



The Plan ADMINISTRATOR

Government Enforcement Initiatives

Qualified plan enforcement activity by both the Internal Revenue Service (“IRS”) and Department of Labor (“DOL”) has increased significantly over the past 12 months. Based on the agencies’ announced FY 2004 Work Plans, plan sponsors can expect this trend to continue. Below are some highlights of recent enforcement activity.

Winter 2003/2004

Timely Deposit of Elective Deferrals

Ensuring the timely deposit of 401(k) elective deferrals has been far and away the major emphasis of examinations conducted by the Department of Labor. Several instances of significant abuse have been widely publicized by the DOL. These cases involved a substantial amount of undeposited funds withheld from employees’ paychecks, often occurring in conjunction with financial difficulty being experienced by the employer. Full monetary restitution, along with civil and criminal penalties, is pursued in these instances from both the plan sponsor as well as from any plan fiduciaries involved in the breach. Increased audit activity is designed to uncover late deposits before they get out of hand.

IPI&S Inc.

**Pension and Employee
Benefit Consultants**

125 South Wilke Road
Suite 300
Arlington Heights, IL
60005-1584
847-392-2999
FAX: 847-392-1053

ROUTE 10:

Guidelines

Remember that the DOL regulations require amounts withheld from employee wages to be deposited

- as of the *earliest date* they can be segregated from the general assets of the employer, but
- in no event later than the 15th business day of the month following the month in which the amounts were withheld.

The time period in which to comply with the general rule first stated above is a factual one based on the employer’s circumstances. Thus, it is the DOL’s opinion that a small employer with one payroll center should be able to complete its deposit within a couple of days of the payroll date. On the other hand, a large employer with several payroll centers may need more time to collect and compile the data for accuracy before transmitting the deposit.

Recent DOL examinations have begun to emphasize the general rule rather than the maximum time period rule. To coincide with this emphasis, the wording on the plan's Annual Report Form 5500 inquiring as to the timely deposit of participant contributions has been changed to remove the word "maximum" from the phrase "within the maximum time period permitted in the regulations." Moreover, the instructions to the 2003 form require the independent auditor for the plan (if required to have an audit) to confirm the accuracy of the employer's response.

Note that the main emphasis of the regulations is to move the withheld funds from the employer's assets to the plan's trust. It is acceptable to temporarily deposit these amounts in a plan money market account (or even a plan checking account) and later to invest the funds pursuant to the participants' investment elections.

Failure to timely deposit participant contributions is deemed to be a loan from the plan to the plan sponsor – a breach of fiduciary duty and a prohibited transaction. Prohibited transactions are subject to a 15% excise tax payable to the Internal Revenue Service on Form 5330. In addition, a breach of fiduciary duty is subject to a potential 20% penalty which may be imposed by the DOL.

Correction

In conjunction with its Voluntary Fiduciary Correction Program (VFCP), the DOL has prescribed a methodology for correcting the late deposit of elective deferrals. This method requires the prompt payment of the deferrals to the plan along with lost earnings. Lost earnings are calculated from the date the deferrals should have been deposited to the date of actual deposit and are based on the greater of:

- the investment return the participant would have earned had the deferrals been invested timely pursuant to plan terms, and
- a rate of interest equal to that charged by the IRS for underpayment of taxes (currently 4%).

Because the earnings calculation is the greater of the above two amounts, it will always produce a positive return, in effect making the employer a guarantor of that return. Moreover, where participants are allowed to self-direct investment of their accounts, the lost earnings must be calculated on each investment alternative. Alternatively, the investment return for the best performing alternative may be utilized. Regardless, calculation of the lost earnings is time consuming, and hence, costly.

Late and Delinquent Filers

The DOL and IRS have announced a joint program to use the resources of both agencies to ferret out plan sponsors who have not complied with their annual reporting requirements. In so doing, they will review all available databases that may indicate a plan exists, e.g. determination letter applications, trust identification number assignments, etc.

The penalties for delinquent returns are quite onerous. For plans subject to ERISA, civil penalties of up to \$1,100 per day may be imposed by the DOL. In addition, the IRS may assess penalties of \$25 per day (up to \$15,000 per return) for failure to timely file plan returns. To encourage voluntary compliance, the agencies have developed the Delinquent Filer Voluntary Compliance (DFVC) Program. For the payment of a relatively modest monetary sanction, plan sponsors can voluntarily cure existing delinquencies. For small plans, the penalty is \$10 per day up to \$750, and capped at \$1,500 for multiple year delinquencies.

Audit Location

The Internal Revenue Service recently announced that except in rare and unusual circumstances, agents will henceforth be required to conduct plan examinations at the plan sponsor's place of business. Historically, these examinations have often taken place in the offices of the plan's third party administrator. The stated rationale is that most of the employer's records are maintained at its business location, e.g., W-2's, payroll records, time files, and income tax returns. The examining agent can interview persons dealing with plan operations and discuss internal controls. In addition, visiting the sponsor's premises also gives agents an opportunity to detect other matters which may impact plan qualification such as the existence of leased employees, misclassified independent contractors, or related business entities.



If you have any questions or concerns regarding the above, please call our office. For further updates and answers to general pension questions, visit our web site:
<http://www.hplspen.com>.

2004 Cost-of-Living Adjustments

The IRS has announced the following year 2004 cost-of-living adjustments for various dollar amounts that affect qualified retirement plans:

<u>Purpose</u>	<u>2003Limit</u>	<u>2004Limit</u>
Defined Benefit Limit	\$160,000	\$165,000
Defined Contribution Limit	\$40,000	\$41,000
Compensation	\$200,000	\$205,000
Highly Compensated Employee	\$90,000	\$90,000
Social Security Taxable Wage Base	\$87,000	\$87,900
401(k) Elective Deferral	\$12,000	\$13,000
401(k) Catch-Up Deferral	\$2,000	\$3,000
SIMPLE Elective Deferral	\$8,000	\$9,000
SIMPLE Catch-Up Deferral	\$1,000	\$1,500
457 Compensation Deferral	\$12,000	\$13,000
457 Catch-Up Deferral	\$2,000	\$3,000



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