

REPORT TO PLAN SPONSORS

July 2008

IRS Audits

The IRS is focusing its audits on key issues that will both promote compliance and ensure that employees receive the benefits that they are entitled to. Among the issues of concern to the IRS is whether all eligible employees are being covered by the qualified plans—and whether they are being covered at the appropriate times.

Our experience is that these coverage issues fall primarily into three categories. Those are:

1. The inadvertent failure of plan sponsors to include employees in their plans, and especially in 401(k) plans.
2. The failure of plan sponsors to include certain classes of employees at the proper time. For example, when temporary or agency employees are converted to regular employees, they are entitled to be credited with their service as temporary or agency employees for all purposes, including eligibility, vesting and benefit accrual.
3. The failure to include employees who may be classified as fitting into excluded categories, but who are actually employees based on the criteria applied by the IRS and the courts. That includes both workers who are classified as independent contractors, but who are actually common law employees, and workers who are given special

employment designations, but where those categories of employees are not excluded by the terms of the plan.

In addition, we also see cases where the documents provide that a plan covers all of the employees of the plan sponsor and any affiliate, but where the employees of the related organizations are not actually placed into the plan. That is a slightly different, but related, issue.

As a word of warning, plan sponsors should audit their internal operations to determine whether they fall into one of those four categories. If so, the practices should be changed and/or the plan documents should be amended, as appropriate. In addition, the past operations of the plan should be corrected by retroactively including those workers in the plan. The IRS has developed specific rules for how to correct those defects and for whether or not the correction needs to be filed with the IRS.

If you find that you have one of those problems, our advice is to work with your ERISA attorneys or benefits consultants to appropriately correct your plan, both retroactively and prospectively.

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