

## Employee Plans News

Issue No. 2015-4, April 1, 2015

### Plan sponsors

[Keep documentation](#) for hardship distributions and plan loans

[Retirement plan distributions to foreign persons](#) require withholding

[Follow up on the plan corrections](#) you agreed to in your VCP compliance statements

[DOL Corner](#) – news from Department of Labor

### Plan document help

[Apply for a determination letter](#) for your individually designed plan

[Tips to expedite](#) the determination letter process

[FAQs on reference lists](#) of changes in qualification requirements (new)

[Updated 403\(b\) Listing of Required Modifications](#) sample plan provisions help plan sponsors draft their plans

### IRAs

[Tax Time Guide](#): still time to contribute to an IRA for 2014

[IRA limits](#) for contributions and deductions

[April 1 deadline](#) to take required retirement plan distributions for many retirees who turned 70 ½ in 2014

### Updated

[SEP Plan Fix-It Guide](#)

[Publication 3998](#), *Choosing a Retirement Solution for Your Small Business*

[Publication 4284](#), *SIMPLE IRA Plan Checklist*

[Publication 4285](#), *SEP Plan Checklist*

[Publication 4286](#), *SARSEP Checklist*

[Publication 4334](#), *SIMPLE IRA Plans for Small Businesses*

[Publication 4484](#), *Choose a Retirement Plan for Employees of Tax Exempt and Government Entities*

[Publication 4587](#), *Payroll Deduction IRAs*

[Publication 4806](#), *Profit Sharing Plans for Small Business*

## **It's Up to Plan Sponsors to Track Loans, Hardship Distributions**

Even if you use a third party administrator (TPA) to handle participant transactions, you're still ultimately responsible for the proper administration of your retirement plan. Make sure you're keeping up with the recordkeeping requirements.

### **Keep documentation for hardship distributions**

The plan sponsor must obtain and keep [hardship distribution](#) records. Failure to have these records available for examination is a qualification failure that should be corrected using the Employee Plans Compliance Resolution System ([EPCRS](#)).

The plan sponsor should retain these records in paper or electronic format:

1. Documentation of the hardship request, review and approval;
2. Financial information and documentation that substantiates the employee's immediate and heavy financial need;
3. Documentation to support that the hardship distribution was properly made in accordance with the applicable plan provisions and the Internal Revenue Code; and
4. Proof of the actual distribution made and related Forms 1099-R.

It's not sufficient for plan participants to keep their own records of hardship distributions. Participants may leave employment or fail to keep copies of hardship documentation, making their records inaccessible in an IRS audit.

Also, electronic self-certification is not sufficient documentation of the nature of a participant's hardship. IRS audits show that some TPAs allow participants to electronically self-certify that they satisfy the criteria to receive a hardship distribution. While self-certification is permitted to show that a distribution was the sole way to alleviate a hardship, self-certification is not allowed to show the nature of a hardship. (See Treasury Regulation Sections 1.401(k)-1(d)(3)(iv)(C) and (D)). You must request and retain additional documentation to show the nature of the hardship.

### **Keep documentation on plan loans**

A plan sponsor should retain these records, in paper or electronic format, for each [plan loan](#) granted to a participant:

1. Evidence of the loan application, review and approval process;
2. An executed plan loan note;
3. If applicable, documentation verifying that the loan proceeds were used to purchase or construct a primary residence;
4. Evidence of loan repayments; and
5. Evidence of collection activities associated with loans in default and the related Forms 1099-R, if applicable.

If a participant requests a loan with a repayment period in excess of five years for the purpose of purchasing or constructing a primary residence, the plan sponsor must obtain documentation of the home purchase before the loan is approved. IRS audits have found that some plan administrators impermissibly allowed participants to self-certify their eligibility for these loans.

### **Additional resources**

- [Internal Controls Protect Your Retirement Plan](#)
  - [Retirement Topics - Plan loans](#)
  - [Retirement Plan FAQs Regarding Loans](#)
  - [Fixing Common Plan Mistakes - Participant Loans in 401\(k\) Plans](#)
  - [Fixing Common Plan Mistakes - Plan Loan Failures and Deemed Distributions](#)
  - [Retirement Plans FAQs regarding Hardship Distributions](#)
  - [Do's and Don'ts of Hardship Distributions](#)
  - [Hardship Distribution Tips from EP Exam](#)
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### **Plan Distributions to Foreign Persons Require Withholding**

Does your U.S. retirement plan make distributions to [foreign persons](#)? If so, you must generally withhold 30% of the payment for federal income tax (IRC Section 1441(a)).

