

**InFRE® Retirement Plan
Administrator Series**

**Fundamentals of
Compliance & Ethics**

Part 2

Presented by
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FUNDAMENTALS OF COMPLIANCE AND ETHICS
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Workshop Overview

A basic understanding of what is required to ensure the retirement plan is in compliance with federal tax laws and the ethics that should be adhered to is necessary for all parties responsible for the program and, in particular, those who have a fiduciary role.

This workshop covers various compliance topics, provides an overview of the fiduciary role and discusses the ethical principles that should govern plan administrators, board or committee members and other fiduciaries.

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Course Topics

- Introduction to Governmental Regulation
- Fiduciary Role and Responsibilities
- Compliance in Form
- Compliance in Operation
- IRS Corrective Programs
- Reporting
- The Role of Independent Professionals in Plan Operation
- Ethics for Retirement Administrators

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Today's Webinar Agenda


- Text Book Chapters
 3. Compliance in Form
 4. Compliance in Operation
 5. IRS Corrective Programs



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Chapter 3



Compliance in Form

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Public Sector Plans

- IRC Section 401(a) qualified plan rules are generally applicable, with some exceptions
 - Table on page 3-3 of text book identifies exemptions
- 403(b) and 457(b) must meet corresponding IRC requirements
- ERISA and rules established by DOL do not apply; State and local laws may establish similar requirements

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Plan Document Structure



- It must be
 - A *written*, definite program
 - *Communicated* to all employees
 - Intended to be *permanent* – not just a quick tax deduction or tax sheltering tool
 - Established and operated for the exclusive benefit of participants and beneficiaries

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Pan Documents Must

- Contain specific language to specifically address IRC requirements or other applicable federal tax code
- Be properly designed, structured, drafted, and executed
- Be communicated to interested parties
- Remain in compliance with ongoing legislation through amendments and/or the restatement process.

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May Include Multiple Documents

- Resolution – authorizing the plan
- Trust agreement - providing assets will be held in trust for exclusive benefit of participants and beneficiaries
- Plan document – establishing design, structure and operational provisions
- Adoption agreement – if the employer adopts a pre-designed plan

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Plan Document Strategies

- Individually designed plan
 - Customized plans developed specifically for the employer
 - Most flexible in plan design and operation
 - Considerable expertise and knowledge necessary to remain in compliance
- Determination letter from IRS may be advisable

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Plan Document Strategies

- Master and prototype (M&P) or volume submitter plans are pre-approved through an IRS determination letter process
- Master and prototype plan
 - Employer’s plan must conform to fit standardized requirements
- Volume submitter plan
 - Hybrid approach that offers a standardized plan with some customization


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Additional Requirements

- The plan must be
 - Communicated to employees
 - Permanent
 - For the exclusive benefit of employees and beneficiaries




Communicate.

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Plan Implementation



Failure to properly implement a plan could potentially result in disqualification and tax deductible contributions being disallowed

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Plan Implementation

- Step 1 – finalize and approve plan design
- Step 2 – adopt a resolution or enact legislation to authorize plan adoption
- Step 3 – draft and execute plan documents
- Step 4 – establish employee communication approach

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Plan Implementation

- Step 5 – submit plan to the IRS for a determination letter
- Step 6 – on-going monitoring to ensure the plan documents remain in compliance
 - Amendment or restatement may be required

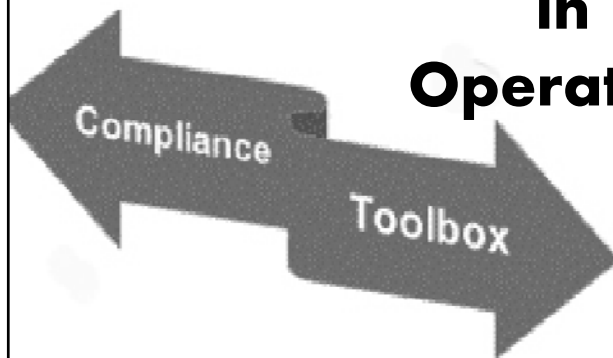
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Chapter 4

Compliance in Operation



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Coverage Rules

- Coverage rules established in IRC 401(a) and 410
- Rules for public sector plans generally set in state or local laws and/or plan document
- Age and service requirement
 - May require employee to be 21 years old and have 1 year of service before becoming eligible
 - Cannot require more, but may require less

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Coverage Rules

- Years of service
 - 1,000 hours of service in a 12-month period
 - Defined in plan document
 - After participant's first year, generally based on plan year
- Hour of service
 - Any hour in which compensation is earned
- Includes paid vacation, holiday, sick and military

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Eligibility and Participation



- Eligible employees have met age and service requirement
- Participation begins when eligible employees are allowed to enter the plan
 - First day of first plan year beginning after the date age/service requirements are satisfied
 - Six months after the date age/service requirements are satisfied

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Year of Service

- IRC defines as a 12-month period in which employee has no less than 1000 hours of service
- Initial year of service starts on employment date and ends on anniversary date
- An hour of service is defined as any hour in which the employee is entitled to be compensated by the employer

