STAY ON THE RIGHT SIDE OF THE IRS: EASY STEPS TO KEEP YOUR 401(K) PLAN COMPLIANT

Running a 401(k) plan for your business is a great benefit for your employees, but it comes with some significant responsibilities. If you don't follow the rules correctly, you could face fines or even lose the plan altogether. But don't worry, the IRS has provided a helpful checklist to keep your plan in good shape.

Before you start

If your third-party administrator (TPA) handles compliance requirements for your plan, you can use this checklist to make inquiries of the TPA to ensure proper compliance is being followed.

Keep in mind that if you, and your TPA if applicable, can answer yes to the below questions there is no guarantee that your plan is fully compliant. The IRS notes that this checklist is meant to be a guide to a more compliant plan.

Questions to ask

The IRS checklist asks the following questions:

Has your plan document been updated within the past few years?

Your 401(k) plan must have a formal written document that meets the current tax laws. When there are changes to the laws, make sure to update your plan to stay compliant.

Are the plan operations based on the plan document terms?

It's crucial to operate the plan according to what's written in the document. Even small changes in administration should be reflected in the plan document to avoid any issues.

Is the plan's definition of compensation for all deferrals and allocations used correctly?

Make sure you're using the right definitions of compensation for contributions and deferrals. For example, include shift differential wages in the calculation for retirement plan purposes. Avoid any discrimination in applying these definitions.

Were employer matching contributions made to appropriate employees under the plan terms?

When making employer matching contributions, follow the plan's terms and allocate them to eligible employees as outlined in the plan.

Has the plan satisfied the 401(k) plan actual deferral percentage (ADP) and actual contribution percentage (ACP) nondiscrimination tests?

The IRS conducts annual nondiscrimination tests to ensure fairness. Work with your third-party administrator to complete these tests on time and address any necessary corrections.

Were all eligible employees identified and given the opportunity to make an elective deferral?

Identify all eligible employees and give them the opportunity to participate in the plan. Keep your payroll/HRIS system updated and notify newly eligible employees about their options.

Are elective deferrals limited to the Internal Revenue Code Section 402(g) limits for the calendar year?

Ensure that elective deferrals don't exceed the limits set by the IRS under Section 402(g) for the calendar year. Correct any excess deferrals promptly to avoid penalties and taxes.

Have you timely deposited employee elective deferrals?

Department of Labor rules require employee deferrals to be deposited to the plan as soon as the employer can reasonably segregate those assets from the

general assets of the company; however, in no event can the deposit be later than the 15th business day of the following month. If you have established that you can remit on the day the deferrals are withheld, a deposit one day after the deferral is withheld could be challenged and considered late. For plans with fewer than 100 participants, a 7-day safe harbor exists for timely deposits.
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Do participant loans meet the plan document and IRC Sec. 72(p) requirements?
Allowing prohibited plan loans to ineligible participants can lead to the IRS taxing participants on such loan amounts.
Were hardship distributions made properly?
When approving hardship distributions, stick to the plan document guidelines. The IRS closely monitors compliance in this area. If a third-party administrator handles approvals, review their reports and controls.
Were top-heavy minimum contributions made?
Review the results of your ADP and ACP discrimination tests and take corrective action if necessary. This may involve making extra contributions for non-key employees or distributing funds to highly compensated employees.
Was Form 5500 filed?
Remember to file Form 5500 within 7 months after the plan's fiscal year end. You can get a 2.5-month extension by filing Form 5558. Late filing can result in significant penalties.

Next Steps

If you answered "no" to any of these questions, don't panic. Many compliance issues can be easily corrected without penalties or reporting to the IRS. However, it's crucial to make corrections promptly.

If you have questions about maintaining your 401(k) plan's compliance, BMF Advisors are here to help.