IRS Issues 8 Benefit Plan Snapshots

The Internal Revenue Service periodically issues Snapshots. Snapshots are employee job aids that provide analysis and resources for a given

technical tax issue. Snapshots are developed through internal collaboration at the IRS and may evolve as the compliance environment changes and new insights and experiences are contributed.

Listed below are Snapshots recently issued in May 2018. Please click on the related link to read specific IRS analysis and resources given in the Snapshots.

- How to Change Interest Crediting Rates in a Cash Balance Plan
- Spousal Consent Period to Use an Accrued Benefit as Security for Loans
- Treatment of 415(c) Dollar Limitations in a Short Limitation Year
- Treatment of 401(a)(17) Limitation in Defined Contribution Plan in a Short Plan Year
- Borrowing Limits for Participants with Multiple Plan Loans
- Qualification Requirements for Non-Electing Church Plans under IRC Section 401(a)
- Vesting Schedules for Matching Contributions
- Plan Forfeitures Used for Qualified Nonelective and Qualified Matching Contributions

The Snapshots can also be obtained at https://www.irs.gov/retirement-plans/ep-issue-snapshots

Snapshots are not laws and regulations but rather analysis and resources to interpret current laws and regulations, Plan sponsors should consider discussing with their providers to determine if any plan operations are inconsistent with the views given in the Snapshots.

A few items which the IRS highlighted in these Snapsots include:

Proration of the IRC Section 415(c) limit –Total annual additions to a participant's defined contribution plan account are limited to the dollar amount imposed by IRC Section 415(c) ($55,000 for 2018). The contribution limit for a short limitation year is determined by multiplying the applicable dollar limit for the calendar year in which the short limitation year ends by a fraction, the numerator of which is the number of months (including any fractional parts of a month) in the short limitation year, and the denominator of which is 12.

Example 1 – Amendment

Plan A is a profit-sharing plan with a calendar limitation year. On June 30, 2018, the plan is amended to change the limitation year to a fiscal year ending June 30. The amendment creates a short limitation period from January 1 to June 30, 2018 (6 months). Because the short limitation year ends in 2018, the prorated short limitation year is calculated based on the 2018 limit of $55,000.

The prorated short year IRC Section 415(c) limit is: $55,000 x (6/12) = $27,500.

Example 2 – Termination

Plan B is a profit-sharing plan with a calendar limitation year. The plan is terminated effective September 15, 2018. The plan termination is treated as if an amendment has been adopted to change the limitation year to a year beginning September 16, 2018. A short limitation year is created from January 1 to September 15, 2018 (8.5 months). Because the plan terminated in 2018, the prorated short year limitation is calculated based on the 2018 limit of $55,000 under IRC Section 415(c).

The prorated short year IRC Section 415(c) limit is: $55,000 x (8.5/12) = $38,958.

Note in both of these examples, in a short limitation year, the IRC Section 415(c) dollar limitation is prorated to reflect a lesser maximum amount of contributions that can be contributed. However, the limitation on compensation for purposes of IRC Section 401(a)(17) does not. For more information on how to apply the IRC Section 401(a)(17) limit to short plan years, see *Issue Snapshot – Treatment of 401(a)(17) Limitation in Defined Contribution Plan in a Short Plan Year*

Participants eligible for part of limitation year

Limits on annual additions and compensation are not prorated for employees who are eligible to participate in the plan for only part of the limitation year (for example, participants entering the plan in July of a calendar limitation year). Proration of these limits only applies when the limitation year is less than 12 months. Plan provisions can limit compensation taken into account to the period of participation. For example, a plan's administrable definition of compensation can be defined to provide that compensation for purposes of applying the allocable share of profit sharing contributions only applies to that portion of a plan year during which an employee is an eligible participant.

Example 3

Plan C is a profit-sharing plan with a calendar limitation year. Susan becomes a participant in the plan on July 1, 2018. The IRC Section 415(c) dollar limit is not reduced for Susan even though she is a participant in the plan for only 6 months. Alternatively, it would be prorated to 50% of the IRC Section 415(c) dollar limit if the plan is amended to create a short limitation year that begins on July 1, 2018 and ends on December 31, 2018.

Plan Termination

One of the more common required prorations of a plan's limitation year occurs when a plan terminates. As noted above, most plans are administered with concurrent plan / limitation years. Termination of such a plan before its last day will lower the dollar limit on the maximum amount of annual additions that may be credited to a participants account in its final year. Treas. Reg. Section 1.415(j)-1(d)(3) requires that when a defined contribution plan is terminated effective as of any date other than the last day of its limitation year, the plan is treated as if it has been amended to change the limitation year to a period ending on the date of termination. This requires proration of the IRC Section 415(c) dollar limitation for the termination year, and might restrict the maximum amount otherwise allocable to a participant.

