Internal Revenue Service

Department of the Treasury

Taxpayer Identification Number:

Name of Plan:

Date:

Plan Number:

Plan Year(s) Ended:

Person to Contact/ID Number:

Contact Telephone Number:

Fax Number:

E-mail Address:

Return Reply to:

Dear Sir or Madam:

This letter constitutes a compliance check. A compliance check is not an audit or investigation under Internal Revenue Code (IRC) Section 7605(b) or an audit under Section 530 of the Revenue Act of 1978.

Our records indicate that you sponsor a 401(k) plan for the benefit of your employees. It has come to our attention that many employers, who have engaged in prohibited transactions due to the untimely deposits of elective deferrals, are incorrectly calculating the excise tax payable on Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans.* These miscalculations are resulting in overpayments of the excise tax. IRC section 4975(a) imposes a 15% excise tax (the first tier) on the amount involved for prohibited transactions (PTs).

Generally, if the employer does not timely pay elective deferrals to a qualified plan, this is considered a prohibited transaction under IRC 4975(c)(1). The prohibited transaction is treated as a continuous transaction and not a discrete transaction. The calculation of the amount involved is the interest on the total of the untimely elective deferrals. Under Revenue Ruling 2006-38, the interest rate for underpayments described in IRC Section 6621(a)(2) on the date the prohibited transaction occurred (or is deemed to occur) is an appropriate interest rate to use when calculating the amount involved when the employer does not make timely payments of elective deferrals to a qualified plan. The following illustrates the application of this calculation and takes into account the first tier excise tax:

Calculation of the Amount Involved

PT Number	Date PTs Occurred	Principal	Interest Rate	Time (Days/Total)	Amount Involved
1.	12/8/2004	$100,000	.05	.0655738 (24/366)	$328
2.	01/1/2005	$100,328	.05	.9972602 (364/365)	$5,003

The aggregate amount withheld as elective deferrals from all employees total $100,000. The amount should have been paid to the qualified trust on 12/8/04. The employer failed to do so and did not actually correct the failure until 12/30/05. The interest rate for underpayments under IRC Section 6621(a)(2) was 5% on 12/8/04 and 1/1/05.

Calculation of the Amount Involved

PT Number	Date Prohibited Transactions Occurred	Taxable Period	2004 Taxable Year	2005 Taxable Year
1.	12/8/2004	12/8/04 to 12/30/05	$328	$328
2.	01/1/2005	01/1/05 to 12/30/05	-----	$5,003
			$328 x .15	$5,331 x .15
			$49	$800

Accordingly, the IRC Section 4975(a) first tier excise tax totals $849 ($49 plus $800). The above illustrations only apply for purposes of determining the amount involved and the excise tax where there is a failure to transmit participant contributions or amounts that would have otherwise been payable to the participant in cash. These illustrations do not apply for prohibited transactions under IRC 4975 in which the amount involved is defined as provided under IRC 4975(f)(4) **Note:** *The above illustration uses a time factor of .0655738 for the 1st Prohibited Transaction (PT # 1) which is different from the time factor of .0628415 used in the Revenue Ruling 2006-38 illustration. It has been determined that the time factor used in the Revenue Ruling did not include the correct number of days the elective deferrals were paid late.*

If the prohibited transaction is not corrected in full as provided by IRC 4975(f)(5), a new transaction is deemed to occur on the first day of each subsequent tax year until correction is made. Any payments made during the year in which full correction is not made are not taken into consideration until January 1, of the following tax year (or the first day of the next tax year for Sponsors not operating on a calendar year basis). The time *(number of days loan outstanding/total number of days in the year)* the prohibited transaction is outstanding is only pro-rated in the year it is initiated and the year in which full correction is made. Separate Forms 5330 are to be filed for each tax year in which the prohibited transaction remains uncorrected. Revenue Ruling 2006-38 provides additional information on the calculation of the amount involved and the excise tax when the employer does not timely pay elective deferrals to a qualified plan.

What Should You Do?

It is important to us that you pay the correct amount of excise tax due for prohibited transactions that occur involving your 401(k) plan.

If you determine you have filed an erroneous Form 5330 to report an excise tax under IRC Section 4975(a) please complete a revised Form 5330, check the box in line item H on page 1 to identify the return as an amended return, complete the appropriate lines, and mail to the **Internal Revenue Service, 2637 N Washington Blvd # 164, North Ogden, UT 84414.** If you are filing a claim for refund, it must state clearly the reasons for claiming the refund and include the appropriate supporting documentation to expedite its processing. For more information on 401(k) plans, including the proper calculation of excise taxes due on late deferrals, you may visit the IRS website www.irs.gov/ep or contact the person whose name and telephone number and e-mail address are identified above. **No further action is required on your part.** We will close this compliance check in 45 days if we do not hear from you.

Sincerely,