Employee Benefit Plans Alert

IRS Revised Priority Guidance: Employee Plan Examinations and Compliance Initiatives

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The Tax Exempt & Government Entities (TE/GE) Division of the IRS recently released their 2021 Program Letter outlining the priorities for their compliance program initiatives for the year. The priorities related to employee plans are briefly outlined in this newsletter. Our Firm has experienced an increase in the number of examinations of retirement plans as we have increased our representation of such plans. On behalf of our clients, we are very familiar with the examination items discussed in the IRS Program and are exceptionally knowledgeable in these matters.

At the conclusion of this newsletter, we have listed some “quick hits” of timely information on employee benefit plans.

Small Retirement Plans

For small exempt organizations that sponsor retirement plans, the TE/GE will be looking at internal controls regarding the administration of the plan, specifically loans – ensuring that the Internal Revenue Code (IRC) limits are not exceeded and that repayments are timely made to the plan. The IRS will ask if the plan has loan policies or procedures that are routinely followed regarding the processing of a plan loan.

For one-participant 401(k) plans, the TE/GE will be reviewing operational or qualification issues, income and excise tax adjustments, or violations of the plan document. The IRS has identified many plan documents that have failed to be timely updated for changes in retirement regulations. There are certain contribution limits in a one-participant plan, as the business owner plays two roles: employee and employer.

The above items appear to be the IRS’s response to a U.S. Government Accountability Office (GAO) review of the IRS’s processing of small employer entity and plan examinations. The GAO study indicated that the IRS failed to assess all the taxes and penalties it could have in many situations.

Worker Classification

The TE/GE will be reviewing to see if employees have been misclassified as independent contractors. Whether a worker is an employee or an independent contractor will determine how income taxes, Social Security and Medicare taxes are paid, as well was how tax documents are prepared and filed (W2 vs 1099). This will also affect Social Security, Medicare and employee benefit eligibility.

The IRS has a Voluntary Classification Settlement Program (VCSP) to reclassify employees. VCSP offers employers partial relief from federal employment taxes.

Required Minimum Distributions (RMDs) in Large Defined Benefit Plans

The TE/GE will be reviewing large defined benefit plans to ensure they have begun RMD distributions by April 1 following the year the participant turns 70½ years of age per IRC Section 401(a)(9). If a participant reached the age of 70½ in 2019, this rule applies, and they must have taken their first RMD by April 1, 2020. If they reach age 70½ in 2020 or later, they must take their first RMD by April 1 of the year after reaching 72. Failure to make RMD payments could disqualify the plan and cause the employee to incur tax on any undistributed amounts.

Section 2203(a) of the CARES Act waived RMDs during 2020 for IRAs and retirement plans, including for beneficiaries with inherited IRAs and accounts inherited in a retirement plan. Additional guidance is provided in IRS notice 2020-51.

Earned Income for Self-Employment Plans

The TE/GE will be reviewing businesses that file Schedule C, Profit or Loss from Business, and a Form 5500. The examination would focus on whether the self-employed individual whose business has a retirement plan has taken the deduction correctly on their personal 1040 via a Schedule 1, not a Schedule C, if the earned income calculation and participant allocation is accurate, as well as complying with nondiscrimination rules and contribution limits.

Partial Termination/Partial Vesting

Due to the pandemic, many companies were faced with the unfortunate decision of having to reduce their workforce. In a prior *Employee Benefits Plan Alert*, we discussed the differences between a furlough (a *mandatory* temporary leave after which the employee is expected to return to work) and layoff (a permanent separation of service). Depending on the number of layoffs – a partial termination may have occurred. Plan amendments that have the effect of eliminating a certain classification of employees from benefiting under the plan, or excluding a portion of employees, can result in a partial termination. The primary result of a partial termination is that affected employees become 100% vested in their account balance/accrued benefit.

The determination of a partial termination is a “facts and circumstances” test reviewed by plan auditors who are reviewing financial statements for retirement plans requiring an audited financial statement and is also being reviewed by IRS examiners.

Plan Liabilities and Unrelated Business Income

The TE/GE will be reviewing the Form 5500 for plan liabilities and determining if there are any taxable unrelated business income (UBI) activities. The IRC has provisions that ensure that any tax-exempt organization that earns income not related to their primary purpose is taxed accordingly.

Inflated Assets

The TE/GE will be reviewing financial information for accuracy of Form 5500. They will target plans whose assets have increased *unreasonably* during the plan year.

Knowledge Is Power

As all of the above examination priorities fall under the TE/GE compliance program for 2021, it would be a good practice for plan administrators to review these items with their fiduciary, plan provider or other pension expert to ensure compliance and enact correction, if needed, prior to receiving an IRS examination notice.

Quick Hits

- The IRS has provided filing and payment relief until May 17, 2021 for individuals (IRS Notice 2021-21) regarding their federal income tax returns. This relief is provided in response to COVID-19 and impacts several benefit plans.

  - The 10% additional tax assessed on a distribution from a retirement plan (e.g., an early distribution made before age 59½) due date for reporting and payment has been postponed from April 15, 2021 to May 17, 2021.

  - The deadline to make contributions to a health savings account, Archer medical savings account, Coverdell education savings account and IRAs for 2020 has been extended from April 15, 2021 to May 17, 2021.

- Excess deferrals made to a retirement plan in 2020 must still be removed from the plan no later than April 15, 2021 in order to exclude the distributions from income; no extension was provided by the Notice.

- Starting in 2021, a one-participant plan or foreign plan required to file an annual Form 5500 must file Form 5500-EZ.

- If a Form 5500-EZ filer is subject to IRS e-filing requirements (mandatory electronic filing), they're required to file electronically using EFAST2. If a filer fails to file Form 5500-EZ electronically when required to do so, they're deemed to have failed to file the return.

- One-participant and foreign plans are no longer permitted to file a Form 5500-SF in place of Form 5500-EZ.

Contact Us

The Employee Benefit Services Group at PKF O'Connor Davies is available to assist plan sponsors in meeting the various compliance requirements applicable to their plan. We also provide a full spectrum of compliance services for qualified retirement plans, nonqualified deferred compensation plans, and welfare plans. For more information, please contact your client services partner or either of the following:

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