Proration of 401(a)(17) limitation – The compensation limit for a short year is determined by multiplying the applicable annual compensation dollar limit for the calendar year ($275,000 in 2018) in which the short year begins by a fraction, the numerator of which is the number of months in the short plan year, and the denominator of which is 12. See Treas. Reg. Section 1.401(a)(17)-1(b)(3)(iii)(A).

Example 1 – Amendment creating a short plan year

Plan A is a profit sharing plan with a calendar plan year. On June 30, 2018, the plan is amended to change the plan year to a fiscal year ending June 30. The amendment creates a short plan year from January 1 to June 30, 2018 (6 months). The plan document provides that allocations for the plan year ending June 30 are based on compensation for the 6-month period. Because the short plan year begins in 2018, the prorated short year limit is calculated based on the 2018 limit of $275,000 under IRC Section 401(a)(17). The prorated short year limit is $137,500 ($275,000 x (6/12) = $137,500).

Example 2 – Initial short plan year

Company C establishes a new § 401(k) profit sharing plan effective October 1, 2018. The plan is a calendar year plan and the first plan year ends December 31, 2018 (3 months). The plan has matching contributions equal to 100% of the first 4% of compensation deferred by a participant for the plan year. For the first plan year, compensation taken into account under the plan is compensation earned after the effective date of the plan. Thus, for the first plan year, the prorated short year limit for the initial plan year under IRC Section 401(a)(17) is $68,750 ($275,000 x (3/12) = $68,750).

Example 3 – Initial short plan year – 12-month measurement period

The same facts as Example 2 except Company C establishes a new Section 401(k) profit sharing plan in July 2018, but the plan is effective January 1, 2018, and the plan document states that compensation taken into account under the plan is compensation earned for the calendar year. The limit under IRC Section 401(a)(17) is not prorated for the first plan year because the compensation measurement period under the plan is 12 months.

Example 4 – Plan termination

Plan B is a profit sharing plan with a calendar plan year. The plan sponsor adopts a resolution to terminate the plan effective September 30, 2018. Final allocations under the plan are based on compensation earned from January 1 to September 30, 2018 (9 months). Because the compensation measurement period is less than 12 months in 2018, the compensation limit must be prorated. The prorated short year limit is calculated based on the 2018 limit of $275,000 under IRC Section 401(a)(17). The prorated short year limit is $206,250. ($275,000 x (9/12) = $206,250).

Participants who join or leave the plan mid-year

A plan may allocate contributions to participants based on compensation earned by an employee only while he or she is a participant in the plan. If that is the case, the IRC Section 401(a)(17) compensation limit is not prorated for employees who participate for only a portion of the plan year (for example, who enter the plan in July of a calendar plan year) provided the plan continues to use a measurement period of 12 months for the other employees. See Treas. Reg. Section 1.401(a)(17)-1(b)(3)(iii)(B).

Example 5 – New participant

Plan P is a calendar year Section 401(k) plan. The plan allocates nonelective contributions to participants based on compensation earned during each employee's period of participation under the plan. Participant B begins employment on January 1, 2018, and becomes a participant in the plan on August 1, 2018. B's elective deferrals and allocated nonelective contribution for 2018 is based on compensation earned during the period August 1 – December 31, 2018. However, the IRC Section 401(a)(17) limit is not prorated because the compensation measurement period applicable to all employees is 12 months.

Borrowing Limits for Participants with Multiple Plan Loans – A qualified retirement plan may, but is not required to, provide for loans. If a plan provides for loans, the plan may limit the amount that may be taken as a loan to an amount that is set forth in the plan document. However, the maximum amount that can be borrowed at any time cannot exceed the amount that is set forth in IRC Section 72(p)(2)(A).

IRC Section 72(p)(2)(A) provides that the amount of a participant loan, when added to the outstanding balance of all other loans from all plans of the employer, may not exceed the lesser of:

(A) $50,000, reduced by the excess (if any) of (i) the highest outstanding balance of plan loans during the one-year period ending on the day before the date on which the loan was made over (ii) the outstanding balance of plans loans on the date on which the loan was made, or

(B) the greater of (i) 50% of the present value of the participant’s vested accrued benefit or (ii) $10,000.

For purposes of this calculation, an employer’s plan includes plans of all members of a controlled group of employers, of trades and businesses under common control, and of members of an affiliated service group.

Reg. Section 1.72(p)-1, Q&A-20(a)(1), provides that, in general, a participant who has an outstanding loan that satisfies IRC Section 72(p)(2) may borrow additional amounts if, under the facts and circumstances, the loans collectively satisfy the IRC Section 72(p)(2)(A) limitation and the prior loan(s) and the additional loan(s) each satisfy the requirements of IRC Section 72(p)(2)(B) and (C).

