JOURNAL of PENSION BENEFITS

ISSUES IN ADMINISTRATION, DESIGN, FUNDING, AND COMPLIANCE
Volume 26 • Number 1 • Autumn 2018

LEGAL DEVELOPMENTS

Employee Plans Issue Snapshots Are Worth a Closer Look

With the focus on tax reform, IRS snapshots are gaining favor as a way for the IRS to provide additional education and clarification to plan sponsors on current developments.

BY ELIZABETH THOMAS DOLD

Elizabeth Thomas Dold is a principal attorney at Groom Law Group, Chartered in Washington, DC. For nearly 20 years, her work has focused on employee benefits and compensation matters, including employment taxes and related reporting and withholding requirements. She regularly advises Fortune 500 companies (including corporate and tax-exempt employers, financial institutions, and third-party administrators) on plan qualification and employment tax issues. Ms. Dold is a past Chairperson of the Information Reporting Program Advisory Committee (IRPAC) and a former adjunct professor at Georgetown Law Center.

The latest edition of *Employee Plans News* highlights a number of new "Issue Snapshots" that were posted on the Internal Revenue Service (IRS) website in May 2018. These snapshots cover a wide range of topics: (1) spousal consent period to use an accrued benefit as security for loans, (2) how to change interest crediting rates in a cash balance plan, (3) treatment of 415(c) Dollar Limitations in a Short Limitation Year, (4) treatment of 401(a)(17) compensation limit in a defined contribution plan in a short plan year, (5) borrowing limits for participants with multiple plan loans, (6) qualification requirements for non-electing church plans under Code section 401(a), (7) vesting schedules for matching contributions, and (8) plan forfeitures used for qualified nonelective and qualified matching contributions. So, a little something for everyone! We briefly summarize these snapshots, which, with the focus on tax reform, appear to be becoming a more popular avenue for the IRS to provide informal guidance to plan sponsors on areas where the IRS believes additional education and clarification is needed for both IRS auditors and plan sponsors.

1. Spousal Consent Period to Use an Accrued Benefit as Security for Loans

This snapshot addresses the applicable period for a spouse to consent to a plan loan where the plan is subject to Code section 417(a)(4) (*i.e.*, for plans required to offer a qualified joint and survivor annuity). The

Copyright © 2018 CCH Incorporated. All Rights Reserved.

confusion arises because the Pension Protection Act of 2006 (PPA) largely amended the various Code provisions to extend the time periods from 90 days to 180 days, but PPA did not expressly amend Code section 417(a)(4), which continues to provide for a 90-day period for spousal consent to a loan. Proposed regulations issued in 2008 [73 Fed. Reg. 59575] would change the existing regulations to extend the period to 180 days, but these regulations [Prop. Treas. Reg. § 1.401(a)-20, A-24(a)(1)] have not yet been made final. This guidance provides that plan sponsors can apply either the 90-day period or the 180-day period, provided that the period used is set forth in the plan document.

Therefore, the key takeaway is to check your plan document and make sure that plan operations are in compliance with the applicable period (either 90 or 180 days).

2. How to Change Interest Crediting Rates in a Cash Balance Plan

This snapshot focuses on how to properly change an interest crediting rate in a cash balance plan, and it includes several helpful examples. It also includes guidance on how to meet the anti-cutback protections under Code section 411(d)(6), focusing on both the "A plus B" approach and a wearaway approach, where the plan amendment reduces (or potentially reduces) the interest crediting rate. It also addresses plans that are terminated to avoid the wearaway approach, which raises bona fide termination issues if another cash balance plan is established shortly thereafter.

The audit tips should be carefully reviewed by plan sponsors that have changed (or are considering changing) the interest crediting rate under their cash balance plans:

- Review any plan amendments to see if they potentially decrease the interest crediting rate.
- If there are reductions in the interest crediting rate, make sure the plan protects the interest crediting rate "promise" in effect before the amendment. Either the A plus B or wearaway approach will accomplish this.
- Ensure that if the wearaway approach is used, the resulting rate does not exceed a market rate of return for participants who are not actively accruing benefits (*i.e.*, principal credits) as of the date of the amendment.
- If correction is needed, notify your manager and work with the field actuaries to develop a correction.

3. Treatment of 415(c) Dollar Limitations in a Short Limitation Year

This snapshot summarizes the proration rules for determining the Code section 415(c) dollar limitation for a short limitation year, which typically results from an initial, amended, or terminating plan year. Proration of the limit (dollar limit for the calendar year in which the short limitation year ends x [number of months in the short limitation year/12]) applies only when the limitation year is less than 12 months. It also explains the applicable rules for participants who are eligible for only part of the limitation year, which does not involve proration of the limit, and how the limit works in the event of a plan termination.

