

April 6, 2010

MEMORANDUM TO CLIENTS

RE: IRS 401(k) Compliance Checklist Coming Soon

The IRS is scheduled to launch a 401(k) compliance check in April. As 401(k) plans increasing become the key retirement plan for many workers, and the economic conditions persist, the IRS wants to get a closer look at the ever changing landscape.

The IRS check-up, which will cover both form and operational compliance, is structured to gather information to draft a 401(k) report and assist in identifying future IRS audit areas and educational outreach. The following Q&As should help explain the scope of the program, and the key concerns of plan sponsors.

- **What is the selection process?** 401(k) plans, irrespective of size and whether or not pre-approved plans, have been randomly selected from Form 5500/census data to provide for an appropriate statistical sample size. Plans currently under audit have been excluded. The letters should be sent to plan sponsors over a few week period.
- **Are we required to complete the checklist?** No. Participation in the program is voluntary. However, failure to timely and fully complete the checklist will likely result in an IRS audit of the plan. The letter to the plan sponsor will fully explain these risks.
- **How long do we have to complete the checklist?** Plan sponsors have 90 days to complete the checklist, with extensions available. For example, an automatic 30 day extension will be available, plus additional reasonable time is available on request. The checklist can be completed on-line with a pin number that can be shared with your attorney or third party administrator.
- **What types of questions will the IRS ask?** The questions will be focused on IRS 401(k) requirements for the plan, focusing on (1) type of benefits offered to employees (and compliance with the IRS rules), (2) prior use of IRS voluntary correction program ("EPCRS"), and (3) impact of economic conditions (such as loans, hardship, suspend match/profit sharing contributions). Importantly, issues under the jurisdiction of the Department of Labor should not be covered (e.g., investments, fees). The list of questions (and glossary of terms) will be posted on the IRS website, they are expected to be extensive and likely involve assistance from the plan's third party administrator and legal counsel.
- **What if the question identifies a plan failure?** Answer the question honestly. However, prior to submission with the IRS, we recommend that legal counsel review the responses to identify any potential IRS violation – plan document, demographic/testing, or operational (failure to follow plan terms) – and consider the appropriate corrective action. The fact that the plan is part of the program does not mean that the plan is "under

examination"; therefore, they should be able to self-correct (SCP) or correct with IRS approval (VCP) under the IRS correction program.

Action Steps

Regardless of whether or not you receive a letter from the IRS, we recommend that a mini compliance audit to ensure that your plan would "pass" the checklist. Once the questionnaire is released, we would be happy to assist you in this effort – identifying the key issues and the appropriate tax-compliant responses. Moreover, if you receive a letter, you should (1) organize an internal team to be responsible for the response, (2) coordinate with your third party administrator to provide as much assistance as possible, (3) prior to submission, provide a copy of the checklist for attorney review and identification of any required corrective action to maintain tax-qualified status of the plan and to ensure that submission will not trigger an audit due to inadequate responses, and (4) retain a copy of the checklist with the plan records. This process should not be rushed; therefore, we recommend automatically requesting the additional 30 day extension.

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