Retirement Update
Vol. XX, No. 5 – May 8, 2015

Internal Revenue Service

Employee Plan News and *Retirement News for Employers* Published

On April 1, 2015, *Employee Plan News*, Issue: 2015-4, was published by the IRS. http://www.irs.gov/pub/irs-tege/epn_2015_4.pdf On April 2, 2015, *Retirement News for Employers* was published by the IRS. http://www.irs.gov/pub/irs-tege/rne_0415.pdf Both publications instruct plan sponsors to keep documentation for hardship distributions and plan loans and explain the withholding requirements for retirement plan distributions to foreign persons. *Retirement News for Employers* also includes an article about how to fix a mistake in a 403(b) plan, if eligible employees were excluded. Note that the publications include additional articles, as well as links to valuable resources.

Documentation for Hardship Distributions and Plan Loans

According to the IRS, a plan sponsor is responsible for recordkeeping information on loans and hardship distributions, even if a third party administrator is used. The article states that failure to have the records available in paper or electronic form upon examination requires correction under Employee Plans Compliance Resolution System (EPCRS). Further, the IRS says that participants cannot keep their own records since they may leave employment or fail to keep copies. It is important to note that regarding self-certification, the IRS says that "while self-certification is permitted to show that a distribution was the sole way to alleviate a hardship, self-certification is not allowed to show the nature of a hardship."

Here are the records required for hardship withdrawals:

1. *Documentation of the hardship request, review and approval;*
2. *Financial information and documentation that substantiates the employee's immediate and heavy financial need;*
3. *Documentation to support that the hardship distribution was properly made in accordance with the applicable plan provisions and the Internal Revenue Code; and*
4. *Proof of the actual distribution made and related Forms 1099-R.*

Loan records required include the following:

1. *Evidence of the loan application, review and approval process;*
2. *An executed plan loan note;*
3. *If applicable, documentation verifying that the loan proceeds were used to purchase or construct a primary residence;*
4. *Evidence of loan repayments; and*
5. *Evidence of collection activities associated with loans in default and the related Forms 1099-R, if applicable.*

Plan Distributions to Foreign Persons Require Withholding

If a plan distribution is paid to a foreign payee, generally 30% must be withheld, unless there is adequate documentation that establishes the payee is:

- a U.S. person, or
- a foreign person entitled to a rate of withholding lower than 30%.

As explained by the article, a retirement plan distribution is presumed to be made to a U.S. person only if the withholding agent has a record of a Social Security number for the payee, and relies on a payee mailing address that is (a) in the United States, or (b) in a foreign country with which the United States has an income tax treaty in effect giving its residents exemption from U.S. tax on payments of this type.

The article explains appropriate documentation, and explains the consequences failing to withhold on a distribution to a presumed foreign person as well as the failure to withhold the correct amount.

Excluding Eligible Employees from Your 403(b) Plan - Fixing Common Plan Mistakes

Here is the article:

> ***The issue***:
> *The universal availability rule requires that all employees must be allowed to make salary deferrals (including Roth contributions, if allowed under the plan) to a 403(b) plan unless the 403(b) plan specifically excludes them and they fall into one of five categories:*
>
> 1. *non-resident aliens*
> 2. *students performing services described in Internal Revenue Code Section 3121(b)(10)*
> 3. *employees eligible to make elective deferrals to the same employer's 401(k), 457(b) or other 403(b) plan*
> 4. *employees who normally work fewer than 20 hours per week*
> 5. *employees who contribute $200 or less annually*
>
> *Employer matching and nonelective contributions aren't subject to the universal availability rule, which is only for salary deferrals. Under the universal availability rule, employees must be given an "effective opportunity" to make a deferral. Determining whether employees have this opportunity depends on the facts and circumstances. Generally, plan sponsors meet this requirement if employees have an opportunity to make or change a deferral election at least once a year.*
>
> ***The problem***:
> *Hospital Z's 403(b) plan permits all eligible employees, except those working less than 20 hours a week, to make salary deferrals. The plan doesn't include matching contributions. Since 2009, part-time nurses haven't been told about the plan and none of them have made any salary deferrals.*
> *On July 1, 2013, during an annual review of the plan's records, it's discovered that many of the part-time nurses regularly work more than 20 hours a week (and work 1,000 or more hours annually).*
>
> ***Fixing the mistake***:
> *To fix the universal availability failure, Hospital Z must make a contribution that generally represents each excluded employee's lost ability to make salary deferrals to the 403(b) plan, called the "lost opportunity cost." This lost opportunity cost is 50% of the salary deferral the employee could have made to the 403(b) plan.*
>
> *Revenue Procedure 2013-12 Appendix A.05(6) allows employers to deem the lost salary deferral amount to be the greater of:*
>
> - *3% of compensation, or*
> - *the maximum deferral percentage for which the plan sponsor provides a matching contribution rate at least as favorable as 100% of the elective deferral made by the employee.*

