

Employee Benefits Corner

By Elizabeth Thomas Dold and David N. Levine*

Employee Plans Enforcement Activities—An Overview

The IRS' Employee Plans office (EP) has often been a leader at creating program to encourage voluntary compliance—from the Administrative Procedure Regarding Self-Correction¹ in 1991 to the modern Employee Plans Compliance Resolution System (EPCRS)² to its significant customer education and outreach efforts.³ However, enforcement remains an important part of Employee Plans' mission and focus.

With the adoption of the "cycle-based" determination letter program, enforcement staff who used to be shifted to determinations to handle the various filing spikes, such as the "GUST" deadline in 2002, are less likely to be temporarily assigned outside their enforcement roles. Further, over the past several years, the headcount in EP's enforcement function has grown to represent a larger portion of EP's staffing. And with new outreach tools, more and more plans are coming in contact with EP's enforcement function.

In this column we provide an overview of compliance and enforcement actions currently being undertaken by EP's enforcement function.⁴



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Employee Plans Compliance Unit

Although the term "enforcement" is normally associated with full-blown "audits" or "examinations," some of the visible activities undertaken by EP's enforcement function over the past several years have been their Employee Plans Compliance Unit (EPCU) compliance checks.

Key Features of the EPCU Compliance Check Program

Key features of the compliance checks are as follows:

- **Purpose.** The purpose EPCU compliance checks are to assess areas of potential noncompliance.



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These projects enable EP's enforcement function to better understand and evaluate areas of noncompliance. Summary information derived from these EPCU compliance checks are publicly disclosed on the IRS website.⁵ The results of an EPCU compliance check can enable the IRS to better focus its agents and guidance to address significant areas of noncompliance.

- **Not an audit.** An EPCU compliance check is not an audit. As a result, EPCU compliance checks do not generally restrict a plan or plan sponsor from utilizing the various voluntary correction programs available under EPCRS. Instead, EPCU compliance checks are generally utilized to assess areas of potential noncompliance.
- **Need to respond.** Failure to respond to a EPCU compliance check can lead to a formal examination of the plan in question. As such, it is important to respond to an EPCU compliance check.

Process for Handling an EPCU Compliance Check

Although it is not a formal examination, many plans and plan sponsors address an EPCU compliance check in the same manner as they would a formal IRS examination. The degree of focus an organization places on an EPCU compliance check may vary based on the complexity (*i.e.*, a two-page survey on significant demographic changes in a plan that are focused on whether a partial termination has occurred or a broader inquiry about the operations of a plan) of the underlying compliance check. Common steps plans and plan sponsors take include the following:

- **Understanding the focus of the compliance check.** The cover letter sent with a compliance check usually explains the focus of the project. The cover letter will generally provide a contact point at the IRS for both telephone and e-mail inquiries.
- **Appointment of a project lead.** On larger EPCU compliance checks, it is often wise to appoint a group or individual to lead the process, especially if data is required from multiple sources (*e.g.*, current and/or prior recordkeepers, human resources, *etc.*).
- **Completion of survey.** While in the past the EPCU has generally relied on paper versions of compliance checks, electronic surveys are now being used and likely to become more and more common over time.
- **Extensions.** Although not necessarily formally stated in a EPCU compliance check letter, the IRS

has, in the past, granted extensions to EPCU compliance check response dates upon request.

- **Review with counsel and other advisors.** Depending on the scope of the EPCU compliance check, the responses are often vetted with counsel and other advisors to determine whether any issues of concern are flagged, and, if incorrectly reported, are addressed before the EPCU compliance check is submitted.
- **Corrections.** Although an EPCU compliance check is not an audit, if compliance issues are identified in the process of completing an EPCU compliance check, it is advisable to move expeditiously to evaluate and address these compliance issues. Although responding to an EPCU compliance check will not necessarily lead to selection for audit, an EPCU compliance check can serve as a helpful guide to proactive compliance efforts.

