# Is There An Elephant In The Room?

Insights
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401(k) Plan documents can read like Russian novels. They are often long and difficult to understand, so it's no surprise that administrative errors in operating such plans happen frequently. Common errors include omitting or including compensation that doesn't meet the definition in the plan document, failing to enroll a new employee or a rehire on time, and botching participant loans (such as a failure to set up repayment of the loan in payroll on a timely basis or extending the repayment schedule beyond the five-year limit).

Since these errors are common, you might overlook them. All operational errors are qualification errors, which means that ultimately, they could affect the tax-exempt status of your plan. While the IRS no longer disqualifies plans unless the employer refuses to take the corrective action, the IRS has the power to asses large penalties for plan sponsors who make mistakes. In the event of a 401(k) plan audit, the employer finds itself with little to no bargaining position in the negation of how much to pay the IRS to maintain plan qualification.

But there is good news. The IRS has had a correction procedure in place for many years that allows an employer to voluntarily correct almost every mistake – including many plan-document errors. This procedure permits self-correction if the error is corrected within two years after the end of the plan year in which the error occurred (with the exception of an error that relates to a participant loan or a plan-document failure).

Self-correction is also available for "insignificant" mistakes made outside the two-year correction period. Significant mistakes that occurred outside the two-year period or plan document errors must be submitted to the IRS for approval through its Voluntary Correction Procedure (VCP). This procedure is not onerous, but does require a filing fee based on the number of participants in the plan (e.g., $8,000 for a plan with at least 501 participants, but not more than 1000).

The requirements for correction through VCP are: 1) identification of the error; 2) correction of the accounts of all affected participants for all years involved (regardless of whether the year is still open to audit); and 3) submission of the correction to the IRS on the required forms. Limited plan-loan failures can also be corrected through VCP (but cannot be self-corrected).

The beginning of the year is an ideal time for a self-audit of plan administration to ensure that the plan is being operated according to its terms. Even if your plan is required to file an independent audit with the Form 5500, the auditors are not tasked with finding every mistake. That's the employer's responsibility. So for the new year, resolve to take a look around. If you see an elephant – don't ignore it!

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