Using the safe harbor correction, Hospital Z must contribute 1.5% (3% of compensation x 50%) of each nurse's compensation for each year they were excluded. They must adjust the contributions for any lost earnings through the date of correction. Hospital Z can use other correction methods to fix this mistake. Any alternative correction method not described in Appendix A or B of Revenue Procedure 2013-12 must satisfy the correction principles in Revenue Procedure 2013-12, section 6.

***Correction programs available**:*
Regardless of which correction program is used, the plan sponsor corrects the mistake the same way – by making a contribution with earnings for the excluded nurses.

Self-Correction Program
To self-correct this plan mistake, Hospital Z must have practices and procedures in place designed to facilitate compliance. Also, the failure must be insignificant because significant plan mistakes must be self-corrected within 2 years. In this case, the earliest plan year the mistake occurred was 2009. The plan sponsor had until the last day of the 2011 plan year to self-correct this mistake.

Voluntary Correction Program
If the Hospital didn't have proper practices and procedures, the failure is determined to be significant or Hospital Z wants IRS approval of its corrections methods, it can file a submission under the Voluntary Correction Program.

Audit Closing Agreement Program
Under Audit CAP, Hospital Z and the IRS enter into a closing agreement outlining the corrective action and negotiate a sanction based on the maximum payment amount.

Making sure it doesn't happen again
You should develop a system to determine whether employees are eligible to participate in the plan. Employees can't be excluded because they are categorized as part-time. Develop a method to determine whether any employee is expected to work fewer than 20 hours a week and regularly check the employee's actual hours worked.

In addition to monitoring the allowable exclusions, ensure that all employees are notified of their right to participate. For example, if some categories of employees have significantly lower participation than others, it may signal that you haven't properly notified those groups of their right to participate. At the very least, you may need to reach out to those employees to inform them of their right to participate in the plan.

IRS Information Letter Addresses Hardship Distribution from a 457(b) Plan

In INFO: 2015-0003, which was dated February 19, 2015 and released March 27, 2015, the IRS responded to an inquiry made by Pennsylvania Congressman Mike Kelly on behalf of a 457(b) plan participant about an unforeseeable emergency distribution. http://www.irs.gov/pub/irs-wd/15-0003.pdf The participant asked whether credit card debt can be considered for a hardship distribution under the rules that govern 457(b) unforeseeable emergency distributions. The IRS said that the participant will need to show the plan administrator that the unforeseeable emergency is due to illness and provide supporting documentation.

457(b) plans may offer distributions to a participant based on an unforeseeable emergency for extraordinary and unforeseeable circumstances resulting from events beyond the control of the participant or his or her beneficiary, including the payment of medical expenses or prescription drug medication. Revenue Ruling 2010-27, which includes examples, is explained by the IRS in the following webpage. http://www.irs.gov/Retirement-Plans/Employee-Plans-News-December-17,-2010-Unforseeable-Emergency-Distributions-from-457%28b%29-Plans The participant seeking the distribution must show that the emergency expenses could not otherwise be covered by insurance, liquidation of the participant's assets or cessation of deferrals under the plan, as the facts and circumstances of each case determine whether a particular financial hardship meets this standard.

