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MID-YEAR COMPLIANCE REVIEW

July 19, 2022

We are a little over halfway through 2022! Summer is a great time for employers to review common retirement plan administrative issues and consider whether any course corrections should be made for their qualified retirement plans ("Plan") as the year goes on.

The following list summarizes some of the more common Plan administration errors we regularly see in our practice:

Late or Unpaid Required Minimum Distributions

Plan participants are generally required to commence required minimum distributions ("RMDs") by no later than the April 1st following the year in which they attain age 72 (or age 70 ½ if the participant was born before July 1, 1949) or, for participants who do not own more than 5% of the company, the date of their termination of employment, if later. Negative tax consequences (in the form of a 50% excise tax) to the participant can result if an RMD is distributed late. Employers should periodically review participant records (especially age and address fields) to ensure that participant data is up to date and participants are having their RMDs started in a timely manner. Additionally, employers should document their missing participant search procedures and make sure their procedures are consistent with IRS and DOL guidance.

Improper Plan Loan Administration

Where a Plan allows loans to participants, those loans must be originated consistent with the Plan's terms, including any adopted loan policy, and applicable IRS regulations. Failing to follow these loan parameters can result in negative tax consequences for participants and potential operational failures for the Plan. Employers should periodically review Plan loan administration against the Plan terms and loan policy to ensure that all loans are being properly administered and paid and to timely correct any errors, as applicable.

Not Fully Documenting Hardship Distributions

As with loan administration, hardship distributions must be made consistent with plan terms and applicable regulations. One of the more recent regulatory changes regarding hardship distributions, the 2019 IRS final hardship regulations, amended the rules relating to hardship distributions. Therefore, if your Plan offers hardship distributions, it should have been amended sometime around 2020 to reflect these final hardship regulations. Employers that offer hardship distributions through their Plans should ensure that an interim amendment was timely adopted for these regulations.

From an administrative standpoint, for an approved hardship distribution request, it is recommended that an employer obtain and maintain (1) documentation showing the hardship request, review, and approval, (2) documentation of the participant's assertion that they have insufficient cash or other liquid assets to satisfy their financial need, and (3) documentation to support that the distribution was properly made in accordance with applicable rules and Plan terms and properly reported for tax purposes. While an employer may engage the services of a third party administrator ("TPA") or record keeper to assist with processing hardship distributions, employers should not assume that the TPA or record keeper is taking steps consistent with these practices without confirmation from the TPA. If an employer is uncertain of their TPA or record keeper's practices regarding hardship distributions, it should review their agreements with the TPA and record keeper, and determine what procedures have been implemented. In the absence of procedures similar to those suggested above, an employer may consider implementing its own internal procedures or otherwise discuss what options it may have with its TPA and record keeper. Hardship distribution documentation may be requested in the event of an audit and if it is not available at the TPA or the employer you may have to go back and request the information from the participant.

Improperly Applying the Plan's Definition of Compensation

Failing to properly apply the Plan's definition of compensation can result in miscalculated deferral contributions, matching contributions and/or employer contributions. Employers should periodically review their payroll codes against their Plan's definition of compensation, particularly following any addition of new pay types or employee groups, to ensure continued compliance. Treatment of compensation paid after termination of employment should also be consistent with the terms of the Plan.

Late Transfers of Participant Contributions

A fiduciary breach can arise if an employer fails to transfer participant contributions (elective deferrals or participant loan payments) from employer assets / payroll to the Plan in a timely manner consistent with applicable regulations. Employers should periodically review payroll practices to ensure that participant contributions are being transferred to the Plan as soon as administratively possible.

Unidentified Controlled Group Members and Undocumented Participating Employers

Where an employer brings in a new affiliate (e.g., by acquiring or establishing a new company or subsidiary), special attention must be paid to the terms of the Plan to address how the employees of the new affiliate are treated under the Plan. If this is not properly tracked and communicated before an acquisition closes, the employees of the new affiliate may be improperly included or excluded from the Plan. Additionally, many retirement plans require that any affiliate of the plan sponsor that desires to adopt the Plan as a participating employer affirmatively elect to participate in the plan prior to its employees commencing participation. This may require that the affiliate (and the plan sponsor) approve resolutions and execute a participation agreement before the affiliate's employees may participate in the Plan. When transactions are being negotiated, benefits counsel should be brought in to ensure that any participating employers are properly documented and to ensure that the Plan is amended where necessary to address new participating affiliates. Additionally, employers should periodically review their corporate structure to ensure that any employers participating in the Plan are properly documented in the Plan documents.

If an issue is identified and not timely addressed, both the Internal Revenue Service and Department of Labor have correction programs that may offer employers relief. The important thing is to address any identified issues in a timely manner and through the appropriate correction program, if applicable, and put procedures in place to make sure those issues do not recur.

If you have any questions or would like additional information, please contact a member of our Employee Benefits & Executive Compensation Practice Group.

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