For the audit tips, plan sponsors with a short limitation year should make sure that the plan document reflects the short limitation year and compliance with the Section 415(c) dollar limit proration rules (and the appropriate compensation to include for the short limitation year):

- Identify the limitation year used by a defined contribution plan maintained by the employer. Has the year changed?
  - Is there an amendment that reflects the change?
  - If not, is it required (for example, not required in the case of a plan termination that creates a short limitation year)?
- If the limitation year has been changed and a short limitation period is created, has a prorated Section 415(c)(1)(A) dollar limitation been used for the short limitation year? For the Section 415(c)(1)(B) compensation limit, has compensation earned only during the short limitation year been used to establish the maximum amount?
- If the plan was terminated, other than at the end of a limitation year, did the plan use a prorated dollar limitation to determine maximum annual additions to the plan?

4. Treatment of 401(a)(17) Compensation Limit in a Defined Contribution Plan in a Short Plan Year

Similar to the above snapshot, this snapshot sets forth the applicable rules for adjusting the Code section 401(a)(17) compensation limit for a short plan year, such as an initial, amended, or terminating plan year. The compensation limit for a short year

is determined by multiplying the applicable dollar limit for the calendar year in which the short year begins by a fraction—the number of months in the short plan year/12. This guidance includes a number of examples, including: (1) short plan years caused by either an amendment, an initial short plan year, or a plan termination, which generally triggers a proration calculation, and (2) the impact of new participants (or participants leaving mid-year), which does not result in proration of the compensation limit.

The audit tips are helpful for all plan sponsors to review to ensure compliance with the Code section 401(a)(17) limit for new participants entering the plan and for plan sponsors with a short plan year:

- Identify the plan year. Is there a short plan year?
- If there is a short plan year, what is the period for measuring compensation?
  - If compensation is measured on the basis of the short plan year, the Code section 401(a)(17) limit must be prorated.
  - If compensation is measured on the basis of a full 12-month period during which the short plan year occurs, in the case of an ongoing plan, the Code section 401(a)(17) limit is not prorated.
- How does the plan measure compensation for participants who enter the plan during the plan year? Was this formula followed in operation?
- In the case of a terminating plan that results in a short plan year, is the Code section 401(a)(17) limit prorated for the short plan year?

5. Borrowing Limits for Participants with Multiple Plan Loans (last reviewed or updated on May 24, 2018)

This snapshot provides an overview of the 72(p) loan limits that apply when a participant has multiple plan loans, along with helpful examples of how to apply the 72(p) limits. It also reminds plan sponsors that this is a controlled group test and that loan refinancing has special rules.

The audit tips are a reminder that loan compliance is on the IRS list of items to review and that full compliance is often a challenge:

- Does the plan document allow loans? If so, does it allow multiple loans?
- Does the employer sponsor any other qualified plans? If so, does the participant have any loans from those plans?
- If a participant has multiple loans from this plan or other plans of the employer, are all loans considered to calculate the Code section 72(p)(2)(A) limit, or if lower, a plan-imposed limit?
- Does a participant have two or more loans outstanding during a one-year period? If yes, review Field Memorandum dated July 26, 2017 and determine if the plan has computed "the highest outstanding balance," for purposes of applying the Code section 72(p)(2)(A) limit, in one of two ways described in said memorandum. One method looks at the single highest outstanding balance of all loans during the one-year period. The other looks at the total of the highest outstanding balance of each loan during the one-year period.
- What is the participant's vested account balance in the plan (or plans, if applicable)?
- Secure a copy of the loan document for each participant loan and review the amount, date, and repayment schedule of each loan.
- Check to see if the plan permits refinancing of plan loans. If so, check whether the refinancing of loans satisfies the requirements in Treas. Reg. Section 1.72(p)-1, Q&A–20.

6. Qualification Requirements for Non-Electing Church Plans under Code section 401(a) (last reviewed or updated on May 24, 2018)

This snapshot provides a nice summary of the various qualification requirements (under ERISA and pre-ERISA) that apply to a non-electing church plan (meaning a church plan under Code section 414(e) that did not make a Section 410(d) election to be subject to ERISA). Notably, a non-electing church plan is not subject to a number of the qualification requirements of Code section 401(a), which are also described in this guidance.

For audit tips, it focuses on whether the plan is a non-electing church plan, if the appropriate election form was filed with the IRS (pursuant to Treas. Reg. Section 1.410(d)-1(c)); and reviewing the plan document, applications for prior determination letters, prior determination letters, and Forms 5500 (if any) for compliance with these rules.