The information letter directs the Congressman to an example in Revenue Procedure 2010-27, stating:

> *One of these examples (Situation 3) addresses an unforeseeable emergency distribution to pay accumulated credit card debt, which is not due to any events that are extraordinary and unforeseeable circumstances arising as a result of events beyond an individual's control. The revenue ruling concludes that the facts in Situation 3 do not present facts indicating that an unforeseeable emergency circumstance has arisen as a result of events beyond the control of the individual.*
>
> *If your constituent, however, is taking the position that the hardship distribution for her credit card debt is being sought due to events and circumstances beyond her control, such as her illness, she will need to show the plan administrator that the unforeseeable emergency is the result of an illness and provide whatever documentation the plan administrator requires.*

Inspector General Reports on Steps to Avoid Excess Contributions to IRAs

The report entitled *Actions Can Be Taken to Further Improve the Strategy for Addressing Excess Contributions to Individual Retirement Arrangements,* Reference Number: 2015-10-020, released on March 17, 2015 by the Treasury Inspector General for Tax Administration (TGITA), concluded that while there have been improvements made to address excess contributions, more should be done. http://www.treasury.gov/tigta/auditreports/2015reports/201510020fr.pdf

As a result of prior audit activity finding excess contributions to IRAs, the IRS developed education materials for individuals and tax preparers. Recent review by TGITA identified a significant number of inaccurate IRA information documents submitted by IRA custodians. In addition, still more can be done to identify those making excess contributions. Recommendations include:

1. Develop educational materials for IRA custodians informing them of common mistakes made on information documents and the importance of submitting accurate information documents.

2. Identify a more complete and accurate universe of individuals whose potential made excess contributions from which to select potentially productive cases.

Department of Labor

Conflicts of Interest Proposed Rule Released

On April 20, 2015, the Department of Labor issued a Notice of Proposed Rulemaking (NPRM) to better ensure that those providing investment advice to plan fiduciaries and/or plan participants and beneficiaries are subject to ERISA's standards of fiduciary conduct, if applicable.
http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28201&AgencyId=8&DocumentType=1 Along with the NPRM, the following explanations were released:

- Fact Sheet - http://www.dol.gov/ebsa/newsroom/fsconflictsofinterest.html
- News Release - http://www.dol.gov/opa/media/press/ebsa/EBSA20150655.htm
- Frequently Asked Questions (FAQ) - http://www.dol.gov/featured/ProtectYourSavings/faqs.htm
- Fiduciary Impact Advice Regulatory Impact Analysis (250 pages) - http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf

Overview

The Employee Retirement Income Security Act (ERISA), which was enacted in 1974, has provided the Department of Labor (DOL) with authority to protect retirement savings, which enjoy significant tax benefits, from conflicts of interest. Since the enactment of ERISA, the retirement plan landscape has moved away from employer sponsored defined benefit plans to defined contribution plans and IRAs, which are typically participant directed. Therefore, the DOL has stated that current guidance is inadequate and that participants have not been provided with appropriate investment advice. The following specifics are summarized from the Fact Sheet:

- **Require more retirement investment advisers to put their client's best interest first, by expanding the types of retirement investment advice covered by fiduciary protections**. *Under DOL's proposed definition, any individual receiving compensation for providing advice that is* <u>*individualized or specifically directed*</u> *to a particular plan sponsor (e.g., an employer with a retirement plan), plan participant, or IRA owner for consideration in making a retirement investment decision is a fiduciary. Such decisions can include, but are not limited to, what assets to purchase or sell and whether to rollover from an employer-based plan to an IRA. The fiduciary can be a broker, registered investment adviser, insurance agent, or other type of adviser (together referred to as "advisers" here). Some of these advisers are subject to federal securities laws and some are not. Being a fiduciary simply means that the adviser must provide impartial advice in their client's best interest and cannot accept any payments creating conflicts of interest unless they qualify for an exemption intended to assure that the customer is adequately protected.*

- **Preserve access to retirement education**. *The Department's proposal carefully carves out education from the definition of retirement investment advice so that advisers and plan sponsors can continue to provide general education on retirement saving across employment-based plans and IRAs without triggering fiduciary duties. As an example, education could consist of general information about the mix of assets (e.g., stocks and bonds) an average person should have based on their age, income, and other circumstances, while avoiding suggesting specific stocks, bonds, or funds that should constitute that mix. This carve-out is similar to previously issued guidance to minimize the compliance burden on firms, but clarifies that references to specific investments would constitute advice subject to a fiduciary duty.*

- **Distinguish "order-taking" as a non-fiduciary activity**. *As under the current rules, when a customer calls a broker and tells the broker exactly what to buy or sell without asking for advice, that transaction does not constitute investment advice. In such circumstances, the broker has no fiduciary responsibility to the client.*

- **Carve out sales pitches to plan fiduciaries with financial expertise**. *Many large employer-based plans are managed by financial experts who are themselves fiduciaries and work with brokers or other advisers to purchase assets or construct a portfolio of investments that the plan offers to plan participants. In such circumstances, the plan fiduciary is under a duty to look out for the participants' best interest, and understands that if a broker promotes a product, the broker may be trying to sell them something rather than provide advice in their best interest. Accordingly, the proposed rule does not consider such transactions fiduciary investment advice if certain conditions are met.*

- **Lead to gains for retirement savers in excess of $40 billion over the next 10 years**.