#### **How do I document the status of a payee?**

You must generally withhold 30% from a plan distribution paid to a foreign payee unless you can reliably [associate the payment with valid documentation](#) that establishes the payee is:

- a U.S. person, or
- a foreign person entitled to a rate of withholding lower than 30%.

Documentation can include Form W-9, Form W-8BEN, or other appropriate sources.

If you don't have documentation, you may be able to apply a lower withholding rate but only if you can verify that the recipient is a presumed U.S. person under the tax regulations.

#### **How do I determine a payee's status if I don't have documentation?**

If you can't reliably document the status of a retirement plan distribution recipient as a U.S. person or a foreign person entitled to lower withholding, you should apply the [presumption rules](#) in the tax regulations (Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)).

## Who can I presume is a U.S. person?

A retirement plan distribution is presumed to be made to a U.S. person only if the withholding agent:

- has a record of a **Social Security number** for the payee, and
- relies on a **payee mailing address** that's
  - in the United States, or
  - in a foreign country with which the United States has an income tax treaty in effect giving its residents exemption from U.S. tax on payments of this type.

A payment that does not meet these rules is presumed to be made to a **foreign person**. See Treasury Regulation Section 1.1441-1(b)(3)(iii)(C) for the complete rule.

## Examples of withholding errors

Plan sponsors and third party administrators are withholding agents and may be liable for taxes and penalties for improper withholding.

### No withholding on distribution to a presumed foreign person

The Employee Plans Examinations group has seen situations in which the plan withholding agent didn't withhold federal income tax on plan distributions that constitute U.S. source income to participants residing in foreign countries, specifically when:

- The participant resides in a country with which the United States **doesn't** have an income tax treaty in effect that entitles the payee, if a resident in the treaty country, to a U.S. tax exemption on their qualified plan distributions;
- The plan sponsor didn't secure Form W-8BEN, Form W-9 or other documentation to determine the payee's status as a U.S. person; and
- The plan sponsor reported the distribution on Form 1099-R.

These participants are **presumed to be foreign persons** and their distributions should be **reported on Forms 1042-S** with 30% federal income tax withheld.

### Improper withholding at a reduced rate

IRS auditors have also seen situations in which a reduced rate of federal income tax (less than 30%) was improperly withheld on qualified plan distributions that constituted U.S. source income to participants residing in foreign countries, specifically when:

- The participant resides in a country with which the United States doesn't have an income tax treaty in effect that entitles the payee, if a resident in the treaty country, to a U.S. tax exemption on their qualified plan distributions; and

- The plan sponsor didn't secure Form W-8BEN, Form W-9 or other documentation to determine the payee's status as a U.S. person or foreign person.

In this situation, the participant is presumed to be a foreign person (Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)).

A withholding agent who makes a payment to a person presumed to be a foreign person **may not reduce the 30% withholding** on it unless the beneficial owner furnishes a Form W-8BEN withholding certificate (Treas. Regs. Sections 1.1441-1(b)(3)(iii)(C) and 1.1441-1(e)(2)(i)). Because the withholding agent didn't secure Form W-8BEN from the participant in this situation, federal income tax should have been withheld at the 30% rate.

### Additional resources

- [Nonresident alien withholding](#)
  - [Treasury Regulation Section 1.1441-1\(b\)\(3\)\(iii\)\(C\)](#)
  - [International Issues Affecting Retirement Plans](#)
  - [Tax Information for Plan Sponsors](#)
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### Voluntary Correction Program: Did You Complete Your Correction?

The Employee Plans Compliance Unit ([EPCU](#)) conducted a [Voluntary Compliance Follow-Up project](#) to determine if plan sponsors completed the corrections they agreed to in their Voluntary Correction Program ([VCP](#)) compliance statements.

When you find errors in your plan's form or operation, we encourage you to fix them using one of our correction programs under the Employee Plans Compliance Resolution System ([EPCRS](#)). If you use VCP and we accept your submission, you will receive an IRS compliance statement that outlines:

- plan failures you identified,
- proposed corrections including revisions to administrative procedures, and
- time allowed to complete the actions.

### Project goals

We reviewed compliance statements issued on plan document and operational qualification failures to learn if sponsors:

- made the corrections listed in their compliance statements,
- corrected the failures within 150 days, and
- revised their administrative procedures.

## Project results

We found the majority of sponsors properly completed the proposed corrections. But, a significant percent of sponsors didn't meet the terms of the compliance statement because they didn't:

- completely correct within the 150-days, or
- implement changes to administrative procedures.

However, due to the nature of this compliance project we didn't ask those sponsors to refile with VCP. In addition to reviewing the VCP corrections, we also found some sponsors that needed to file an amended or delinquent Form 5500 return.

