



For your information®

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## New compliance check program for 457(b) non-governmental plans

The Employee Plans Compliance Unit (EPCU) of the IRS recently announced a new compliance check program for 457(b) deferred compensation plans that are sponsored by tax-exempt, non-governmental employers. The program objective is to enable the IRS to gather information about the level of compliance in these plans. In total, 400 employers are due to receive letters containing a questionnaire by the end of the project, September 30, 2014. Employers will have 15 days to complete the questionnaire.

### Background

In April of 2010, the IRS sent compliance check questionnaires to approximately 1,200 plan sponsors of qualified defined contribution plans. The questionnaire was 45 pages long with 69 questions. The IRS used those questionnaires to identify potential noncompliance areas among plan sponsors. Based on the success of the qualified defined contribution plan questionnaires, the IRS has elected to expand that program to section 457(b) non-governmental, tax-exempt plans.

### Focus of the IRS

The new IRS [compliance check program](#) will focus on the following issues:

- Verify that plans are in compliance with section 457(b) and do not contain impermissible provisions
- Identify areas of noncompliance
- Determine the types of entities sponsoring the plan and whether they are eligible to do so
- Assess whether participation is limited to a select group of highly compensated employees, managers, directors, or officers
- Learn whether unforeseeable emergency distributions were made

In situations where the plan is not being operated in accordance with the Code, the plan sponsor will be advised of the necessary corrections including a possible audit and/or correction under the Voluntary Compliance Program (VCP).

**Buck Comment.** It is unclear how the VCP program will be applied, since non-governmental 457(b) plans generally cannot be corrected under the Employee Plans Compliance Resolution System, according to IRS Revenue Procedure 2003-12. However, the Revenue Procedure states that the IRS *may* consider submissions by tax-exempt entities — to correct unfunded section 457(b) deferred compensation plans that were erroneously set

up to benefit rank and file employees — if the plan has been operated in a manner similar to a qualified plan. It is unknown how the IRS will react when they encounter 457(b) plan errors by tax-exempt entities that do not fall within this narrow area of consideration.

## How employers will be selected

The IRS will examine the 2011 W-2 forms filed by an employer containing the “G” code in box 12 (indicating amounts deferred under a 457(b) retirement plan) to identify plan sponsors. It will also use the employer’s Form 990 filing to determine whether the employer is a tax-exempt entity. If the plan sponsor believes that the questionnaire was received in error, they should contact the IRS and explain the circumstances. While employer responses to the compliance check questionnaire are voluntary, failure to respond may trigger an IRS response, perhaps even an audit.

## Caution is in order when answering certain questions

While the questionnaire contains only ten questions (see [EPCU letter](#)), a yes or no response to three of them may trigger an immediate response from the IRS, as the questions relate to certain provisions that are not permissible in a non-governmental 457(b) plan. The questions ask whether:

- The plan includes a loan provision (number 5)
- An age 50 catch-up contribution is permitted (number 6)
- Assets are held for the exclusive benefit of participants (number 8)

While all of the above features are permissible in a *governmental* 457(b) plan, they can result in severe adverse consequences for participants and beneficiaries (and possibly the plan sponsor) if they are found in 457(b) plans sponsored by non-governmental, tax-exempt employers.

*Question 4* requests a breakdown of headcount by highly compensated employees, management employees, and all employees. As unfunded non-governmental 457(b) plans must only benefit a *select group* of management or highly compensated employees, covering too many eligible participants may indicate that the plan is not a “top hat” plan. If a plan is deemed not to satisfy the requirements of a top hat plan, it risks being subject to all provisions of ERISA. The top hat plan exemption would not be necessary for section 457(b) plans sponsored by non-qualified church controlled organizations that are non-electing church plans under ERISA.

*Question 10* addresses hardship withdrawals. Section 457(b) plans can offer withdrawals due to unforeseeable emergencies, which are subject to different rules than hardship withdrawals (which are typically made available under section 401(k) and 403(b) plans). While some of the reasons permitted for an unforeseeable emergency distribution may also apply to hardship withdrawals (such as costs to prevent eviction or foreclosure, funeral expenses, unreimbursed medical expenses, or the unreimbursed cost of home repairs due to casualty losses), certain other hardship eligible events (such as purchase of a primary residence or tuition payments) would not qualify.

**Buck Comment.** Plan sponsors who receive a letter are advised to consult with their legal counsel for additional advice on addressing any compliance issues that are found before responding to the IRS.

## In closing

While the questionnaire may appear short and simple on the surface, employers who are contacted need to respond carefully. Indication that a 457(b) plan contains a provision that is not permissible will raise a “red flag” that may trigger an IRS audit. Even plan sponsors who do not receive a letter should consider a review of the plan document and operations in IRS focal areas to preemptively address any compliance issues they find.

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