

## employee benefits lawflash

January 31, 2013

## IRS Updates and Expands Qualification Correction Program

*New provisions for correcting operational and plan document errors take effect on April 1.*

On December 31, 2012, the Internal Revenue Service (IRS) updated its Employee Plans Compliance Resolution System (EPCRS) through the issuance of Revenue Procedure 2013-12.<sup>1</sup> EPCRS provides retirement plan sponsors with the opportunity to correct operational and plan document errors in order to preserve a plan's tax-qualified status. Depending on the nature of the error and the manner in which it is to be corrected, EPCRS contains three separate component programs known as (i) the Self-Correction Program (SCP), (ii) the Voluntary Correction Program (VCP), and (iii) the Audit Closing Agreement Program (Audit CAP). The new revenue procedure expands and enhances the existing version of EPCRS, which was last revised and updated in Revenue Procedure 2008-50.

### Highlights of Clarifications and Changes

- **Section 403(b) plan errors are now covered.** Perhaps the most significant change in the updated EPCRS is the expanded coverage of issues and errors involving 403(b) plans. Notably, under the new EPCRS, 403(b) plan sponsors can now address plan document errors, such as the failure to timely adopt a written 403(b) plan document on or before January 1, 2009, as required by the final 403(b) regulations issued in July 2007. Before EPCRS was updated, there was no available program to correct 403(b) plan document errors. In addition, the new EPCRS describes how to correct the failure to satisfy the "universal availability" requirement that applies to 403(b) plans. While these and other changes in the updated EPCRS make the correction of 403(b) errors more similar to the correction of errors for other tax-qualified plans, there can still be differences in how corrections must be implemented for 403(b) plans due to their unique characteristics.
- **Section 436 benefit restriction errors are now covered.** The new EPCRS covers the correction of errors involving the failure to comply with the benefit restriction requirements imposed by section 436 of the Internal Revenue Code. As a matter of background, section 436 imposes certain restrictions on defined benefit retirement plans (e.g., restricting lump-sum payments and restricting increases in benefits) if the plan's funded status is below certain thresholds. The new EPCRS provides guidance about how to correct these failures and also confirms that corrective distributions made to correct an error are not, themselves, subject to the benefit restrictions in section 436. However, the new EPCRS indicates that, in certain instances, correcting a benefit restriction error under the new EPCRS may require the plan sponsor to make a contribution to the plan in order to make the plan whole for the error.
- **Corrective matching contributions can be subject to vesting.** Plan sponsors have previously been required to correct the failure to make prescribed employer-matching contributions by making a qualified nonelective contribution (QNEC). QNECs are required to be fully vested when contributed and are subject to special distribution restrictions. Under the new EPCRS, a plan sponsor can make corrective matching contributions that will be subject to the plan's vesting and distribution rules for matching contributions (except that corrective contributions to a "safe harbor" plan still must be fully vested when made).
- **Nondiscrimination testing errors cannot be corrected with forfeitures.** The new EPCRS clarifies that amounts in a plan's forfeiture account may not be used to make contributions or allocations to correct nondiscrimination testing errors (e.g., for actual deferral percentage and actual compensation percentage).

1. View Revenue Procedure 2013-12 at <http://www.irs.gov/pub/irs-drop/rp-13-12.pdf>.

testing errors). Contributions or allocations to correct these types of errors must be QNECs and fully vested when contributed. For this reason, forfeitures do not qualify for this purpose.

- **Recovery of overpayments has been clarified.** In general, plan sponsors must attempt to secure repayment of any overpayments paid to a participant. Under the prior revenue procedure, plan sponsors were required to make a corrective contribution to the plan if the participant did not repay the full amount of the overpayment. Under the new EPCRS, plan sponsors are not required to make a corrective contribution if the overpayment was related solely to the premature distribution of a participant's vested benefit that was otherwise determined to be in accordance with the plan's terms.
- **Actuarial adjustments should be made for defined benefit plan corrective distributions.** The new EPCRS clarifies that a corrective distribution from a defined benefit plan should be actuarially increased to take into account the delay of the payment.
- **More flexibility is available for correcting preapproved plans.** Under the new EPCRS, a corrective amendment adopting a plan provision that is otherwise not provided in a preapproved plan's adoption agreement generally will not cause the plan sponsor to lose reliance on the plan's opinion or advisory letter or prohibit the plan from using the six-year (rather than five-year) remedial amendment cycle for preapproved plans.
- **Reasonable steps must be employed to locate lost participants.** In August 2012, the IRS suspended the use of its letter-forwarding program for purposes of assisting plan sponsors in locating missing participants. Under the new EPCRS, plan sponsors are required to take reasonable steps to locate missing participants, such as mailing a letter to the participant's last-known address using certified mail and, if that fails, using another search method, such as the Social Security letter-forwarding program, a commercial locator service, a credit reporting agency, or the Internet. Because the IRS letter-forwarding program was suspended, plan sponsors have an extended deadline for locating participants in certain cases.

## Highlights of Procedural and Administrative Changes

- **Use of new VCP forms is required.** Beginning April 1, 2013, plan sponsors will be required to use new Form 8950, "Application for Voluntary Correction Program (VCP)," and Form 8951, "Compliance Fee for Application for Voluntary Correction Program Submission under the Employee Plans Compliance Resolution System (EPCRS)," to apply for correction under VCP. These forms should be used in lieu of the streamlined application procedures, which have been replaced with schedules that should be submitted with Forms 8950 and 8951 for standard errors. Submissions prepared using the forms should be sent to the IRS Service Center in Covington, KY (rather than Washington, D.C.).
- **Determination letter procedures have been clarified.** Sponsors of individually designed plans generally obtain a determination letter once every five years. The updated EPCRS identifies situations in which a determination letter filing may not be submitted under EPCRS. For example, a determination letter application may not be submitted in conjunction with the correction of a demographic error or a failure to adopt amendments required under the terms of a favorable determination letter.
- **Application fees have been modified.** The new EPCRS clarifies and makes adjustments to VCP application fees as follows:
  - There is a reduced \$500 fee for a VCP submission covering only a failure to timely adopt an amendment on which a favorable determination letter is conditioned, so long as the amendment was adopted no more than three months following the date on which it should otherwise have been adopted.
  - For a VCP submission that covers multiple errors that are subject to a reduced fee, the fee for the entire submission will be the sum of the reduced fees, up to the fee determined pursuant to the regular fee schedule.
  - The fees for multiple employer plans and multiemployer plans are based on the number of participants in the plan (rather than assets).
  - There are increased fees for certain nonamender errors discovered during the processing of a determination letter application, subject to a reduction in the event that the amendment is adopted prior to the end of the plan's extended remedial amendment period.

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- **Certain section 457 plans may still be corrected outside of the EPCRS.** Consistent with prior guidance, the IRS still provides relief for governmental 457(b) plans outside of EPCRS (using standards that are similar to EPCRS), but there continues to be no explicit relief for 457(b) plans sponsored by tax-exempt organizations.

## Effective Date

Plan sponsors may voluntarily apply these new EPCRS provisions beginning on or after December 31, 2012. Starting April 1, 2013, however, these new EPCRS provisions are mandatory.

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