Recent EPCU Compliance Checks

The EP examinations function currently has multiple EPCUs, which allows EP examinations to conduct a number of EPCU compliance checks at the same time. Examples of significant EPCU recently completed and ongoing EPCU compliance checks include the following:

- **401(k) compliance check.** The EPCU 401(k) compliance check⁶ was the highest profile of the EPCU projects in recent years. This high profile relates to both the depth (*i.e.*, 69 detailed questions with multiple subparts) and the method of completion (*i.e.*, default to an electronic format). This EPCU compliance check was sent to a wide range of 401(k) plans of all sizes and covered questions addressing the following: (1) the demographics of the plan, (2) participation requirements and data, (3) data on employer and employee contributions, (4) top-heavy and nondiscrimination rule compliance, (5) distributions and plan loans, (6) automatic contribution arrangements, (7) Roth contribution features, (8) the use of EPCRS program, (9) features of plan administration, and (10) other questions ranging from employer securities, to UBIT, to FBAR reporting, to automatic contribution arrangements. Because of the wide range of these questions, many plan sponsors, especially larger plans, worked with the recordkeepers, advisors, in-house staff, and counsel to address these issues. The formal EP examinations report on the 401(k) compliance check has yet to be issued.
- **403(b) compliance checks.** There are three recent EPCU compliance check projects that have focused

on 403(b) plans' compliance with the Code Sec. 403(b) "universal availability" rule⁷ that generally takes the place of the Code Sec. 410(a) eligibility and Code Sec. 401(k) ADP testing rules. Two of these surveys—the K-through-12th grade universal availability compliance check⁸ and the slightly broader Code Sec. 403(b) higher education project,⁹ because it focuses on universal availability and compliance with the Code Sec. 403(b) plan document requirements—emphasize obtaining data on compliance and encouraging plan sponsors to bring their plans into compliance. A third Code Sec. 403(b)-related project is a follow-up¹⁰ to the K-12 project, which follows up with respondents whose answers indicated a failure to comply with the universal availability rules in their response to the initial EPCU 403(b) K-12 compliance check. It is not clear what subsequent IRS follow-up will occur if a K-12 plan response to the follow-up is that it has not corrected the failure.

- **Partial termination compliance check.** A number of plans and plan sponsors have recently received compliance checks based on their Form 5500 participant data indicating significant reductions in the number of participants covered by a plan. This EPCU compliance check is focused on ascertaining whether plans have complied with the rules under Code Sec. 411(d)(3) that participants affected by a partial termination be 100-percent vested in their plan contributions (in the case of a defined benefit plan, 100-percent vested to the extent funded). It is not currently clear what, if any, IRS follow-up will occur after the initial responses to this EPCU compliance check are tabulated.

Enforcement Actions

IRS enforcement can take many forms—from simple correspondence-driven reviews of small employer plan Form 5500s to large employee plans team audit (EPTA) examinations.

Examinations

Most commonly, a plan sponsor will receive a letter from the IRS advising them that they are under examination for a specific year within the open statute of limitations period (generally three years). A more basic examination will generally include a list of requested documents, which generally includes plan documents (including interim amendments, trust document, latest determination letter), 5500s, summary plan description and nondiscrimination testing data. In many cases, a

formal opening meeting will be held with the IRS agent at the plan sponsor's office (the IRS' preferred location) although in certain cases the correspondence with an IRS agent may be solely by telephone. The scope of an examination may be of focused limited scope (*i.e.*, a focus on specific issues) or a "full scope" examination.

Examples of issues that are commonly raised on an examination include the following:

- **Documentary compliance.** Whether the plan has amended for legally required amendments, interim amendments and any amendments required pursuant to a prior determination letter request.
- **Coverage and participation.** Whether the plan is covering the required (as set forth in the plan document) and nondiscriminatory group of employees.
- **Vesting.** Whether the plan satisfies both the plan and legally required vesting standards.
- **Contributions and accruals.** Whether the plan is allocating contributions and/or crediting accruals consistent with plan terms, the Code Sec. 411 accrual rules and the Code Sec. 401(a)(4) testing rules.
- **Top-heavy.** Whether the plan complies with the Code Sec. 416 top-heavy rules.
- **ADP and ACP testing.** Whether the plan satisfies the ADP and ACP tests as set forth in the plan document and as required under Code Sec. 401(k) and (m).
- **IRS compliance initiatives.** There are periodic IRS-wide initiatives on particular issues, such as worker classification concerns, that may also result in specific areas of emphasis in an EP examination.
- **Abusive tax transactions.** The IRS maintains a list of abusive EP tax transactions.¹¹ Agents may flag any transactions falling in this class during their examinations.

In addition, other issues may be raised depending on the type of plan involved, such as multi-employer plans and Code Sec. 403(b) plans.

