

AUGUST 2011

## New IRS Compliance Check Project to Target Higher Education Organizations and Their 403(b) Plans

After many years of inattention to the operation of 403(b) Tax-sheltered Annuity Plans, including whether employers were operating their plans in full compliance with the applicable requirements of the Internal Revenue Code, the federal government (IRS and DOL) has intensified its focus on these plans<sup>1</sup> over the past four years. Continuing this focus into 2011, the IRS announced earlier this year that its Employee Plans Compliance Unit was launching a “compliance check” project. This project focuses on the extent to which higher education organizations are complying with the universal availability rule applicable to 403(b) Plans that permit voluntary salary reduction contributions from employees of the school, which is the most common type of 403(b) plan. The universal availability rule requires that if any employee is eligible to make pre-tax salary reduction contributions to the school’s plan, then all employees (except for certain statutory exclusions<sup>2</sup>) of the school must be eligible to make pre-tax salary reduction contributions into the plan.

### Complying with the IRS Compliance Check

The IRS “compliance check” begins with a questionnaire (officially, IRS Form 886-A) that the IRS has been mailing in batches since the end of April to approximately 300 higher education organizations across the country. (We understand the IRS has been mailing the questionnaire to 30-60 schools at a time, and the last group of schools will be receiving their questionnaires in the next few weeks.) According to the IRS, it chose the higher education organizations randomly, and they comprise large, medium and small public and private higher education organizations including vocational and trade schools. The goal of the IRS project, again according to the IRS, is not to have these schools end up in audits or examinations conducted by the IRS, but rather to give the schools the opportunity to self-correct any errors and problems that are identified through the course of completing the 21-question questionnaire.

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- 1 In 2007, the IRS issued 403(b) regulations, which among other things, required plan sponsors to have a written plan document in place by the end of 2009. Also in 2007, the DOL revamped its Form 5500 annual return requirements applicable to 403(b) plans beginning with the 2009 plan year, as well as added the requirement for an ERISA audit for certain 403(b) Plans that have 100 or more participants.
  - 2 The two main exceptions are for (a) student workers at the school they attend, and (b) employees who normally work less than 20 hours per week.

**Some Dos and Don'ts** - If you receive, or have received, an IRS “compliance check” letter, then:

1. Be sure you complete all applicable questions in the questionnaire, and remember to fill in the name of your school and the school's tax identification number at the top of each separate page of the questionnaire. **Note** that your answers should apply for the 2010 plan year only. (If you have a non-calendar plan year, you should provide your responses for the plan year ending in the 2010 calendar year.)
2. Complete and return the questionnaire to the IRS within the requested timeframe. The IRS generally requests that you return the questionnaire within 25 days from the date of the “compliance check” letter. If you can't meet that response deadline, then contact the IRS person named in the “compliance check” letter to request an extension of time.
3. If you would like a lawyer, accountant or other tax professional to represent you during the IRS compliance check, you must send the IRS a completed written Power of Attorney (Form 2848), which you may download from the Forms section of [www.irs.gov](http://www.irs.gov).
4. Although there is no fine or penalty for not responding to this “compliance check,” not responding is not a good idea. Ignoring the “compliance check” can lead to a formal examination of your plan by the IRS. For instance, the likelihood of a plan audit or examination increased dramatically for non-responders (and for incomplete responders) in prior “compliance check” projects of the Employee Plans Compliance Unit.
5. Take any steps that are necessary in order to bring your 403(b) plan into compliance with the universal availability rule and the other requirements set forth in the IRS's 403(b) Regulations that were issued in 2007. In particular, check that the plan document's eligibility section does not continue to exclude classes of employees that used to be allowable under old IRS guidance from 1989 (e.g., collectively bargained employees and visiting professors), but which the 2007 regulations no longer permit. Generally, IRS fines, penalties, and sanctions are higher when the IRS discovers an uncorrected plan error during a plan audit or examination.

### **Being Proactive**

Even if your school isn't one of the approximately 300 schools that the IRS selected for the compliance check project, performing your own self-exam to determine your plan's compliance with the universal availability rule is a good idea. Going through a copy of the questionnaire (Form 886-A) which you can find online at [http://www.irs.gov/pub/irs-tege/403b\\_form\\_886a.pdf](http://www.irs.gov/pub/irs-tege/403b_form_886a.pdf), can be a useful way to confirm your own plan's compliance with this rule. To the extent you determine that your plan is not properly following the universal availability requirements, you can self-correct any such error without too much difficulty. By doing so, your plan should be in better shape should the IRS ever select your plan for audit or examination.



### **Next Steps by the IRS**

After reviewing your school's answers to the questionnaire, the IRS will either (a) issue to the school a "closing letter" stating that the plan appears to be compliant, and the matter is closed, or (b) to the extent any answer on questionnaire is unclear or incomplete, the IRS may request additional clarifying information. After the school furnishes the additional information, if the IRS believes the school has a problem with plan compliance, then the IRS will recommend that the school correct the problem by following one of the correction methods as described in the IRS's follow-up letter. To correct a universal availability error, the IRS correction method generally requires that the school make a fully-vested employer contribution into the plan that compensates affected employees for the "lost deferral" opportunity for each prior year or portion of a year that the employees were improperly excluded from the plan in violation of the universal availability rule. These corrective contributions must be paid by the school, not by salary reduction contributions of the employees.

### **Project Expected to Culminate in IRS Report**

The IRS has stated that it expects to compile the collected data from the project and then publish a report that describes not only the overall responses to the questionnaire, but also (a) the specific areas where the IRS should devote its resources for further education, guidance and outreach, and (b) how future enforcement efforts by the IRS can address and help avoid ongoing non-compliance in the universal availability rule and the plan document requirements applicable to 403(b) Plans.

### **Questions or Assistance?**

If you have questions about this Alert or would like our assistance with responding to this IRS 403(b) "compliance check," or in reviewing your 403(b) plan for compliance with the universal availability rule, please contact Richard Cohen at (860) 251-5803, or any other member of our Employee Benefits Practice Group as listed on page 1 of this alert.

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