To determine the maximum loan amount, the $50,000 limit is reduced by the difference between the highest outstanding loan balance of all of the participant’s loans during the one-year period before the loan is made and the outstanding loan balance of all the participant’s loans at the time the new loan is made. In addition, the adjusted maximum loan amount is further reduced by the current outstanding balance of loans on the day the new loan is made. The loans cannot exceed the lesser of that amount or the greater of 50% of the participant’s vested accrued benefit or $10,000.

Loan refinancing

Special rules apply to loan refinancing. The regulations permit a loan to be refinanced. In a refinancing, the prior loan is replaced by a new loan. A participant may wish to do this in order to take advantage of a lower interest rate. The loan that is replaced is treated as repaid at the end of the transaction. The loan being replaced is called the replaced loan. The new loan resulting from the transaction is referred to as the replacement loan. For purposes of the amount limitation of IRC Section 72(p)(2)(A) (as discussed above), both the replaced loan and the replacement loan are treated as outstanding at the time of the refinancing if any portion of the replacement loan has a later repayment date than the replaced loan. See Reg. Section 1.72(p)-1, Q&A-20(a) and Example 1 of Reg. Section 1.72(p)-1, Q&A-20(b).

Example 1: Calculation of the maximum amount of loan when there are no prior loans.

Assume that Plan A permits participant loans.

Joseph's vested account balance is $15,000. Joseph can borrow up to $10,000, even though this amount exceeds half his vested account balance. Sally's vested account balance is $125,000. Sally can borrow $50,000.

Example 2: Calculation of the maximum amount of loan when there are prior loans.

Assume that Plan B permits participant loans (including multiple loans).

Mark has a vested account balance of $200,000 and took a loan for $40,000 on August 1, 2013. On December 1, 2015, when the loan balance is $25,000, Mark wants to take another loan from the plan. The loan balance on December 1, 2014, was $32,000. The maximum amount that Mark can borrow is $18,000. This is calculated by first determining the repaid loan amount for the one-year period before the loan was made. That amount is $7,000. It is the difference between the highest outstanding loan balance for the one-year period ending on December 1, 2015 ($32,000) and the outstanding balance on the day of the loan ($25,000). The $50,000 limit is reduced by the repaid loan amount to $43,000 ($50,000 – $7,000). Therefore, the maximum amount of the new loan is the reduced limit minus the outstanding balance on the day of the loan, which is $18,000 ($43,000 – $25,000).

Example 3: Calculation of the maximum amount of loan when the prior loan was for $50,000.

Assume that Plan C permits participant loans (including multiple loans).

Leah received a loan on March 1, 2014, for $50,000, with amortization made on a quarterly repayment schedule. Assume the outstanding balance on September 1, 2014, was $35,000, because the participant paid extra amounts toward principal. The repaid loan amount for the one-year period before the loan was made is $15,000 ($50,000 – $35,000). Therefore, the $50,000 loan limit is reduced to $35,000 ($50,000 – $15,000). As the adjusted maximum amount ($35,000) is the same as Leah's outstanding balance on September 1, 2014, Leah cannot receive an additional loan on September 1, 2014.

Note: If a balance of $50,000 existed at any time during the prior one-year period, a new loan is not permitted, even if the prior loan was completely repaid.

Qualified Matching Contributions – QMACs are matching contributions that are eligible to be treated as elective contributions for purposes of the ADP test. A QMAC is subject to most of the same distribution restrictions applicable to elective contributions. One notable exception is that unlike elective deferrals, QMACs currently can't be distributed on account of an employee's hardship. However, for plan years beginning after 2019, they can, pursuant to changes enacted by the Section 41114(a) of the Bipartisan Budget Act of 2018, P.L. 115-123. QMACs that an employer takes into account for the ADP test are disregarded in performing the ACP test – they cannot do "double duty."

QMACs must be nonforfeitable "when they are contributed to the plan." Reg. Section 1.401(k)-6. Reg. Section 1.401(m)-5 similarly provides that a QMAC must be nonforfeitable "at the time the contribution is made." On January 18, 2017, proposed regulations were published in the Federal Register that would change the definition of QMACs. Under the proposed regulations, employer contributions to a plan will qualify as

QMACs if they are nonforfeitable when they are allocated to participants' accounts, and need not be nonforfeitable when they are contributed to the plan. Taxpayers may rely on the proposed regulations. See Plan Forfeitures Used for Qualified Non-Elective and Qualified Matching Contributions for a detailed discussion of the proposed regulations.

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Who We Are

Torrillo & Associates, LLC specializes in employee benefit plan audits including 401k audits, 403b audits, pension plan audits, and other retirement plan audits. We are licensed in 10 states including Pennsylvania, New Jersey, Delaware, New York and Florida. We are also able to practice in additional states that have passed firm mobility.

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