Employee Plans Team Audit

For larger plans, generally defined as plans with 2,500 or more participants, the EP function maintains a special program—the Employee Plans Team Audit.¹² Unlike a "traditional" audit with a single agent assigned to the examination, EPTA conducts an in-depth review of plan documents and operations led by a Case Manager, Team Coordinator and, as appropriate, a team of IRS staff—from agents, to systems experts, to actuaries and accountants. This team structure allows a deeper level of review of a large plan, including a focus on internal controls and other key IRS focus areas, such as international concerns. EPTA generally functions

similar to a traditional audit, although a formal opening conference will specifically focus on the items that are part of the expected review, the anticipated length of the examination, the terms of document requests and various logistical issues. Senior EP staff may also attend an opening conference. A key distinction of the EPTA process is a usually greater depth of review and inquiry, and thus potentially a longer period of time under examination. Compliance issues frequently identified in EPTA include the following:¹³

- **Failure to adopt timely amendments.** Even in large plans, the failure to timely adopt required and interim amendments is a common error discovered during EPTA.
- **Definition of compensation.** Larger plans may often have more complex definitions of compensation with certain carve-ins and carve-outs, such as rules on the inclusion or exclusion of executive compensation. Because multiple compensation definitions may be used and for multiple purposes—from ADP/ACP testing to 415 testing to contribution calculation—errors in determining compensation are regularly discovered during EPTA.
- **Eligibility.** Larger plans, due to acquisitions, plan redesign and multiple operating divisions with different payroll systems may fail to consistently apply plan eligibility rules.
- **Required minimum distributions.** Required minimum distributions after attainment of age 70 1/2 or retirement pursuant to Code Sec. 401(a)(9) continue to be regular failures regularly discovered during EPTA. As plans move toward allowing more lifetime distributions, these failures may increase.

Common Issues to Address When an Examination Commences

Although each examination is unique, there are a number of key considerations to consider when an examination commences:

- **Oversight of examination process.** How will the examination be managed? Will in-house legal, in-house legal, outside combination or other

advisors lead this process?

- **Management of on-site agent.** Who will be the lead point of contact when an agent is on-site? As noted above, general IRS practice is to default an on-site visit to a plan sponsor's office rather than at the office of its counsel.
- **Disclosure of existing failures.** EP examinations has frequently encouraged plans to disclose plan/plan sponsor-identified failures early in the examinations process because EP may be more flexible with respect to failures identified by a taxpayer rather than the IRS.

Conclusion

From the EPCU to EPTA, EP examinations has a number of tools available to enhance EP's understanding of key compliance issues while also working to enhance compliance in the employee plans community as a whole. Many of these tools will allow EP examinations to continue to expand its contacts with the employee plans community. As EP examinations engages more and more employee benefit plans, careful thought by plans and plan sponsors—from self evaluation on common audit errors to document retention—is likely to continue to be of increasing importance.

ENDNOTES

- * All views expressed in this column are those of the authors and not necessarily those of the IRS.
- ¹ Memorandum from John E. Burke, Assistant Commissioner of Employee Plans and Exempt Organizations to Assistant Regional Commissioners of Examination and District Directors of Brooklyn, Chicago and Cincinnati.
- ² Rev. Proc. 2008-50, IRB 2008-35, 464.
- ³ See www.irs.gov/retirement/article/0,,id=96907,00.html (Correcting Plan Errors).
- ⁴ The IRS provides extensive examinations related resources on its website. See www.irs.gov/retirement/article/0,,id=147731,00.html.
- ⁵ See www.irs.gov/retirement/article/0,,id=218636,00.html.
- ⁶ See www.irs.treas.gov/retirement/article/0,,id=223440,00.html.
- ⁷ Reg. §1.403(b)-5(b).
- ⁸ See www.irs.gov/retirement/article/0,,id=171019,00.html.
- ⁹ See www.irs.treas.gov/retirement/article/0,,id=238459,00.html.
- ¹⁰ See www.irs.gov/retirement/article/0,,id=224705,00.html.
- ¹¹ www.irs.gov/retirement/article/0,,id=118821,00.html.
- ¹² www.irs.gov/retirement/article/0,,id=129221,00.html.
- ¹³ www.irs.gov/retirement/article/0,,id=206511,00.html.

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