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## employee benefits lawflash

June 14, 2013

### IRS Announces Compliance Check Program for Tax-Exempt Employers

*Sponsors of 457(b) plans may receive questionnaires aimed at identifying noncompliance issues.*

On June 3, the Employee Plans Compliance Unit of the Internal Revenue Service (IRS) announced the creation of its Section 457(b) Plan Compliance Check Questionnaire Program.<sup>1</sup> The IRS will use the data gathered from the questionnaire initiative to gain a better understanding of the 457(b) plans of tax-exempt employers and the plans' overall compliance with section 457(b) of the Internal Revenue Code (the Code). Specifically, through the compliance check program, the IRS seeks to learn more about the operation of 457(b) plans of nongovernmental employers, verify whether the plans comply with the requirements of the Code, identify noncompliance issues, and develop recommendations to remove barriers to compliance.

#### Overview of the Program

Under the compliance check questionnaire program, the IRS will focus on verifying the following issues: (1) whether deferrals reported on an employee's Form W-2 represent a 457(b) plan; (2) whether the plan sponsor is eligible to offer a 457(b) plan; (3) whether participation in the plan is limited to a select group of highly compensated employees, managers, directors, or officers (participation in a 457(b) plan of a tax-exempt entity is required to be limited to a "top hat" group, i.e., a select group of management or highly compensated employees); (4) whether the plan contains impermissible features; and (5) whether unforeseeable emergency distributions have been made.

This new Section 457(b) Plan Compliance Check Questionnaire Program comes on the heels of the Section 401(k) Compliance Check Questionnaire Final Report issued by the IRS in March 2013.<sup>2</sup> Through the Section 401(k) Compliance Check Questionnaire Program, the IRS contacted approximately 1,200 randomly selected 401(k) plan sponsors and asked them to respond through an online portal. Of the 1,200 401(k) plan sponsors receiving the questionnaire, 98% responded and the IRS followed up with audits of the 2% that did not respond.

After the success of the Section 401(k) Compliance Check Questionnaire Program, it is not surprising that the IRS is launching a similar initiative for section 457(b) plans. What is surprising, however, is the IRS's decision to investigate the compliance of 457(b) plans solely of tax-exempt employers, particularly because the IRS has, to date, declined to provide plan sponsors with any meaningful procedure for correcting 457(b) plan compliance issues. Most recently, the IRS updated and overhauled its Employee Plans Compliance Resolution System (EPCRS), which applies to tax-qualified retirement plans (including 401(k) and 403(b) plans) as of April 1, 2013, but it specifically declined to address 457(b) plans. As such, 457(b) plan sponsors potentially may be in the awkward position of being questioned about compliance issues without having any good way to correct defects that may be identified.

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1. View the IRS's announcement at [http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-\(EPCU\)--Non-Governmental-457\(b\)-Plans-Project](http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-(EPCU)--Non-Governmental-457(b)-Plans-Project).

2. View the final report at [http://www.irs.gov/pub/irs-tege/401k\\_final\\_report.pdf](http://www.irs.gov/pub/irs-tege/401k_final_report.pdf).

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## Implications

The IRS expects to send compliance check questionnaires to approximately 200 tax-exempt employers during the IRS's 2013 fiscal year and another 200 during its 2014 fiscal year. According to statements made at the American Bar Association Section of Taxation's May 2013 meeting by Cheryl E. Press, senior counsel in the IRS's Office of Chief Counsel, Tax Exempt and Government Entities, these 457(b) plan sponsors will be selected randomly based upon information reported on IRS Forms 990.

The IRS noted that, in instances in which it finds issues of noncompliance with section 457(b), it may initiate an audit of the plan or advise the sponsor to seek voluntary correction through the IRS. The IRS may make voluntary correction available to the plan sponsor depending upon the facts and circumstances surrounding the plan and the error. It is unclear how this would work in practice because EPCRS does not address 457(b) plans.

Given that the IRS audited the 2% of plans that did not respond to the Section 401(k) Compliance Check Questionnaire Program, we expect that the IRS is unlikely to consider participation in any compliance check questionnaire as voluntary. Plan sponsors that receive a questionnaire from the IRS should consult with counsel for assistance in completing the questionnaire. Moreover, regardless of whether a questionnaire is received, plan sponsors may want to consider evaluating their 457(b) plan operation and administration to proactively address any compliance issues before they may be brought to the IRS's attention in future years through the compliance program.

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