

Benefits Advisory and Compliance

Bulletin

September 2010

Although there were few compliance developments in August, the Internal Revenue Service (IRS) did make two significant announcements regarding the use of forfeitures in 401(k) plans and 403(b) plan corrections.

Regulatory Developments

IRS Announces Position on Use of Forfeitures to Correct ADP Failures

The IRS informally announced that employers are not permitted to use forfeitures (i.e., nonvested amounts left in employee accounts) to correct a failed 401(k) ADP test under the Employee Plans Compliance Resolution System (EPCRS). The IRS intends to clarify how forfeitures may be used in the next updated EPCRS revenue procedure. This change in position came about when the IRS determined the use of forfeitures to correct a failed ADP test violates the requirement that qualified nonelective contributions (QNECs) need to be fully vested at the time of contribution.

Insight: The IRS will apparently start treating the use of forfeitures to fund QNECs in a 401(k) plan as a qualification error and assess penalties. However, there is no indication that the IRS intends to retroactively apply its change in position under the EPCRS program to plans that have compliance letters or self-corrected ADP tests using forfeitures to fund QNECs. While the IRS has indicated that it will not recognize plan terms allowing employers to use forfeitures to fund additional benefits, employers may be able to rely on the plan's current determination letter to continue this practice. Employers that want to continue to rely on existing plan provisions should seek advice on the potential consequences.

IRS Cautions 403(b) Plan Sponsors Not to Wait for EPCRS to Correct Errors

The IRS informally advised Section 403(b) plan sponsors that failed to adopt a written plan document by the end of 2009, or failed to operate their Section 403(b) programs according to the terms of their written plan document, to correct those plan errors now. The IRS cautioned these plan sponsors not to wait for an updated EPCRS revenue procedure, because its release is still pending.

Insight: Because 403(b) plans have undergone numerous changes, plan sponsors face significant challenges in complying with them. To reduce the risk of noncompliance, 403(b) sponsors should

consider putting formal procedures in place to periodically review plan operations. These procedures are also a prerequisite for using the self-correction program under EPCRS.

This document is incomplete without the accompanying discussion by a Towers Watson consultant. All materials and intellectual capital contained within are property of Towers Watson. This publication was prepared to support our clients' need for information on the issues discussed. Recipients should understand that this publication does not constitute, and should not be used as a substitute for, legal, accounting, actuarial, tax or other professional advice. If such advice is required, the recipient should engage the services of the appropriate professional.

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.

For more information, please visit towerswatson.com.