordingly. No reduction is made from the account balances of the employees who received an allocation of the improper forfeiture.

Another way to correct these errors is by use of the *Reallocation Correction Method*. Generally, the account balance of the employee who incurred the improper forfeiture is increased by an amount equal to the amount of the improper

forfeiture and the amount is adjusted for earnings. The account balance of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that employee's account.

## Making Sure It Doesn't Happen Again

Calculating the vesting percentage of participants receiving benefit payments accurately and timely is vital for employers maintaining defined contribution plans. The plan document, employee data, etc., should be carefully reviewed to ensure that employees are correctly credited with vesting service. When a participant is receiving a benefit pay out, a quick check of the employee's vesting percentage can prevent these errors before they occur.

However, keep in mind that despite all of your good efforts, mistakes can happen. In that case, the IRS can help you correct the problem and retain the benefits of your qualified defined contribution retirement plan. ■

## The Filing Cabinet

Forms – you can't live with them, you can't live without them. Just like you use forms when running your business – everything from spreadsheets to receipts to invoices – you also use forms when dealing with a retirement plan.

### 2005 Form 5500 Now Available for Viewing

With its [Media Release](#) of July 25, 2005, DOL/EBSA, along with the IRS and Pension Benefit Guaranty Corporation announced the release of the 2005 Form 5500. This represents the earliest the form, schedules and related instructions have been made available and reflects the government's continued commitment to improve the Form 5500 filing process.

The most significant changes to the form are:

- The elimination of the Schedule T (*Qualified Pension Plan Coverage Information*);
- Refinement of the **Schedule B** (*Actuarial Information*) and its instructions on the reporting of investment returns, actuarial assumptions and the summary of eligibility and benefit provisions used in valuations; and

- Updated instructions for the Schedule A (*Insurance Information*) that reflect the latest DOL/EBSA guidance on the reporting of insurance fees and commissions.

Informational copies of the form, schedules and instructions are available for viewing on the [EBSA web site](#) and the [Retirement Plans Community web page](#) by clicking on “EP Forms & Publications” under the “Related Topics” section.

Filers are also invited to contact the EFAST Help Line for general assistance by calling (866) 463-3278.

## To Be Discontinued: Package X

The IRS intends to discontinue Package X, *Informational Copies of Federal Tax Forms* (a 3-volume set of reference forms) after this summer. The decision to discontinue this product reflects the IRS transition to electronic media and communications. The IRS noted that all of the forms are available on its [web page](#). This move will save the agency nearly \$2 million in production and distribution costs.

In addition, the Publication 1796, *IRS Tax Products* (a CD-ROM equivalent to Package X), is available for purchase from the superintendent of documents under the [Government Printing Office](#) and the [National Technical Information System](#). ■

## Let's Just Take It One Three-Month Period at a Time

-  = contribution
-  = conference
-  = file forms

Operating a retirement plan can be a time-consuming job. There are deadlines, not just for reports and forms but also for making contributions. There are conferences and seminars. And then there is information you need to give to participants.

So to help you navigate the retirement plan timeline, here is our month-by-month look at some of the important moments in the months to come. Please note that all of the filing dates below are for calendar year plans - adjust the dates for non-calendar year plans:

-  **August 23-25:** [IRS Nationwide Tax Forum](#) – Las Vegas, NV.
-  **August 30-September 1:** [IRS Nationwide Tax Forum](#) – Chicago, IL.
-  **September 15:** Deadline for making final required minimum contributions for 2004 calendar year money purchase and defined benefit plans.
-  **October 15:** Third quarterly contribution due date for 2005 calendar year defined benefit plans.
-  **October 17:** File the 2004 [Form 5500](#), *Annual Return/Report of Employee Benefit Plan* or [Form 5500-EZ](#), *Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan* with DOL/EFAST for those who filed for a 2 1/2 month extension prior to August 1.
-  **November 1:** Last date for employers with [SIMPLE IRA plans](#) or SIMPLE 401(k) plans to notify eligible employees of salary reduction rights and of the type of employer contribution to be made.

**For a comprehensive list of upcoming EP Educational Events, visit the [Retirement Plans Community web page](#), select “Educational Services” under “Related Topics” and then “Upcoming EP Educational Events.”** ■

