

## Employee Plans News

**Issue 2013-3, September 13, 2013**

[Large Case Audit Program phone forum](#) (October 16, 2 p.m. EDT) - learn about the selection and audit process, internal controls and international issues

[Form 8955-SSA penalty assessments](#) - a programming error caused approximately 4,000 penalty notices to be sent by mistake

[Automatically revoking](#) spousal beneficiary designations on legal separation can lead to plan errors

[Frozen defined benefit plans project](#) - the Employee Plans Compliance Unit found frozen plans were amended for EGTRRA but had other errors

**Favorable determination letters** - don't rule on Defense of Marriage Act language - As of September 9, 2013, letters will include a caveat that we have not made any determination about plan language (including any amendments) related to Section 3 of DOMA or *U.S. v. Windsor*, 133 S. Ct. 2675 (2013), which invalidated that section

## Form 8955-SSA Penalties Assessed in Error

Approximately 4,000 plan sponsors received erroneous [CP 283C](#), *Notice of Balance Due for Incomplete/Late Penalties* for their Form 8955-SSA, *Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits*. These erroneous notices were dated between July 28 - August 26, 2013.

We corrected the programming error that generated the notices and abated the erroneous penalties. We also sent letters apologizing for the error; it isn't necessary to reply to the notice or to contact the IRS.

If you received an IRS penalty notice dated between July 28 and August 26, 2013, for an issue unrelated to this programming error, you must respond according to the instructions in the notice.

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## Automatically Revoking Beneficiary Designations on Legal Separation Can Lead to Plan Errors

Automatically revoking a participant's designation of his or her spouse as beneficiary when the participant is legally separated may cause a plan to violate the spousal death benefit rules.

A qualified retirement plan must provide that it will pay at least 50% (100% for profit-sharing plans) of a participant's death benefits to the participant's current spouse, **unless** the participant has waived this spousal benefit, with his spouse's consent. These rules (the qualified pre-retirement survivor annuity (QPSA) rules) apply regardless of whom the participant designates as his beneficiary.

### Effect of Legal Separation

Some plans are written to automatically revoke a participant's spousal beneficiary designation when the participant divorces or is legally separated.

However, **legal separation** only eliminates the requirement that a participant obtain spousal consent to waive the spousal death benefit and name another beneficiary. The separated spouse must still receive the spousal death benefit unless the participant has:

- waived the death benefit, and
- specifically designated another beneficiary.

### Automatically revoking a legally separated participant's beneficiary designation doesn't affect the spouse's right to QPSA benefits

Although a legally separated participant can **waive** the spousal death benefit without spousal consent, a plan's **automatic revocation language**, by itself, doesn't satisfy the waiver rules. Automatically revoking a beneficiary designation, therefore, **has no effect on** the legally-

separated spouse's rights to death benefits under the QPSA rules. (Internal Revenue Code Sections [401\(a\)\(11\)](#) and [417](#)).

However, a plan's automatic revocation language is often misunderstood as **eliminating** a legally-separated spouse's right to death benefits, and may cause a plan administrator to pay death benefits to the wrong person.

### **Plan language**

To prevent this confusion, the IRS will no longer permit **pre-approved plans** to contain provisions that automatically revoke a participant's spousal beneficiary designation upon legal separation.

**Individually designed plans** must either eliminate this language or clarify that the revocation does not affect the spouse's rights to the QPSA death benefits. For example, a pension plan that provides that the spouse is entitled to 50% of a participant's benefit, but allows the participant to designate a different beneficiary for the rest, must specify that the revocation only affects the beneficiary of the remaining 50%.

### **Automatic revocation for divorce**

Retirement plans may continue to provide that if participants get a divorce, their designation of their former spouse as plan beneficiary is automatically revoked.

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## **Updating Frozen Defined Benefit Plans for Current Law and Other Compliance Issues**

During the [Frozen Plan Amendments project](#), the [Employee Plans Compliance Unit](#) looked at whether sponsors of frozen defined benefit plans had amended their plans for the Economic Growth and Tax Relief Reconciliation Act of 2001.

### **Project goals**

We designed the Frozen Plan Amendments project to learn:

1. If plan sponsors amended their frozen plans for current law by the required deadlines
2. Whether the sampled plans were actually frozen defined benefit plans
3. Reasons the plans were frozen
4. The effective date of the freeze
5. What sponsors intended to do with their frozen plans in the short term

### **Background**

Generally, participants in a frozen plan don't accrue new benefits.

Just as with active plans, a frozen plan must comply with the requirements of Internal Revenue Code Section 401(a) to retain its tax-qualified status. If plan sponsors don't amend their frozen plans for current law by the required deadlines, their plans could become disqualified. The deadline depends on whether the plan is a pre-approved plan or an individually designed plan.

- **Pre-approved plans** - Plan sponsors who adopted a pre-approved plan had until April 30, 2012, to adopt their EGTRRA plan restatement.
- **Individually designed plans** - Sponsors of individually designed plans should have amended for EGTRRA during their [5-year remedial amendment cycle](#) that is generally based on the last digit of their EIN.

Additionally, special rules and annual testing requirements for the minimum coverage and participation requirements of IRC Sections 410(b) and 401(a)(26) and non-discrimination apply to frozen plans.

## Project results

Overall, the project showed that sponsors of the sampled frozen defined benefit plans amended their plans for current law by the required deadlines, however we found other issues:

- **Incorrect pension feature code listed on Form 5500**
  - Some sponsors selected pension feature code 11, frozen defined benefit plan, when their plan was a defined contribution plan.
  - Some sponsors selected pension feature code 11, frozen defined benefit plan, when their plan wasn't frozen.
- **Form 5500 filed incorrectly** - Some SEP plan sponsors filed a Form 5500 series return. SEP plans don't have a Form 5500 filing requirement.
- **No Form 5500 filed** - A few sponsors didn't file a Form 5500. Being frozen doesn't eliminate the Form 5500 filing requirement. A frozen plan isn't a terminated plan. A terminated plan:
  - has been formally terminated,
  - no longer credits service for benefit accruals and vesting, and
  - has distributed or is distributing all plan assets as soon as it's administratively feasible, generally within one year after the date of plan termination (Revenue Ruling 89-87).
- **Employer no longer in existence** - In a few cases, the sponsoring corporation dissolved or self-employed owner retired or died, but the assets remained in the trust. A qualified plan needs a sponsoring employer.

If any of these situations sound familiar, talk with your benefits professional. If you are a benefits professional, make sure you talk with your clients about the differences between active, frozen and terminated plans.

## Planning tips

Now may be a good time to review your frozen defined benefit plan to see if you:

1. Still have a valid reason for keeping the plan frozen
2. Have filed Form 5500 for your plan by the filing deadline
3. Used the correct pension feature code on Form 5500
4. Amended the plan for current law by the required deadline

### **Missed the deadline to amend your plan?**

If you've missed the deadline to amend your plan for EGTRRA, EGTRRA good-faith amendments, interim amendments, or amendments required to implement optional tax law changes, you may be able to correct this failure through our [Voluntary Correction Program](#).

### **Contact us**

If you have questions about this project, [e-mail](#) us and include "Frozen Plan Amendments" in the subject line.

### **Additional resources**

- [Form 5500](#) series and instructions
- [Form 5500-EZ](#) and instructions