

Tax News

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Correcting a Retirement Plan's Failure to Follow its Terms

For your business' retirement plan to be "tax-qualified," it needs to follow two basic requirements. First, the plan's written document must contain all of the provisions required by the tax and pension laws. Second, the plan must be operated in a way that follows those written provisions.

Knowledgeable professional advisors can help your business meet the first requirement for a proper written plan document. But it is not unusual for a plan, over time, to fail in some way to operate according to its written terms.

When this happens, the employer-plan sponsor could be held liable for financial penalties and, in the worst case, the plan could be disqualified and all tax benefits lost by the plan sponsor and the participating employees.

What to Do

If your plan fails to follow its written provisions, the IRS offers ways to correct the mistake. Generally, failure to follow the plan's terms can be fixed by:

- Correcting the error so that the plan's operation now matches the plan's terms, or
- Retroactively amending the plan document so that the plan's provisions comport with the way the plan was operated

The IRS recently clarified that its Self Correction Program (SCP), part of the Employee Plans Compliance Resolution System, can be used for the first approach and, in limited situations, for the second approach. SCP may be used to correct an operational failure by amending the plan document to match the plan's prior operations in three situations:

- *Maximum Compensation Failures.* This occurs when a 401(k) or other defined contribution plan allocates contributions or forfeitures based on a participant's compensation that is more than the maximum allowed.

- *Hardship Distributions and Loan Failures.* Making hardship distributions or loans in cases where the plan does not allow them can be corrected by a retroactive amendment, as long as the hardship distributions or loans would otherwise have met the law's requirements.
- *Early Inclusion of Otherwise Eligible Employee Failures.* Including an otherwise eligible employee in the plan too early (for instance, before the employee met the minimum age or service requirements) may be corrected by amending the plan retroactively.

We Can Help

Making corrections through the SCP generally requires professional assistance. Call Doeren Mayhew today at 248.244.3080 for answers to your questions and concerns.