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MetLife Resources is a division of Metropolitan Life Insurance Company, 200 Park Avenue, New York, NY 10166.
At MetLife, we’re committed to providing you with ongoing communications that will help you make decisions regarding your defined contribution plans. We hope this information will help prepare you for a potential IRS plan audit. Preparation and confidence in your own internal processes are key drivers that can increase the likelihood of a successful plan audit outcome.

In addition to this paper, we have prepared in-depth discussions covering topics ranging from Information Sharing Agreements to the “Universal Availability” requirement, with an emphasis on the potential impact on your 403(b) plan. You can view copies of previously released papers at our 403(b) Resource Center at www.metlife.com/mlr.

For more information, please contact your local MetLife representative, or call 1-877-638-7526 to have a representative contact you.

About The Author
Robert C. Sproule, Esq. serves as Assistant General Counsel for MetLife with focused knowledge on laws relating to employee retirement benefits for government and nonprofit employees. Mr. Sproule holds a Bachelor of Science degree from Cornell University, a Master of Business Administration degree from Lehigh University and a Juris Doctorate degree from Indiana University School of Law where he graduated Summa Cum Laude.

About MetLife
For over 140 years, MetLife has been one of the country’s most trusted financial institutions. The MetLife enterprise serves more than 90 of the top 100 Fortune 500®-ranked companies. In addition, the top credit rating agencies have repeatedly recognized us for our financial strength.¹

MetLife Resources is a division of Metropolitan Life Insurance Company and specializes in providing retirement plan products and other financial products and services to healthcare, education, governmental and other nonprofit employers and their employees. MetLife Resources currently offers defined contribution retirement plan services to 1.3 million participants and has approximately $35 billion in retirement plan assets under administration.²

¹ For current ratings information and a more complete analysis of the financial strength of Metropolitan Life Insurance Company and MetLife Insurance Company of Connecticut, please go to www.metlife.com and click on “About MetLife,” “Ratings.”
² LIMRA Not-For-Profit Report, Q4 2012.
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Summary

The prospect of undergoing an IRS audit may create anxiety in sponsors of defined contribution plans. However, there are some things you can focus on now that can greatly enhance your chances of passing an audit should your plan be subject to one:

- Be prepared.
- Fully understand your compliance responsibilities.
- Make timely notification to the IRS of any plan corrections.
- Enlist the cooperation of your approved plan providers (where appropriate).
- Keep your records organized and up to date.

Incorporating these steps into your ongoing plan administration processes is key to coming through an IRS audit successfully.

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It is possible that the Internal Revenue Service will continue to focus efforts on enhancing 403(b) plan compliance for the foreseeable future. What does this mean for an employer that maintains a 403(b) plan? While not all 403(b) plans may be audited, some plans will be included in the IRS audit program. Like any type of audit, being prepared can speed up and simplify the IRS audit process. The purpose of this paper is to highlight three main areas that an employer can focus on to be better prepared:
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If your plan is audited, the IRS will want to review records documenting that you are following the terms of your written plan. The IRS may ask for plan records and other data in an effort to determine if your organization is complying with the terms of the plan and applicable law. Be sure you can locate all of these records. If you have not been maintaining comprehensive records, it's never too late to start.

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- Information sharing agreements
- Payroll master file or employee census records for all employees who performed any hours of service at any time during the plan year (The IRS will want these records to verify eligibility, participation, and coverage.)
- Copies of cancelled checks and other records supporting contributions made to your plan
- Copies of employee salary reduction agreements
- Information relating to maximum contribution limit calculations for your employees
- If applicable, copies of your plan test results and the data for preparing discrimination, coverage, and contribution percentage testing

To reduce the amount of audit preparation time, many employers have found it very helpful to collect and review these documents before receiving an audit notice from the IRS.

Hardship Distributions

A 403(b) plan may permit employees to receive a hardship distribution as long as the distribution is necessary to satisfy an immediate and heavy financial need. The employer’s written plan must clearly state that participant hardships are available under the plan (subject to the provisions of the participant’s insurance or custodial account contract). The IRS has provided “Safe Harbor” rules that permit employees to receive a distribution of elective deferrals while still employed. To meet the Safe Harbor requirements, the hardship distribution must meet both “financial need” and “deemed necessary” rules.

Under the Safe Harbor “financial need” rules, a distribution may be made to:

- Pay uninsured medical and/or hospital expenses for the employee and the employee’s spouse and dependents;
- Pay costs directly related to the purchase of an employee’s primary residence;
- Prevent eviction from, or foreclosure on the mortgage on, an employee’s primary residence;
- Pay upcoming, post-secondary educational expenses of an employee and the employee’s spouse, children and dependents;
- Pay funeral expenses for an employee’s deceased parent, spouse, child or dependent; or
- Pay for the repair of, or damage to, the employee’s principal residence that qualifies for the casualty deduction.

Under the Safe Harbor “deemed necessary” rules, it is the employer’s responsibility to confirm that the employee has obtained all other currently available distributions and nontaxable loans under the plan, and all other plans that are maintained by the employer. In addition, the employee must not be permitted to make elective deferrals to any plan maintained by the employer for at least six months after receipt of the hardship distribution.

Hardship distributions cannot be rolled over to another plan or to an IRA. They are generally subject to the 10% early distribution penalty on distributions made prior to the employee reaching age 59½.
Loan Repayments
Generally, an employer that maintains a 403(b) plan for its eligible employees may permit plan loans as an optional plan feature. In doing so, the employer’s written plan must specifically allow loans. If employees are permitted to borrow from their plan accounts, the loan provision should be based on a detailed, written loan program.