Proposed Exemptions

Under ERISA and the Internal Revenue Code, individuals providing fiduciary investment advice to plan sponsors, plan participants, and IRA owners are not permitted to receive payments creating conflicts of interest without a prohibited transaction exemption (PTE). According to the Fact Sheet, the DOL issued the proposed exemptions detailed below so interested parties have a better sense of how the fiduciary requirements and exemptions work together.

- Proposed Best Interest Contract Exemption - http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28202&AgencyId=8&DocumentType=1

- Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs - http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28207&AgencyId=8&DocumentType=1

- Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks - http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28203&AgencyId=8&DocumentType=1

- Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTE 75-1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks - http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28206&AgencyId=8&DocumentType=1

- Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1 - http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28204&AgencyId=8&DocumentType=1

- Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters - http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28205&AgencyId=8&DocumentType=1

Next Steps

The 75-day notice and comment period concludes July 6, 2015. Subsequently, public hearing will be scheduled shortly after the close of the initial public comment hearing. The public record will be reopened for comment after the public hearing is held. As stated in the Fact Sheet, “Only after reviewing all the comments will the Administration decide what to include in a final rule—and even once the Department of Labor ultimately issues a final rule, it will not go into effect immediately.”

Top Hat Plan Filings Reviewed

The Department of Labor’s Employee Benefit Security Administration (EBSA) recently revised information detailing the filing requirements for “top hat” plans. http://www.dol.gov/ebsa/efiletophatplanfilinginstructions.html A top hat plan is an unfunded or insured pension plans for a select group of management or highly compensated employees.

Plan administrators are encouraged to file plan statements using an electronic system, which is described on the web page. If the regulations proposed in 2014 are finalized, plan administrators would be mandated to file such statements electronically. http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=27830&AgencyId=8&DocumentType=1

It is important to note that an existing top hat filing by an employer does not cover a *new* top hat plan that is subsequently adopted. The webpage explains that a new filing is not required when a top hat plan is amended to include a separate class of participants. The determination of whether a new arrangement is a separate plan or part of an existing plan is determined under all of the facts and circumstances.

Office of Inspector General Finds that Small Pension Plans Receiving Audit Waivers Need More Frequent Review

On March 31, 2015, the Department of Labor, Office of Inspector General (OIG), Office of Audit released Report Number: 05-15-002-12-121. *Small Pension Plans Receiving Audit Waivers Need More Frequent Review.* http://www.oig.dol.gov/public/reports/oa/2015/05-15-002-12-121.pdf Unlike larger pension plans, generally plans with fewer than 100 participants are not required to receive an annual audit of plan financial statements to provide assurance to participants that plan assets are available to satisfy benefit obligations. The purpose of the study was to ascertain whether the Employee Benefits Security Administration (EBSA) provides sufficient oversight to small plans claiming audit waivers to ensure that fraud and mismanagement does not occur.

Finding that since 1976, EBSA had performed reviews of plan filings claiming audit waivers only twice, the OIG concluded that EBSA did not provide sufficient oversight of small plans claiming the audit waiver. Efforts were hampered by the insufficient allocation of resources to regularly conduct comprehensive reviews. Recommendations include the periodic comprehensive reviews of samples of small plans claiming an audit waiver as well as compliance with ERISA 412 bonding requirements.

The non-Voya Financial® Web site links mentioned in this material are provided for your information only. Although deemed reliable, accuracy cannot be assured. Voya does not exercise control over, endorse nor accept responsibility for the content, product and/or services provided at non-Voya sites.

No part of this document is intended to provide tax or legal advice. Any questions involving tax or legal matters should be referred to your plan’s legal counsel or tax advisor. For financial professional/Plan Sponsor use only. Not for public distribution.