Overview of the Employee Plans Compliance Resolution System (”EPCRS)

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Agenda

- EPCRS Overview
- EPCRS Programs
  - SCP
  - VCP
  - Audit Cap
- Fix It!

EPCRS Revenue Procedure

- Revenue Procedure 2008-50 is the current applicable document for EPCRS
- An update to the Rev. Proc. is expected sometime in 2010
  - Primary purpose: to reflect the written plan requirement under the final 403(b) regulations

EPCRS Programs

- EPCRS consists of three correction programs
  - Self-Correction Program (SCP)
  - Voluntary Correction Program (VCP)
  - Audit Closing Agreement Program (Audit CAP)

Types of Plans covered

- Qualified plans under IRC § 401(a)
- 403(b) plans
- SEPs and SARSEPs under IRC § 408(k)
- SIMPLE IRAs under IRC § 408(p)
- Eligible governmental IRC § 457(b) plans (outside of EPCRS)

EPCRS Objectives

- Preserve tax deferred benefits for participants under §§ 401(a) (qualified plans), 403(b) (tax-sheltered annuities), 408(k) (SEPs and SARSEPs), 408(p) (SIMPLE IRAs)
- Income/excise tax relief: §§ 72(p) (loans), 72(t) (early distributions), 4974 (min. distributions), 4972/4973 (excess contributions), 4979 (ADP/ACP test)For 403(b) plans, SEPs, and SIMPLE IRAs

Correction Principles *ref: §6 of Rev. Proc. 2008-50*

- <u>Full correction</u> includes all taxable years, whether or not the taxable year is closed
- The correction method should <u>restore the Plan and its participants to the position they would have been in had the failure not occurred</u>**.**
- <u>The correction should be reasonable and appropriate for the failure.</u>
  - Appendix A/B - correction deemed to be reasonable
  - Other: Consistency with the IRC; provide benefits to NHCEs; keep assets in plan;
  - **Consideration will be given to corrections approved by another govt. agency (e.g., DOL's reg. for abandoned plans (new))**

Categories of Failures

- Plan document failure: “Form”
- Operational Failure: Failure to comply with plan’s terms
- Demographic Failure: Failure to satisfy coverage, discrimination rules even after following plan’s terms
- Employer Eligibility Failure
- **Note: EPCRS not available for ATAT/diversion/misuse of plan assets**

EPCRS Programs: Self Correction (SCP)

- Available for plans that:
  - Have only Operational Failures that are not egregious
  - Have compliance-oriented practices and procedures
  - Correct the error within 2 years of its occurrence (if failure is significant)
  - Made limited use of correction by plan amendment

EPCRS Programs: SCP cont d

- Egregious failure examples:
  - Plan only covers Highly Compensated Employees (HCEs)
  - Plan provides favorable benefits to owners via Collectively Bargained Arrangements not negotiated in good faith (see Notice 2003-24)
  - Plan provides HCEs benefits that are several times 415 limit

EPCRS Programs: SCP cont d

- Practices and procedures reasonably designed to promote compliance
  - Plan document not enough
  - Need not be formal
  - Generally should be in plan before failure
- Operational failure should have occurred because of oversight or mistake in applying procedures

EPCRS Programs: SCP cont d

- To determine whether correction timely, must determine whether error is significant or insignificant
- Indicators include:
  - Did other failures occur during same period?
  - What percentage of assets/contributions were involved?
  - For how many years did the failure occur?
  - How many participants were affected relative to total?
  - How many affected vs. how many could have been affected?
  - Was correction made in reasonable time after the failure was discovered?
  - Why did the failure occur?