A 403(b) plan loan is not taxable to the employee as long as the loan satisfies the following guidelines:

- The loan must be made as part of a written loan program maintained by the employer.
- An employee may generally borrow the lesser of 50% of their vested account balance, or $50,000.
- The loan must be repaid within a period of no more than five years, unless the loan is used to purchase the employee’s primary residence.
- Loan repayments must be made in substantially level payments, at least quarterly, over the life of the loan.

The $50,000 maximum loan amount must be reduced if the employee has an outstanding loan under the plan (or any other plan of the employer or related employer) during the one-year period ending the day before the new loan. The amount of the reduction is the employee’s highest outstanding loan balance during that period minus the outstanding balance on the date of the new loan.

Identifying Common 403(b) Compliance Issues
Employers should review their plan documents and administration procedures to determine whether the plan meets current compliance requirements. They should also pay particular attention to the following compliance issues that the IRS commonly reviews.

Universal Availability
If an employer permits one employee to elect to defer salary into its 403(b) plan, then the employer must extend this offer to all employees of the organization. This is referred to as the “universal availability” rule. Certain employees, however, may be excluded from the plan and not cause the plan to violate this rule:

- Employees who will contribute $200 or less annually;
- Employees who participate in a 401(k) or 457 plan, or in another 403(b) plan maintained by the employer;
- Non-resident aliens;
- Employees who normally work less than 20 hours per week (subject to certain limitations); and
- Students performing services described in section 3121(b)(10).

In addition to permitting eligible employees to make elective deferrals into the plan, all eligible employees must be informed of their right to do so. Employees must also be provided a meaningful opportunity to make and change their elections during the year.
Application and Coordination of the Age 50 Catch-Up and 15 Years of Service Catch-Up

In addition to making basic elective deferrals, a 403(b) plan may also permit employees to make two different types of catch-up elective deferral contributions: Age 50 Catch-Up and 15 Years of Service Catch-Up contributions.

Age 50 catch-up contributions are generally available to employees who are age 50 or older by the end of the tax year. Subject to certain limitations, 15 years of service catch-up contributions are generally available to employees who (1) did not make the maximum amount of elective deferrals in previous years and (2) have accumulated 15 years of service with the same employer. For the purpose of 15 years of service catch-up contributions, "employer" refers to: school, hospital, home health service agency, welfare service agency, church or a similar organization.

403(b) plan sponsors often make errors in determining whether an employee is eligible for one or both types of catch-up contributions, and in determining the amount of catch-up contributions that an employee may make. For example, an employee’s 15 years of service allowable catch-up contribution may be limited if an employee is eligible to make both types of catch-up contributions. This is because elective deferrals in excess of the basic contribution level must first be allocated to 15 years of service contributions before being allocated to age 50 catch-up contributions. Failure to adhere to this methodology and properly limit contributions made under this 15-year rule is a common error and a frequent compliance issue.

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<th>15 Years of Service Catch-Up Types of Employers</th>
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Failure to Have a Written Plan Document

The regulations generally require an employer that offers a 403(b) plan to have adopted a written plan prior to January 1, 2010. The written plan must include all of the material provisions regarding eligibility, benefits, applicable limitations, and the time and form under which benefit distributions are made. In some cases, the employer may be able to satisfy the written plan requirement by adopting a simple basic plan which incorporates the existing terms of annuity contracts, custodial agreements and other documents. Together, these components may satisfy the written plan requirement.

On March 28, 2013, the IRS released a pre-approved written plan procedure for 403(b) plans that will assure employers their plans comply with all applicable 403(b) plan document requirements. MetLife intends to offer pre-approved 403(b) plan documents to customers as soon as our plan is approved under the procedure.

Post-Severance Elective Contribution Requirements

Current regulations stipulate that no employee elective deferrals can be made from compensation payable from any payroll period that begins after severance from employment unless the compensation meets one of the following rules:

- Two and One-half Month Rule
- Total and Permanent Disability Rule
- Qualifying Military Service Rule

The Two and One-half Month Rule allows employee elective deferrals to be made from certain compensation paid by the later of (1) two and one-half months after severance from employment, or (2) the end of the limitation year (usually a calendar year) that includes the date of severance from employment. Regular compensation, overtime, shift differential, commissions, bonuses, and other similar payments are eligible for the Two and One-half Month Rule, as well as certain leave cash-outs and deferred compensation payments.

Employees may also be eligible to make elective deferrals from post-severance compensation paid to them when they are permanently and totally disabled or when they end employment to perform qualified military service. However, specific requirements must be satisfied in order to make elective deferrals under these terms.

Contributions Made On a Timely Basis

One of the most important responsibilities of a plan sponsor is remitting participant contributions in a timely manner. You also have a legal obligation to remit contributions as soon as administratively possible for those employees who have elected to reduce their salaries in order to make contributions. When you don’t remit contributions on time, your employees could lose money they otherwise may have gained had the contributions been invested. Additionally, if the plan stipulates that you will contribute a certain percentage of an employee’s compensation, you have a legal obligation to do that in a timely manner.
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Areas of Focus

- Collecting and maintaining information about your plan
- Identifying common plan compliance issues
- Correcting compliance issues
Preventing For An IRS Audit

By: Robert C. Sproule, Esq.
Assistant General Counsel, MetLife

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MetLife Resources
Metropolitan Life Insurance Company
200 Park Avenue, New York, NY 10166
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MLR19000340128  L0413387712[exp0614]Al Stated@DC
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