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Vesting Rules

- Plans may impose requirements on when participants become fully vested
- Participants' contributions must be immediately vested
- Vested benefits cannot be taken away or forfeited
- Plans may use vesting schedules more favorable to employees, but not less

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Vesting Rules

- Two schedules allowed
 - 7-year graduated: a portion of account becomes vested each year after year 2 and 100% vested after year 7
 - 5-year cliff vesting: employee 100% vested after 5 years
- Similar requirements generally found in public sector plan rules identified in statutes and/or plan document

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Vesting Schedules

GRADUATED VESTING

Years of Service	Vested %
1	0%
2	0%
3	20%
4	40%
5	60%
6	80%
7 or more	100%

CLIFF VESTING

Years of Service	Vested %
1	0%
2	0%
3	0%
4	0%
5 or more	100%

4/4-6

IRC Contribution & Benefit Limits

IRC Imposes limits on benefits and contributions within retirement plans. These requirements apply to public and private sector plans. To be in operational compliance, the employer must establish processes to ensure limits are not exceeded.

Annual Addition Limits – IRC 415

Applies to all plans, including public sector

- 415(b): applies to defined benefit plans
 - Annual participant benefit cannot exceed the maximum set by the IRC
- 415(c): applies to defined contribution plans
 - All amounts allocated to a participant account, including employee/employer contributions and forfeitures, cannot exceed the lesser of 100% of compensation or annual IRC maximum

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Annual Addition Limits – IRC 415

- Contribution and benefit limits adjusted for inflation
 - IRS publishes limits each year at www.irs.gov
- Two legislative actions impacted the application of 415(b) on public sector plans
 - 1986 Tax Reform Act and 1988 Miscellaneous Revenue Act
 - Established grandfather 415(b) provision to protect benefits of employees who became members prior to 1/1/90

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Elective Deferral Limits – IRC 402(g)

- Applies to all pre-tax salary deferrals
 - 457(b), 401(k) 403(b) plans
- Aggregate contributions to 401(k) and 403(b) are subject to annual limit
- Deferrals to 457(b) are not coordinated with other plan types
- Limit is subject to inflation adjustments, published by the IRS each year

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Compensation - IRC 401(a)(17)

- Establishes maximum annual earnings limit as base for contributions and benefits
 - Does not apply to 457(b) plans
- Dollar limit is also indexed for inflation and is published annually by the IRS

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Correcting Excess Deferrals



- Deferrals that exceed 402(g) limit are excess deferrals
- Limit is applied on aggregate basis of all qualified plans maintained by the employer (does not include 457(b) plan)
- Excess amount plus any associated earnings must be distributed by the tax filing deadline of the year in which deferrals were made

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Correcting Excess Deferrals



- Reported as taxable income in the year the deferral was originally made
 - Earnings on these amounts also reported as income
 - Losses reduce reportable income in the refund year
- Failure to timely correct excess may
 - Disqualify the retirement plan
 - Subject participants to double taxation

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Age 50 and Over Catch-up

- Permits additional contribution over 402(g) limit for participants age 50 and up
- Applies to all plan types including 457(b), 403(b) and 401(k)
- Regular contributions must first be made before the age 50 catch-up
- Dollar amount indexed for inflation and included in IRS annual adjustments

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403(b) Catch-up: 15-year Rule

- Applies only to 403(b) plans
- Eligible participants must have at least 15 years of service with the same employer
- Allows for deferrals over 402(g) limit
 - Up to \$3,000 a year
 - Subject to lifetime limit of \$15,000
- If eligible for both age 50 and 403(b) catch-up, 15 year rule applies first

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457(b) Catch-up Provision

- Applies only to eligible 457(b) plans
- 457 catch-up applies in three consecutive years prior to designated normal retirement age
- Underutilized deferrals determine the maximum amount that can be deferred
- Maximum annual deferral is 2 times 402(g) limit

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Required Minimum Distributions

- IRC 401(a)(9) applies to all public and private sector retirement plans
- Required beginning date (RBD): April 1 following the later of
 - Calendar year participant attains 70½
 - Retires
- RMD rules must be satisfied separately for each plan type

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RMD Calculation

■ Joint and Last Survivor Table

- Participants whose sole beneficiary is a spouse who is more than 10 years younger

■ Uniform Lifetime Table

- Participants whose spouse is not the sole beneficiary or is not more than 10 years younger

■ Single Life Expectancy Table

- A beneficiary for an account of a participant

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Beneficiary – RMD Rules

■ Factors that influence RMD rules

- Distributions began prior to the RBD
- Distributions began after the RBD
- Distributions began after participant's death
- Spouse or non-spouse as beneficiary
- No beneficiary designation

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Reporting Distributions

- Distributions must be reported to IRS on form 1099-R
- Must be provided no later than January 31 of calendar year
- Form 945 is used to report taxes that are withheld from distributions

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Qualified Domestic Relations Orders

