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When SIMPLE Is Not Simple, and Is Expensive - Spring 2019

Employers too often adopt IRA-type savings plans expecting to avoid the detailed administrative and IRS compliance requirements of tax qualified Profit Sharing and Defined Benefit Pension Plans. The realities include:

- IRA-type plans require the same employer's administrative attention, and impose the same fiduciary exposure as tax qualified Profit Sharing and Defined Benefit Pension Plans.
- The employer cheerfully sails forward with implicit administrative costs and allegedly no fiduciary responsibility for investment management.
- Employees believe they can be effective investment managers with no guidance despite management's use of professionally qualified investment advisors for its investment decisions.
- IRA-type savings plans are heavily promoted by investment sources to market retail consumer investment products directly to financially naive individual buyers.
- Although there are no annual Form 5500 and possible PBGC filings, the administrative cost savings for their preparation and filings are negligible.
- The employer may temporarily avoid the cost of independent advisors, but the cost for corrections can be much greater.

Administrative costs skyrocket when an IRS Plan Audit finds a plan failure or a beneficiary claims his or her death benefit is insufficient; or, a participant claims investment disclosures and the universe of investment options violate ERISA's investment fiduciary standards. Plan failures occur when the employer or third party administrator makes a mistake that invalidates the plan's favorable tax status to cause contributions and account balances to be taxable with past due taxes paid with interest and penalties by both the employer and plan participants. For example, SIMPLE IRA plan failures include:

- The plan document is not current with IRS requirements.
- Contributions are not timely deposited.
- Incorrect contributions are deposited for an employee for any reason.
- An eligible employee is excluded from participation.
- Employer contributions are not deposited for eligible terminated employees.
- Compensation applied for calculations does not fit the plan's definition.
- Benefits are incorrectly calculated and distributed.
- Disclosure requirements to employees are not properly prepared and timely distributed.
- More than 100 employees earn \$5,000 or more.
- The employer sponsors another tax qualified plan making the employer ineligible to sponsor a SIMPLE IRA.

See IRS' [SIMPLE IRA Plan Fix-it Guide](#) on the Internet. Correction of a plan failure to reinstate a plan's favorable tax status requires a Voluntary Correction Program (VCP) filing with IRS. See next page for VCP filing requirements and causes of plan failures.

Continued, next page.

When SIMPLE Is Not Simple, and Is Expensive - Spring 2019, page 2 of 2

Revenue Procedure 2019-19 describes IRS' Compliance Resolution System. IRS can impose monetary sanctions to restore a plan's tax qualified status in addition to the User Fee and the employer's time and expenses required for correction(s). See IRS Forms 8950, 8951, and 14568-D on the Internet for the enormous amount of information that must be electronically filed with the User Fee to apply for reinstatement of a SIMPLE IRA plan's tax qualified status. The -D Schedule is the Model VCP Compliance Statement for SIMPLE IRA plans. Other Schedules apply for other plan types. The recently reduced VCP User Fees for the filings range from \$1,500 to \$3,500 depending on the plan's asset amount. The monetary sanctions IRS can impose to reinstate a plan's tax qualified status vary with the complexity of the correction(s) and IRS' time required to process the filing. The employer must make the correction(s) under the proposed correction procedures he submits to IRS with IRS' approval acknowledged in an IRS Compliance Statement pending payment of any monetary sanctions.

IRA-type savings arrangements fall prey to mismanagement for reasons that include:

No centralized administration - there are usually no independent advisors for investment management, accounting, legal, and actuarial support services to oversee all aspects of a plan's administration to prevent plan failures; and, administrative functions are usually divided among the product sources and the employer's human resources department with no centralized oversight or responsibility for the plan's proper administration.

Employer oversight lacking - the employer is frequently insulated from the day-to-day administration because the sales agent communicates marketing information directly to employees. Restricted investment options may lessen the employer's ability to comply with ERISA's prudent man investment standards. Tax deferrals for the business owners are usually not sufficient to justify their close administrative attention because older, longer-service, and higher-paid owners and employees are not more advantaged than the rank and file employees. Employers do not think critically in either the selection of these type of plans or their periodic administrative requirements.

Sales agent misrepresentations - commissioned sales agents often represent themselves as qualified to advise employers in pension and employee benefit matters. The sales agents gleefully distribute low-cost plan documents, employee disclosure forms, administrative forms to enroll employees, and account balance statements that bypass employer scrutiny. This leads to poor planning and plan failures.

SIMPLE IRA plans are expensive - employers are required to match employee contributions up to 3% of "Compensation" as defined by the plan. Lost opportunity costs include: (a) losses of larger annual investment returns net of expenses available through large unallocated funds under professional investment management; (b) unavailability of plan design options that fit the employer's overall compensation policy and business objectives that can allocate much more of the contributions to higher-paid business owners and higher-paid employees with annual nondiscrimination testing; and, (c) unavailability of non-vested forfeitures remaining with plan assets to reduce the employer's costs.

Self-administered, tax qualified retirement plans permit the full range of plan design options under IRS regulations that enable direct employer control and monitoring of plan administration and investments. The inherently superior plan design options of a Defined Benefit Pension Plan can accumulate tax deferrals for the business owners and managers under a well designed compensation policy exceeding the cost to fund benefits for the remaining employees in any sized employer entity.

Please call or e-mail any questions or comments.

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