Here Comes the Department of Labor

Retirement Plan Audits Begin for Code Section 401(a)(9) Compliance

By Eric W. Gregory

In recent months, the Department of Labor has begun expanding its audit initiative directed at large defined benefit and defined contribution retirement plans, examining plans that it suspects have not made reasonable attempts to locate terminated vested participants who have reached their "required beginning dates" under Internal Revenue Code § 401(a)(9).[1] This initiative draws attention to the importance of maintaining updated records regarding retirement plan participants and the consequences of not doing so under both the Code and the Employee Retirement Income Security Act of 1974 (ERISA).

This article provides an overview of the Code's qualification requirements as they relate to required minimum distributions, the Department of Labor's interest in required minimum distributions, the reasons to keep plan data updated, and the department's guidance on missing plan participants.

The requirements of Code Section 401(a)(9)

To constitute a qualified retirement plan, a plan must comply with Code § 401(a). Maintaining tax qualification allows, among other things, the current deductibility of employer contributions, tax-deferred growth of investments held in the plan's trust, and tax deferral of contributions until amounts are actually received by employees. Code § 401(a)(9) and its applicable regulations are one such qualification requirement that addresses when distributions must begin and in what form they may be made.

Code § 401(a)(9) requires a qualified plan to ensure that the entire interest of a participant will be distributed, beginning no later than the required start date.[2] In general, the required start date is April 1 following the end of the year in which the participant attains age 70½ or has a termination of employment, if later.

Code § 401(a)(9) not only has implications for the qualified status of retirement plans, but also affects plan participants directly. An excise tax is imposed by Code § 4974(a) on a payee under any qualified retirement plan if the amount distributed during the payee's tax year is less than the required minimum distribution for the tax year. The amount of the excise tax is 50 percent of the amount by which the required minimum distribution exceeds the actual amount distributed during the tax year.[3]

The Department of Labor's interest in required minimum distributions

The IRS has long been investigating required minimum distributions as a part of its plan audits, as it has primary jurisdiction over the qualified status of plans. In contrast, ERISA provides the Department of Labor with the authority to conduct civil and criminal investigations of ERISA violations, including fiduciary issues. ERISA § 404(a) imposes the requirements that a fiduciary act solely in the best interests of plan participants, with the exclusive purpose of providing benefits to them and defraying reasonable expenses of administering the plan. A plan sponsor has a fiduciary responsibility to maintain procedures for locating participants and paying participant benefits when required. Therefore, the department has an interest in ensuring that participants are informed about benefits payable under retirement plans and are actually receiving distributions.

Fast Facts

Numerous plans audited by the Department of Labor did not have procedures for locating missing participants and had significant recordkeeping issues, leading to unpaid benefits to participants who had reached their required beginning date.

A plan sponsor has a fiduciary responsibility to maintain procedures for locating missing participants and paying participant benefits when required.

Department of Labor Field Assistance Bulletin 2014-10 provides useful guidance on steps to take to locate missing plan participants.

According to informal statements by representatives of the Department of Labor's Employee Benefits Security Administration, which is responsible for audits, an increase in the number of investigations is due to plan participant inquiries after receiving a Potential Private Retirement Benefit Information notice from the Social Security Administration. The Social Security Administration keeps a database of individuals who have been identified by the IRS as having qualified for retirement benefits under private plans. Frequently, this information is not up to date, but it serves as a reminder to participants of benefits they may have left behind in a former employer plan.

An Employee Benefits Security Administration representative indicated that numerous audited plans did not have procedures for locating missing participants and had significant recordkeeping issues that led to unpaid benefits to participants who had reached their required beginning date. One plan had more than $120 million in back payments owed to participants over the age of 70½. Additionally, some audited plan records indicated that placeholder birthdates were being used for participants, resulting in numerous participants appearing to be well over 100 years old.

Other reasons to keep plan data updated

Outside of maintaining fiduciary obligations and avoiding a Department of Labor audit, other good reasons for a plan sponsor to keep up-to-date records include avoiding additional steps upon plan termination and preventing uncashed distribution checks.

Keeping updated participant data helps reduce the number of steps to take when a plan needs to be terminated. In Field Assistance Bulletin 2014-10, the Department of Labor provides guidance for locating missing participants in terminating defined contribution plans. In the bulletin, the department states that fiduciaries must consider making distributions into individual retirement plans or federally insured bank accounts or identify unclaimed property funds in the event the participants cannot be located upon plan termination. In a standard defined benefit plan termination, the plan sponsor must either pay the Pension Benefit Guaranty Corporation the value of the benefit or purchase an annuity for a missing participant. Regularly updating plan records reduces the chances that missing participants might give rise to the need for these steps at plan termination.

Updated participant data also helps to reduce the chances that distribution checks will go uncashed. Representatives from the Department of Labor have taken the position that each distribution remains a plan asset until the check is cashed or a wire transfer is successful. Therefore, it is incumbent upon plan fiduciaries and their service providers to attempt to locate participants to get them to take action.

How to locate missing participants

In Field Assistance Bulletin 2014-10, the Department of Labor takes the position that finding missing participants is part of discharging one's fiduciary duty of prudence under ERISA § 404(a).[4] The department provides helpful advice to fiduciaries about appropriate steps to take to locate missing participants. Unfortunately, however, the guidance is limited to terminating defined contribution plans and does not specifically extend to ongoing defined contribution or defined benefit plans. Nevertheless, the principles are applicable in other contexts. The department suggests a series of four initial actions:

(1) Use certified mail to attempt to contact the missing participant at any known address.

(2) Check related plan and employer records to determine if any additional contact information exists for the missing participant.

(3) Check with the designated plan beneficiary to try to contact the missing participant.

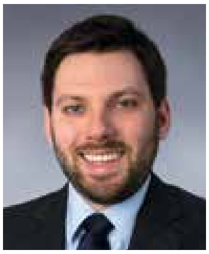
(4) Use free electronic search tools like Google, public record databases (such as those for licenses, mortgages, and real estate taxes), obituaries, and social media to locate the missing participant.[5]

To the extent that the participant cannot be located using any of the above, the Department of Labor states that ERISA's duties of prudence and loyalty require the consideration of additional steps. Depending on the size of a distribution, it may require the use of fee-based Internet search tools, commercial locator services, credit reporting agencies, information brokers, investigation databases, and analogous services.

Free Internet searches can be particularly helpful in locating missing participants. For instance, using search operators such as quotation marks around a name often brings up results with associated phone numbers. And one can frequently find additional contact information by searching an e-mail address or phone number. It's also possible to create a Google news alert in someone's name. Another helpful tool is using a Google image search of someone's photo to find matches on social networking sites like LinkedIn, Facebook, or Twitter. Finally, Google's own social network, Google+, can be searched.

Conclusion

It is critical that plan sponsors have a set of procedures for updating plan data and finding missing participants. Sponsors should periodically perform an internal audit to ensure the adequacy of participant records. They may also want to receive regular updates from their third-party administrator on uncashed participant checks. If any issues are found, it is imperative that sponsors take action as soon as possible. ■



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ENDNOTES

1. 26 USC 401.
2. 26 CFR 1.401(a)(9)-2; 26 CFR 1.401(a)(9)-3.
3. 26 CFR 54.4974-2, A-1.
4. US Dept of Labor, *Field Assistance Bulletin No. 2014-01* <https://www.dol.gov/ebsa/regs/fab2014-1.html> (accessed August 8, 2016).
5. *Id.*