- QDRO is a court order that assigns a portion of benefit to alternate payee
- State or local laws regulate QDROs in public sector plans
- Plan administrator responsible for determining legitimacy of orders

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Chapter 5

IRS Corrective Programs



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Disqualifying Defects

- In form: when the plan document fails to follow current laws
- In operation: when the plan is not administered according to the plan document or IRC requirements
- In demographics: when coverage or participation rules are not met

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Defect in Form

Plan document language

- Contrary to or disregards current law
- Conflicting language within the plan itself
- Missing required language
- Not amended to conform to new or revised regulations

Defect in Operation

- When a plan is not administered according to the plan document or IRC requirements
 - Contributions not allocated correctly
 - Distributions not made when required
 - Ineligible individuals participate
 - Contribution limits exceeded

Demographic Failures

- Typically not found in public sector 401(a) qualified plans
 - Same coverage and participation rules not applicable as private sector plans
- May occur in other plan types including 403(b) and 457(b) plans
 - 403(b) universal availability rule

Additional Defects in Qualified Plans

- Employer eligibility failures
 - Employer not eligible to sponsor the particular type of plan
- Exclusive benefit violation
 - Misuse or diversion of plan assets

Consequences

- Assets of the plan trust become taxable
- Vested contributions become subject to federal income tax
- Account balances may be prohibited from tax free rollovers to another qualified plan
- Plan fiduciaries potentially face lawsuits

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Employee Plans Compliance Resolution System (EPCRS)

- Self Correction Program (SCP): no notification to IRS or fees required
- Voluntary Correction Program (VCP): errors corrected with assistance from IRS
- Audit Closing Agreement Program (Audit Cap): errors found during an IRS audit are corrected via this program
- Information about EPCRS: www.irs.gov/ep

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Self Correction Program (SCP)

- Correction process for insignificant errors
- No reporting or IRS fees required
- Plan sponsor must maintain records of correction in event of audit



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Voluntary Correction Program

- For more significant errors
- Written submission and fee to the IRS required
- Corrections are made with IRS assistance and approval



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Audit Closing Agreement Program

- Failures found during audits
- Fee to IRS is greater than through the VCP, but less than would be owed for a plan disqualification



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EPCRS Overview



EPCRS is principled on the goal of

- Restoring the plan and benefits as if errors had not occurred
- Making corrections that are reasonable and appropriate for the defect or failure
- Applying the correction method consistently for all similar defects within all plan years

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Public Sector Issues

- State constitutions, statutes and court cases need to be examined
- Appropriate correction based on facts and circumstances of each situation
- Correction involving state protected benefits are filed under the VCP

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Self Correction Program

- Available to 401(a) qualified plans, 403(b), SEP plans and SIMPLE IRAs
- Allows self correction of insignificant operational defects at anytime
- For more significant errors, problem must have been discovered within two years of the occurrence
 - IRS determination letter must have originally been received on plan status

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Self Correction Program

- Defects that cannot be corrected under SCP include
 - Egregious failures
 - Plan document failures.
 - Demographic failures.
 - Employer eligibility failures.
 - Failures involving the misuse or diversion of plan assets.

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Voluntary Correction Program

- Available to 401(a) qualified plans, 403(b), SEP plans and SIMPLE IRAs
- Correction requires a fee to IRS and their approval
- Used for defects not eligible for SCP
 - Significant failures discovered after 2 years
 - Plan document failures
 - Demographic failures
 - More than one qualification failure

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Voluntary Correction Program

- Anonymous submission: plan sponsor identification can be excluded until agreement on corrective actions has been reached
- Group submission: eligible organizations that may use the VCP are
 - Sponsors of master or prototype plans
 - 403(b) service or annuity providers
 - Entity that provides administrative services for plan sponsors

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Audit Closing Agreement Program

- Audit CAP is used to correct problems found during IRS audit
- Sanction fee is based on negotiated percentage of taxes that would be due if the plan was disqualified – maximum payment amount
- Payment based on severity of failure and considers any corrective actions previously taken

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Examination and Correction Process

- IRS Employee Plans (EP) Examinations
 - Responsible for overseeing plan compliance
 - Conducts examinations to review operational features
- IRS Employee Plans Compliance Unit
 - Develops compliance projects
 - Performs data analysis to focus on areas of non-compliance

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Common Defects

- Plan document is not amended timely
- Minimum distribution rules are not met
- Contribution and/or benefit limits exceeded
- Loan procedures fail to meet IRC rules
- In-service withdrawals are permitted but not identified in plan document
- Ineligible employers adopt a plan

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Section 457(b) Plans

- Currently not eligible for ECPRS
- Failures to comply with IRC 457(b) must be corrected within 180 days of identification of error or defect
- Involvement of IRS or fee is not required
- IRS is expected to issue future guidance

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Recap of Today

Text Book Chapters

3. Compliance in Form
4. Compliance in Operation
5. IRS Corrective Programs



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Future Webinars

June

- Reporting
- The Role of Independent Professionals in Plan Operation
- Ethics for Retirement Administrators

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Any Questions?



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