AdvisorFacts

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Finding and Fixing Common Plan Mistakes

To err is human. Even the most organized and meticulous plan sponsors can make mistakes, as can the countless others they rely on to help them administer their plans and process plan transactions. A functioning 401(k) plan has a lot of moving parts that create the potential for mistakes (e.g., payroll changes, withholding elections, contribution calculations, dates of hire, dates of termination). One wrong data entry point can cause an excess contribution or misapply a vesting schedule. Fortunately, the IRS, which is responsible for enforcing the retirement plan rules under the tax code, realizes how easily plan mistakes can happen and provides tools to help plan sponsors voluntarily find and fix mistakes. If an error is fixed, the plan sponsor can usually avoid or reduce potential penalties and preserve the tax benefits associated with saving in a tax-qualified retirement plan.

As a plan advisor, you can help plan sponsors keep an eye out for common mistakes and introduce measures they can take to prevent errors. If they discover an error has been made, you can also introduce them to simple—and often inexpensive—IRS-approved correction programs and correction professionals.

Common Plan Mistakes and How to Prevent Them

According to the IRS website, plan mistakes commonly occur in all areas of plan operations. Establishing policies and procedures (internal controls) to administer the plan and monitor operations can help plan sponsors prevent mistakes or detect them soon after they are made. Documenting policies and procedures is also important to ensure consistent operations.

Common Mistakes	Internal Controls to Prevent and Detect Mistakes[1]
Improperly excluding employees from participating in the plan	Establish a system to ensure employees are provided the opportunity to defer upon satisfying eligibility requirements; periodically audit payroll systems and plan entry dates against list of new hires.
Failing to execute a deferral election or a Roth vs. pre-tax deferral election	Establish a system to ensure payroll processors receive deferral election information, educate them on the difference between pre-tax and Roth withholding; periodically check the payroll withholding process against deferral election forms.
Allowing excess deferrals (exceeding IRC Sec. 402(g) limit)	Establish a system to monitor cumulative deferral amounts and communicate with plan participants when they near the deferral limit ($18,500 for 2018, plus $6,000 age 50 catch-up contribution); track employees who participate in more than one plan of the employer.
Exceeding the annual additions (IRC Sec. 415) contribution limit	Prepare allocation schedules showing all amounts contributed and allocated for plan participants to ensure the limit (lesser of 100% of compensation or $55,000 for 2018) is not exceeded.
Failing to provide a required safe harbor 401(k) notice	Maintain a calendar of due dates for required participant communications and assign responsibility for verification of completion.

Common Mistakes	Internal Controls to Prevent and Detect Mistakes[1]
Failing to apply the plan's vesting schedule accurately	Annually and upon a plan participant's termination or distribution request, review census data to ensure vesting service is credited correctly.
Allowing a hardship distribution or loan that did not satisfy the plan's requirements	Establish an approval process that includes a checklist to ensure that distributions comply with the terms of the plan, including documentation requirements and loan terms.
Missing loan payments	Ensure payroll department receives notice of the loan and re-payment terms before loan is distributed; reconcile payroll deposits to the plan with amounts that should have been deposited based on individual salaries, election forms, and loan documents.
Failing to distribute a required minimum distribution	Monitor the age of all participants approaching age 70½ to ensure distributions are made timely.

Footnotes

[1]*IRS website, Fixing Common Plan Mistakes, https://www.irs.gov/retirement-plans/plan-sponsor/fixing-common-plan-mistakes*

IRS Tools for Plan Reviews

Plan sponsors should review the requirements for operating their 401(k) plan every year. To help plan sponsors perform plan reviews, the IRS created the 401(k) Plan Checklist (https://www.irs.gov/pub/irs-pdf/p4531.pdf). This 10-question checklist contains links to more information about the compliance requirements associated with each question, as well as how to fix the error, and avoid the mistake in the future. This self-audit tool does not cover all plan requirements, but it will help plan sponsors make certain they are meeting the basic requirements and serve as a springboard for further assessments.

IRS Correction Program—EPCRS

If a plan sponsor discovers a mistake in their plan operations, they may use the IRS Employee Plans Compliance Resolution System (EPCRS) to fix the mistake and make the plan or the affected participant whole. Correcting under the EPCRS allows plan sponsors to bring the plan back into compliance without losing its tax benefits. The EPCRS offers three ways to correct mistakes and maintain compliance:

Self-Correction Program (SCP)

The SCP permits plan sponsors to self-correct insignificant operational failures. An operational failure occurs when the plan sponsor fails to follow a provision of the plan document (e.g., incorrectly excluding employees from the plan). No IRS application form or fee applies. Even when the problem is significant, a plan sponsor who discovers the problem within two years of the year in which the problem occurred can correct it under SCP and pay no fee.

Voluntary Correction Program (VCP)

If a plan experiences a qualification failure, including operational failures, plan document failures, demographic failures, and employer eligibility failures, the plan sponsor may use the VCP to correct the error if they discover the problem before the plan comes under IRS examination. Under VCP, the plan submits a correction application to the IRS, along with a fee, which is typically much smaller than the amount would be following a plan audit. If the IRS approves the correction method, it will issue a compliance statement and the plan must timely correct the error as outlined in the compliance statement.

Audit Closing Agreement Program (Audit CAP)

The Audit CAP program may be used to correct plan errors that are discovered during an IRS audit. There is a much higher sanction involved based on the extent and severity of the failure.

Advisor Action Steps

Present the IRS 401(k) Compliance Checklist to plan sponsors – Educate plan sponsors about the importance of monitoring plan operations to maintain compliance and provide the checklist tool to help them conduct self-audits.

Serve as a gateway to plan corrections services – Introduce plan sponsors to service providers (e.g., ERISA attorneys, third party administrators) that can field corrections questions and assist with an EPCRS correction if a compliance problem is discovered.

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