# 7 Common Plan Errors and How to Avoid Them

RETIREMENT MANAGEMENT SERVICES, LLC
905 Lily Creek Road Louisville, KY 40243

4/1/2024

# 7 Common Plan Errors and How to Avoid Them

*Leisha Gosling, MBA, CEBS, QKC, QKA*

We all know that employer-sponsored retirement plans are a great way for employees to save money for retirement and the employer contributions to a company plan are a part of the employer's overall compensation package for their employees. However, correctly maintaining a retirement plan comes with responsibilities and administrative duties to ensure compliance with the various complex employee benefit plan laws and regulations, making it important to have knowledgeable service providers and strong internal company controls.

The IRS recognizes that mistakes happen in administering retirement plans so they have put processes and procedures into place for corrections. The IRS expects plan administrators and service providers to catch mistakes and correct them right away and even encourages the use of self-correction for many errors.

We will discuss seven common mistakes and provide tips on how to keep them from happening.

1. **Late Contributions.** Government regulations dictate the deadlines by which contributions must be made and there are different deadlines for employee deferrals and company contributions. Employee deferrals and loan repayments must be deposited as soon as reasonably possible for a large plan (which is generally assumed to be around the same time as payroll taxes are submitted to the IRS) or by the seventh business day for plans covering less than 100 participants. Contributions deposited after the deadline are deemed to be late and may require corrections that include additional contributions to make participants whole for lost earnings, notices to participants, or additional government filings. Late participant deferrals must also be disclosed on your Form 5500 filing.

   Employer contributions must be contributed no later than the due date of the company's tax return including any extensions for things calculated on an annual basis and generally by the end of the quarter following when they were due if they are being made on a more frequent basis than annually.

   ***To avoid errors, make sure you know who is submitting contributions to your retirement plan (may be an individual or may be directly from your payroll provider) to set processes and procedures to make sure the contributions are deposited in accordance with the required timing standards. It is important to ensure you have a back-up process in place when individuals are on vacation.***

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243

www.consultRMS.com Phone: 502-429-0767

2. **Compensation.** The compensation that is to be used for retirement plan purposes is defined in the plan document so it is important to understand how this is defined for your plan and to make sure that your payroll company is using the proper definition if they are helping you calculate employer contributions. Some plans may exclude certain types of compensation, such as, bonuses, commissions, overtime, or fringe benefits and reimbursements. If incorrect types of compensation are included/excluded, this type of failure can result in participants receiving a contribution allocation that is greater than/less than the amount they should have received.

   ***To avoid errors, know what your definition of compensation is and work with the payroll provider to make sure the correct compensation is being used. You should also spot check these calculations on a periodic basis as not all compensation items happen every payroll period.***

3. **Eligibility.** Errors in determining who is eligible to participate and when they begin participation are common. Mistakes often occur in a controlled group situation after a merger or acquisition when otherwise eligible employees are excluded and do not receive an allocation of contributions to which they are entitled or alternatively, when ineligible employees are included in the plan and the employer has made additional contributions which it did not need to make to the plan.

   ***To avoid errors, understand how your plan defines eligibility to the plan (you could have different eligibility for employee contributions and employer contributions). Plan administrators need to apply the eligibility rules correctly and consistently. The plan document should be referenced for the eligibility requirements and your recordkeeper can often help you with this determination if you provide them with full payroll data each pay period. Also, be sure to include your third party administrator (TPA) if you have any questions, especially, during an acquisition or merger to make sure the acquired employees are properly handled.***

4. **Impermissible Distributions.** The plan document will define when a participant is allowed to take a distribution or required to take a distribution from the plan. Often, distributions are very limited while a participant is still working and there are specific timing rules for participant distributions after a separation of service (even, termination of employment, becoming disabled, reaching normal retirement age, for example). Errors occur when a participant receives a distribution where the law or plan terms do not permit the distribution. It is important to review all distributions to determine whether they are allowable.

   ***To avoid errors, understand what your plan document and the law allows/requires. It is important that these are monitored and knowledgeable personnel are involved in the approval process.***

5. **Loans.** Retirement plans may allow participants to take loans, but are not required to offer loans so it is important to make sure what your plan allows. Loan errors often result from the plan sponsor's failure to withhold loan payments or not reaching out to service providers if an employee who has a loan goes on a leave of absence. When repayments are not completed timely, the loan may be considered defaulted and the participant is then taxed on the loan in the year of the default. It is also important to make sure that loans are not allowed for a longer period of time than allowed in the plan document. Most plans limit plan loans to 5 years for all purposes.

   ***To avoid errors, the plan/loan administrator should always follow the written procedures, especially, regarding repayment terms, interest rates, repayment lengths, the maximum number of loans, and the terms and processes for taking loans. Reach out to service providers immediately if you have questions on when loan payments should be started and how to handle leaves.***

6. **Compliance Testing.** All 401(k)/retirement plans are required to perform certain tests each year to prove compliance with IRS regulations. The two with the most errors in completion are the Average Deferral Percentage (ADP)/Average Contribution Percentage (ACP) Test and the Top Heavy Test.

   **ADP/ACP Testing.** These tests are designed to ensure that highly compensated employees do not benefit more in the 401(k) plan than the non-highly compensated employees in the amounts of deferrals that they make to the plan or the amounts of matching/after-tax contributions. Failure of the ADP and/or the ACP tests require either refunds to the highly compensated employees or corrective contributions to the non-highly compensated employees. These corrective actions have specific deadline dates for completion.

   **Top Heavy Testing.** The law requires that if the account balances of key employees comprise 60% or more of plan assets, non-key employees are entitled to receive a minimum benefit or contribution from the employer (generally 3% of compensation for a 401(k) plan). This top-heavy minimum must be deposited by the last day of the next plan year.

   ***To avoid errors, make sure that your TPA is completing your testing on a timely basis or consider adopting certain plan designs that provide contribution or testing exemptions for these tests.***

7. **Form 5500 Series Filings.** Failure to file the Form 5500 (and Form 8955-SSA, if required) timely can be a costly mistake. The Form 5500 (and Form 8955-SSA, if due) plus required attachments are due 7 months after the end of the plan year unless an extension to file the Form 5500 is requested. The extension request is automatic and provides an additional 2 ½ months to your completion date. The plan administrator must understand the filing requirements and make sure the filing is completed timely. Large plan filers (those who have more than 100 participants with account balances) also need to ensure that they schedule to have their mandatory CPA audit completed in time to be included with the Form 5500 filing.

   ***To avoid errors, understand the filing requirements, document who files the form, and confirm completion each year.***

With continuous monitoring and periodic self-audits, retirement plan sponsors can avoid many of the problems detailed here. As for plans that are not in compliance, the IRS and DOL have several programs for voluntary self-correction of operational errors and fiduciary violations. If caught early enough, many issues can be easily fixed by the plan sponsor. If you think you may have an error, contact your account executive immediately to discuss so that we can work with you on a timely resolution.