Exhibit 1

Vesting for Matching Contributions	
General Rules	At least (a) 3-year cliff (100% after 3 years), or (b) 6-year graded (20% after 2 years, 40% after 3 years, 60% after 4 years, 80% after 5 years, and 100% after 6 years)
	Also, 100% vested at normal retirement age
	Full vesting is also required on plan termination
	In the case of partial termination, all affected participants must be fully vested in all amounts credited to their accounts
Non-QACA ADP Safe Harbor Contributions	100% vested at all times
QACA ADP Safe Harbor Contributions	100% vested after no more than 2 years of service
ACP Safe Harbor Contributions	Can follow the general rules, provided that the plan is an ADP safe harbor plan and the match: (1) does not take into account deferrals and/or employee contributions exceeding 6% of the participant's safe harbor compensation, (2) does not increase in rate as the level of elective deferrals and/or employee contributions increases, (3) if discretionary, does not exceed more than 4% of the participant's safe harbor compensation, and (4) for HCEs, is not made at a greater rate than that for any non-HCE at the same level of elective deferral and/or employee contributions
Simple 401(k) Plan Contributions	100% vested at all times
QMACs	Per 2017 proposed regulations (described below), 100% vested when they are allocated to participants' accounts

7. Vesting Schedules for Matching Contributions (last reviewed or updated on May 24, 2018)

This snapshot reviews the various vesting schedules that are permissible for matching contributions within defined contribution plans (other than non-electing church plans and governmental plans, which have special rules). It also provides a number of helpful examples. These rules are summarized below:

Importantly, it includes the following audit tips, which plan sponsors should also keep in mind to avoid any pitfalls when providing for matching contributions, which vary depending on the type of plan:

- Review the plan to determine if it permits matching contributions.
- Identify the vesting schedule for the matching contributions.
- Is the vesting schedule permitted under Code section 411(a)(2)(B) (see the "general rules" above)?
- Identify the employees who are eligible to receive matching contributions.
- In a traditional safe harbor 401(k) plan, are matching contributions that are intended to satisfy the actual deferral percentage (ADP) test safe harbor 100% vested at all times?
- In a Qualified Automatic Contribution Arrangements (QACA) safe harbor 401(k) plan, are matching contributions that are intended to satisfy the ADP test safe harbor 100% vested after no more than 2 years of service?
- If a Savings Incentive Match Plan for Employees (SIMPLE) 401(k) plan, verify that all contributions are 100% vested.

8. Plan Forfeitures Used for Qualified Nonelective and Qualified Matching Contributions (last reviewed or updated on May 24, 2018)

This snapshot reviews the change set forth in proposed regulations issued in January 2017 (82 Fed. Reg. 5477), which changes the definition of qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs) to permit forfeitures to be used to fund such contributions. It reiterates that taxpayers can rely on these proposed regulations currently. It also reviews the use of QNECs and QMACs to address ADP/Actual

Contribution Percentage (ACP) nondiscrimination testing failures. The guidance includes the following example: Plan A is a traditional 401(k) plan with 100 participants, 20 of whom are highly compensated employees (HCEs). The Plan uses a six-year graded vesting schedule for profit-sharing contributions, and the Plan provides for correction of ADP test failures with QNECs. In the 2017 plan year, five employees terminated prior to becoming fully vested, resulting in $20,000 of forfeitures. Therefore, for the 2017 plan year, the Plan may provide that the $20,000 of forfeitures can be used as QNECs to the extent necessary for the Plan to pass the ADP test.

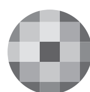
Notably, it includes the following audit tips that plan sponsors should keep in mind to avoid any pitfalls when running and correcting ADP and ACP testing:

- Determine if the plan needed to make either a QNEC, QMAC, or both to pass ADP/ACP testing.
- Determine if the plan provides for QNECs and/or QMACs as a corrective methodology.
- Review the plan language to determine the correct funding source for QNECs and QMACs. (For pre-approved plans, most providers amended the plans to include the language to permit forfeitures to fund QNECs and QMACs, while individually designed plans may not have been amended in reliance on the IRS' operational compliance list and are waiting for the regulations to hit the IRS' required amendment list.)

Conclusion

Keep an eye on this website—*https://www.irs.gov/retirement-plans/ep-issue-snapshots*—which provides helpful guidance on various plan qualification issues and alerts plan sponsors to what might be coming in the event of a plan audit. ■

Copyright © 2018 CCH Incorporated. All Rights Reserved.
Reprinted from *Journal of Pension Benefits*, Autumn 2018, Volume 26, Number 1, pages 66–69, with permission from Wolters Kluwer, New York, NY, 1-800-638-8437, www.WoltersKluwerLR.com



Wolters Kluwer