Does Your Retirement Plan Pass the Test?

Be sure you make these changes before the IRS appears at your door.

By Christine Sivak & Craig C. Gabel

Many nonprofits are confused about retirement-plan regulations, according to recent studies. The IRS is currently making an effort to assure that all nonprofits are complying with these rules.

Some Background

The IRS published regulations on July 26, 2007, that affected 403(b) retirement plans. A 403(b) plan, also known as a tax-sheltered annuity, is a tax-advantaged retirement savings plan available for public education organizations, 501(c)(3) organizations, cooperative hospital service organizations, and self-employed ministers in the U.S.

Estimates indicate that there are close to $600 billion in 403(b) retirement plan assets, representing about 17% of total assets of defined contribution plans. With those numbers and the impact on the retirement of so many Americans, it's important that nonprofits make the appropriate regulatory changes before the IRS appears on the doorstep.

What Are the Most Common Errors?

The IRS has been auditing 403(b) plans and found many compliance errors. Now's a good time for you to perform an internal compliance audit to identify any operational or document failures. The IRS has published a list of the issues found during its audits, which is a good starting point for your internal audit.[1]

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Error Number 1: Applying an Improper ERISA Label

A common misconception is that 403(b) plans that are exempt from the Employee Retirement Income Security Act (ERISA) are also exempt from complying with IRS retirement-plan regulations. While ERISA plans are more greatly affected by the IRS regulations, non-ERISA plans are also required to take action.

A 403(b) plan is considered a non-ERISA plan if the organization acts as nothing more than a facilitator for the deposit of employee salary withholdings. The IRS has uncovered many instances where nonprofits have misapplied the ERISA, or non-ERISA, label. As a result, we suggest that you engage legal counsel to ensure that you make a proper determination.

Error Number 2: Not Following the Rules for All Employees

The most frequent error is not following 403(b)(12)(A) rules. Under these regulations, if your organization permits one employee to defer salary into a 403(b) plan, then you must extend this offer to all employees who don't meet statutory exclusions.

It's easy to incorrectly assume that employees who have a support role in the organization or who work in what some consider a part-time role aren't eligible for the plan. But you can't make this assumption merely because of someone's position in the organization.

[1] http://www.irs.gov/pub/irs-tege/pub4546.pdf

[2] http://www.dol.gov/opa/media/press/ebsa/EBSA20100056.htm

If anyone should have been given the right to contribute salary deferrals, but was improperly excluded, your organization will need to make a contribution to the plan on behalf of that employee. You can do so under the IRS's Employee Plans Compliance Resolution System (EPCRS). It's in your best interest to remedy this issue quickly because the dollar amounts keep accruing interest.

Error Number 3: Holding On to Money Too Long

It's common for organizations to fail to remit 403(b) elective deferral contributions in a timely fashion. These salary deferral contributions must be transferred to the annuity or custodial account as soon as is reasonable for the proper administration of the plan.

For example, the plan could provide for section 403(b) elective deferrals to be contributed within 15 business days following the month in which these amounts would otherwise have been paid to the participant. ERISA 403(b) plans are subject to stricter time frames and should follow the Department of Labor's guidelines.[2]

If salary deferral contributions aren't remitted in time, the IRS will give you a chance to correct the error by depositing missed earnings. Since the earnings amount compounds daily, it's important to identify and correct this failure as soon as possible.

Error Number 4: Not Keeping an Eye on Loans and Hardship Distributions

Along with dramatic swings in our economy, there's been an increase in plan loans and hardship distributions. Participants are tapping into their accounts to make ends meet during tough economic times.

Maintaining loan programs in 403(b) plans can be difficult. Some vendors may not allow loans. Those that do may not be collecting the loan payments.

It's important to understand that your organization is ultimately responsible for your plan's loan program. You shouldn't rely exclusively on the vendors to make sure the loan program is running smoothly.

It's also common to see the record keeping for hardship distributions neglected. IRS agents will validate that hardship requests are for heavy financial needs and for the proper amount. But it's up to you to make sure the record keeping for such distributions is complete.

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Make Compliance a Priority

Having a prudent process in place to manage your retirement plan will make it easier to comply with the IRS rules. Doing so will assure that you maintain the tax-qualified status of the plan and enhance the value of this important employee benefit.

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Moving Forward

These and other articles in the Society for Nonprofits' Library (www.NonprofitWorld.org/members) will help you comply with IRS rules:

Are You Ready for This Year's New 403(b) Regulations? (Vol. 27, No. 4)

Need a CPA at Little Or No Cost? Five Ways to Find Help (Vol. 28, No. 2)

Retirement Plan Changes (Vol. 26, No. 6)

Where to Find Free Legal Assistance (Vol. 26, No. 2)