# 401(k) Plan Reviews Help Avoid Compliance Mistakes

While 401(k) plans offer employers and their employees' tax-favored opportunities to save for retirement, as tax-qualified retirement plans under the Internal Revenue Code ("IRC") and covered by the Employee Retirement Income Security Act ("ERISA"), they are also subject to numerous legal compliance requirements under such laws. These requirements apply generally upon the establishment of the plan and throughout the term of the plan.

Accordingly, it is important that employers review the 401(k) plan requirements to ensure ongoing plan compliance with applicable law. Such a review should be undertaken no less frequently than annually. Failure to comply with these 401(k) plan requirements can result in the disqualification of the plan under the IRC, and the related loss of the favorable tax benefits associated with 401(k) plans, as well as the imposition monetary penalties and liability.

Below is a checklist of compliance requirements for operating a 401(k) plan that should be periodically reviewed.

***Timely Plan Amendments.*** 401(k) plans, as is the case generally with all tax-qualified retirement plans, must be timely amended for applicable changes in the law (via statutory, regulatory, or other government-mandated plan changes), as well as for discretionary or optional plan changes (e.g., changes to the level of contributions). In addition, changes to the plan document will often also require changes to the 401(k) plan's summary plan description (or, as applicable, reflected in a summary of material modification).

***Operate the Plan Pursuant to its Terms.*** Failure to operate the plan in accordance with its terms can result in negative tax consequences and a breach of fiduciary duty.

***Ensure Proper Definition of "Compensation" is Used Under the Plan.*** A participant's "compensation" is relevant for purposes of calculating contribution allocations, as well as in complying with certain IRC-required nondiscrimination testing requirements.

***Confirm Applicable Employer Matching and Nonelective Contributions are Timely and Properly Allocated to Eligible Participants.***

***Comply With Applicable Contribution Nondiscrimination Tests.*** 401(k) plans are subject to special nondiscrimination tests applicable to elective salary deferrals (pre-tax and Roth contributions) on the one hand and to matching contributions and employee after-tax contributions on the other. These tests generally limit the contribution amounts that may be allocated to higher paid participants. Failure to timely correct noncompliance with these nondiscrimination tests can result in additional tax penalties on the employer.

***Ensure all Eligible Employees Have the Opportunity to Participate in the Plan.*** Improperly excluding eligible employees from the 401(k) plan may result in "corrective additional contributions" made by the employer to the plan.

***Ensure Elective Salary Deferral Contributions do not Exceed Annual Limit.***

Elective salary deferral contributions under all 401(k) plans are subject to an IRS-prescribed annual calendar year limit. For 2019, the dollar limit for elective salary deferrals to all 401(k) plans is $19,000. For those participants who are age 50 or older during 2019, the dollar limit for "catch-up" elective salary deferrals is an additional $6,000 (if the plan otherwise permits such catch-up contributions). These dollar limits are subject to annual adjustments by the IRS based on changes in the "cost-of-living."

***Timely Contribution of Elective Salary Deferrals to the 401(k) Plan.***

Generally, under ERISA, elective salary deferrals must be deposited into the plan no later than the earliest date such amounts can reasonably be segregated from the employer's general assets. A special safe harbor deposit timing rule applies to "small plans" (i.e., less than 100 participants as of the beginning of the plan year). Failure to timely deposit elective salary deferrals can result in a "prohibited transaction" under the IRC and ERISA.

***Ensure Plan Loans are Property Administered.*** While participants may borrow from their account under a 401(k) plan (if the plan permits loans), if such loans do not comply with legal requirements or are not timely repaid, the amount of such loan will be taxable to the participant.

***Ensure "Hardship" Distributions are Properly Administered.*** 401(k) plans may allow participants to receive a distribution while employed if they have an "immediate and heavy" financial need that generally cannot be met from other available financial sources. Hardship distributions must be made in accordance with legally compliant plan terms and procedures. The regulatory rules for hardship distributions were recently revised and liberalized by the IRS.

***Is a "Top-Heavy" Plan Minimum Contribution Required?*** If a 401(k) plan is a "top-heavy" plan (i.e., account balances for "key employees" exceed 60% of account balances for all participants), then the plan will be subject to a minimum contribution requirement for all "non-key employees." Top-heavy plan status is generally more common among small employer plans.

***Timely Form 5500 Annual Reporting Requirement.*** 401(k) plans are required to file annual information returns (Form 5500 Reports) with the U.S. Department of Labor. The type of Form 5500 report, and the scope of the report information required, depends generally on the size of the plan (e.g., plans with 100 or more participants generally must include an independent plan auditor report with the Form 5500 filing). Failure to timely file Form 5500 reports (generally by the end of the seventh month following the end of the plan year unless such filing due date is extended) can result in significant late filing penalties.

As you can see, 401(k) plans are subject to many legal compliance requirements and the failure to comply with such requirements can result in substantial costs and penalties. Accordingly, employers that sponsor 401(k) plans are strongly encouraged to periodically review their plans to ensure compliance with applicable legal requirements and the avoidance of plan-related liabilities.