## Correction

Complete the proposed corrections in your compliance statement within the 150-day deadline. For example, you made plan loans to married participants without obtaining spousal consent. Your compliance statement says you agree to secure spousal consent for those distributions and update your qualified joint and survivor administrative procedures to include language for the spouse's signature on loan applications. You need to prepare the paperwork, contact the affected individuals, obtain the spousal consents, revise your loan documents and complete all necessary administrative actions within 150 days of the compliance statement's date.

If the plan sponsor doesn't complete the corrective actions within 150 days of the compliance statement's date, the compliance statement is invalid. The sponsor will have to file another VCP submission, along with a compliance fee, and identify that they didn't complete the corrections within 150 days from the date the compliance statement was issued.

If you need additional time to complete the proposed corrections in your compliance statement, [request an extension in writing](#) before the 150-day correction period expires. Submit your request for an extension of the correction to the agent that worked on your submission and issued the compliance statement. You'll need to explain why you need more time, what steps you've taken so far and the extension of time requested.

In addition, if you find errors on the information reported on your Form 5500 return, file an amended Form 5500 as soon as possible to avoid additional penalties and interest. If you haven't filed your Form 5500, [IRS](#) and Department of Labor ([DOL](#)) have programs to help you catch up with late annual reports.

If you find other errors in your plan's form or operation, fix them using EPCRS. Because a compliance check isn't an examination, you can still correct certain form and operational mistakes by using EPCRS.

## Prevention

Your VCP submission included steps you agreed to take to ensure that the failures you disclosed don't happen again. Review your compliance statement to make sure that you have implemented those changes. You may also want to consult your benefits professional to ensure your administrative procedures prevent errors from occurring in your retirement plan. To make sure that you've corrected your errors within 150 days, keep track of the 150 days on a calendar and communicate with the administrators who are helping you to correct your plan errors during this period.

## Contact us

If you have questions about the Voluntary Compliance Follow-Up project, [email](#) us and include "VC Follow-Up" in the subject line. Make sure to include your phone number and the best time to reach you, and we'll contact you with answers.

## Additional resources

We have many resources to help you keep your retirement plan in compliance. Our resources can help you find and fix errors and avoid making them in the future.

- [Correcting Plan Errors](#)
- [Check-Ups](#)
- [Fixing Common Plan Mistakes](#)
- [Fix-It Guides](#)
- [A Guide to Common Qualified Plan Requirements](#)
- ["Maintaining Your Plan" Video](#)
- [IRS Form 5500 corner](#)
- [Other Correction Programs for Retirement Plans](#) (DOL)
- [What You Should Know About Your Retirement Plan](#) (DOL)

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## DOL Corner

The Department of Labor's Employee Benefits Security Administration (DOL/EBSA) announced new guidance as featured below. You can subscribe to [DOL/EBSA's](#) home page for updates

### Annual funding notice – final rule

On Feb. 2, DOL/EBSA published a [final rule](#) implementing the annual funding notice requirements under ERISA Section 101(f), as amended by the Pension Protection Act.

The rule requires the plan administrator of a defined benefit pension plan that is subject to the Pension Benefit Guaranty Corporation's (PBGC) insurance program to furnish a

funding notice annually to participants, beneficiaries, labor organizations representing such participants or beneficiaries, employers obligated to make contributions to a multiemployer plan and the PBGC. The final rule contains model notices.

Among other things, the notice must show the plan's funding percentage, the assets and liabilities that determine the funding percentage, the fair market value of the plan's assets on the last day of the plan year, the plan's funding and investment policies and allocation of assets, and known events that are projected to have a material effect on the plan's funding.

An estimated 27,000 plans covering approximately 44 million participants and beneficiaries are subject to this disclosure requirement.

### **Annual funding notice – Field Assistance Bulletin**

On Jan.14, DOL/EBSA issued [Field Assistance Bulletin \(FAB\) 2015-01](#) on the annual funding notice requirements following the Highway and Transportation Funding Act of 2014 (HAFTA).

The FAB provides guidance on compliance by plan administrators of single-employer defined benefit pension plans with the annual funding notice requirements of ERISA Section 101(f) as amended by Section 2003 of the Highway and Transportation Funding Act of 2014. The FAB includes a modified supplement to the model annual funding notice that plan administrators may use to comply.

### **Outreach and education**

For notice of upcoming events as they are scheduled, subscribe to [DOL/EBSA's](#) website home page. DOL/EBSA conducts seminars on retirement plans and health benefits plans for small businesses.