



**403(b) Compliance
What to Expect in an
Audit**

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Introduction

<p>The Government wants people to save money</p> 	<p>The Government needs tax revenue so they want the rules followed</p> 
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IRS Audits

- Like winning the LOTTERY – ALMOST
 - Random Selection; or
 - Joint examination or referral from other IRS functions
- Initial Contact from IRS
 - Letter
 - By telephone
 - Followed up by letter

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Don't Panic!




- Inform heads of payroll, human resources, etc.
 - Those areas that may be involved in the audit
- Decide who will be the primary contact for the IRS audit
- Contact your TPA and investment companies
 - So they will be aware that records may be requested
- Contact counsel
 - If you desire their participation

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The IRS Audit Process


- The IRS will issue you an Information Document Request (IDR) in order to analyze internal controls
 - Remember weak system could equal expanded audit



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IRS 403(b) Audits: From a Vendor's Point of View

- Send your vendors a copy of the notification of IRS audit:
 - Actual copy of IDR
 - Letter from Employer
 - Letter from TPA



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Keys for a Successful Audit

- Open Communication with IRS
 - If information on IDR does not seem to be best approach to obtain results, talk to the auditor
- Influence on length of audit
 - IDR turnaround time
 - Clear communication between IRS and employer

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Commonly Requested Records

- Plan documents & Contracts
- Benefit Handbooks; employment contracts; Union contracts
- Payroll & HR files
- 1099-R & W-2 records
- Participant account records
 - Includes loan and distributions

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What to Expect Vendor to Provide - Documents

- Annuity Contract and/or Custodial Agreement
- Annuity/Custodial enrollment form
- Marketing materials
- Participant statements
- Sponsor statements



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Vendor Issues

- Vendors sometimes refuse to provide records
- If necessary, a summons may be issued
- Employers often drop vendors who do not cooperate



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The Review

- First and foremost the plan must be operated in accordance with the Plan Document (e.g., if you don't allow loans—don't sign off on a loan)



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IRS Review

- Contracts under the Plan
 - List investment companies allowed in the plan
 - List inactive companies



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IRS Review

Movement of Funds-Does Plan Allow?

- Exchange: movement of money within plan
- Transfer: movement of money to another plan
- Movement to non-payroll slot vendor
 - Allowed in Plan?
 - Requires ISA!

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The Review

- Excess IRC 402(g) contributions (\$16,500 – 2011 Annual)
 - Including the 15 year catch-up rule
- Excess IRS 415 contributions (\$49,000 – 2011 Annual)

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The Review

- Plan loan violations IRC 72(p)
 - Single loan limit for all plans of the employer; monitoring among plans is a challenge
 - Issues with new loans & defaulted or outstanding loans

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The Review

- Hardship distribution failures (hardship withdrawal is last resort)
 - Other financial resources
- What qualifies
 - Need receipts to justify

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Hardships

403(b) Plans

- Immediate and heavy financial need
 - Medical care
 - Purchase home
 - College tuition
 - Prevent eviction/foreclosure
 - Funeral/burial expenses
 - Repair home
 - Tax and penalty due to distribution

457 Plans

- Unforeseeable Emergency
 - College tuition not unforeseen emergency
 - Purchase of home not unforeseen emergency

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Hardships

- Both Plans 403(b) and 457 Plans required contributions to cease



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The Review – Common Violation

- **Catch Up Contributions**
 - **15 Year Catch Up**
 - **More complicated than Age 50 Catch Up**
 - Ordering rules (law requires use of Age 50 Catch-up first)
 - Record retention for contribution averaging purposes during employment (must average less than \$5,000/yr)
 - 15 years of service with employer
 - Maximum of \$3,000/yr - \$15,000 maximum

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The Review

- **In-Service Distributions**
 - Age 59 ½
 - Disabled
 - Death
 - Mandatory distributions of accounts with small balances

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The Review


- **Universal availability**
 - Review written plan provisions
 - Detailed review of internal control to identify exclusions
 - Review of payroll records and HR records
 - Also to identify exclusions
 - Reclassified employees from employment tax audit

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The Review – Common Violation

Eligibility Issues

- Exclusion of EEs normally working < 20 hrs/week or 1000 hour rule
- When must EE enter the plan if he/she works 1000 hours?



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The Review – Common Violation

- 5 year post-severance ER Contributions - Non-Elective
 - Does the written plan allow
 - Review for elective deferral option
 - Review union contracts
 - Review state law

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IRS Review

- Orphaned Accounts Rev. Proc. 2007-71
 - Contract where vendor received no contributions after 1/1/05
 - “reduced due diligence”
 - Orphaned plans current employees no longer contributing to vendor
 - “Good faith effort” to obtain ISA

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The Review

- IRS 415 excess in 403(b) as result of employee being in control of another organization (e.g., if 403(b) participant owns 50% or more of an outside business)
 - The outside business plan limit (401(k), SEP is coordinated with 403(b) limit)
 - How is EE informed of limit?
 - IRC 403(b) taxed first

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Final Step: Closing or Expanding Audit

- Discuss issues and reach agreement
 - Adjustments might require expansion of audit – Additional issues
- Evaluate adjustments under Employee Plans Resolution System
 - Rev. Proc. 2008-50
- Issue closing letter

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United States Department of the Treasury

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Retirement Plans Community Topics

- Newsletters
- Published Guidance
- E-File Form 990/990-E/990-B
- Correcting Plan Errors
- Examinations/Enforcement
- **Topics of Focus**
- Online Resources
- More Topics ...

IRS Resources

- Compliance & Enforcement
- Contact My Local Office
- eFile
- Forms and Publications
- Frequently Asked Questions
- Newsroom
- Taxpayer Advocate Service

IRC 403(b) Tax-Sheltered Annuity Plans

A 403(b) tax-sheltered annuity (TSA) plan is a retirement plan offered by public schools and certain tax-exempt organizations. An individual's 403(b) annuity can be obtained only under an employer's TSA plan. Generally, these annuities are funded by elective deferrals made under salary reduction agreements and nonexclusive employer contributions.

What's New

Announcement 2008-34
This announcement contains drafts of the [revenue procedure and sample plan language](#) for 403(b) prototype plans.

The draft revenue procedure explains the proposed 403(b) plan prototype program for issuing opinion letters and the sample plan language can be used to draft 403(b) prototype plans. Interested persons are invited to comment on the drafts of the revenue procedure and the sample plan language or any other aspect of the 403(b) prototype plan program. The IRS also requests entities that anticipate filing an opinion letter application as a 403(b) prototype plan sponsor send an email to opinionletters@irs.gov (mass submitters should send an estimate of the number of opinion letters).

Resources

Guidance

[403\(b\) Final Regulations](#)
(released July 24, 2007)

Published July 26, 2007 in the [Federal Register](#), with a general effective date of taxable years beginning after December 31, 2006, these regulations encompass the changes made by legislation from the past 42 years. By finalizing the select 403(b) plans other than other salary reduction arrangements (401(k) and 407(b)), administration of 403(b) plans will be simpler, which should lead to increased compliance.

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The End

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