EPCRS Programs: SCP cont d

- SCP requires “substantial completion” of an operational failure, either 1 or 2 below
  1. Both of the following are true:
     a. In correction period, sponsor is reasonably prompt in identifying failure, formulating correction method, and initiating correction in a manner that demonstrates a commitment to completing correction as expeditiously as practicable
     b. Within 120 days after the last day of the correction period, sponsor completes correction of the operational failure

EPCRS Programs: SCP, cont d

2. Both of the following are true:
   a. During correction period, correction is completed with respect to 65% of all affected participants affected by the operational failure
   b. Thereafter, sponsor completes correction for remaining participants diligently

EPCRS Programs: Voluntary Compliance (VCP)

- Key Elements:
  - Employer notifies IRS of qualification failures
  - Employer proposes: method of correction; revision to administrative practices and procedures
  - Employer and IRS agree to the methods of correction and the proposed revision of administrative procedures
  - IRS issues compliance statement and agrees not to pursue disqualification for identified failures if correction is completed within 150 days of the issuance of the compliance statement

EPCRS Programs: VCP cont d

Streamlined VCP available for:

- Appendix D
- Appendix F
  - Late interim amendment or other late amendments
  - SEPs/SARSEPs
  - SIMPLE IRAs
  - Plan loan failures
  - Employer eligibility failures
  - 402(g) failure
  - Failure to distribute Required Minimum Distributions
  - Correction of operational failure by plan amendment

EPCRS Programs: VCP cont d

Common errors include:

- Failure to submit fees- VCP; determination letter
- Failure to submit with correct signatures- e.g. penalty of perjury statement must be signed by the plan sponsor; Power of Attorney cannot sign
- Failure to include total plan assets and participants
- Incomplete submission (all required items not submitted); Incomplete/inaccurate POA forms

EPCRS Programs: Audit Closing Agreement Program (Audit CAP)

- IRS discovers failure (usually on audit; sometimes in DL application review) and offers resolution by closing agreement
- Conditions for closing agreement:
- Correction of failures
- Payment of sanction
- Consequence: Plan's qualified status preserved

EPCRS Programs: Audit CAP

- Sanctions take several forms:
  - Negotiated percentage of the maximum IRS could get after disqualifying plan
  - Fee schedule for nonamender failures caught in DL process based on number of participants and most recent compliance (GUST, TRA, etc.)
    - $2,500 to $80,000
- Moral: check before you file
  - VCP is cheaper

Fix It!

In 2010, Hannah Rationale, suspecting that her predecessor Harry Rayburn was somewhat inexperienced in plan administration, decides to audit the Company's 401(k) plan. The plan, which has 70 participants and a balance of $1.1M, was established January 1, 2007, and allows deferrals and matching (50% up to 6% of eligible pay) on salary and bonus. Hannah discovers:

- *59 employees made deferrals and received match on ineligible compensation (mileage expense reimbursement) in one pay period in amounts ranging from $.40 to $3.80, for a total of $140.*
- *14 employees were allowed to contribute and be matched on retention payments in amounts ranging from $30 to $450, for a total of $3,600 of ineligible contributions in one pay period, two years earlier.*
- *For three plan years, 4 employees made elections and received match on ineligible compensation in amounts ranging from $42 to $510, for a total of $2500. These employees also received improper contributions on retention payments.*
- *In total, 65 people were effected, $8000 (plus earnings) of improper contributions were made.*
- *One NHCE employee hired July 1, 2008 elected to invest 100% in a growth stock fund; instead, his matching contributions and deferrals were invested 50% growth stock and 50% bonds.*
- *Investment election records are missing for one employee.*
- *Three loans were in default: one for $0.04, one for $10.24, and one for $2,000.*

Fix It Again!

Two years ago, Lower 40 Mortgage Company decided to reduced its profit sharing formula beginning in 2008. In late 2007, the change was announced to employees, SPDs were adjusted, and plan amendments were executed, but Pat Abercrombie was out on leave and the change was never implemented. During plan years 2008 and 2009, employees received twice their permitted allocation under the Plan as amended. Upon noticing the error, Pat adjusts each account and distributes the excess plus earnings to the participants and former participants. Each participant receives a 1099-R for the disgorged amounts with Code D in box 7. Ten of the participants were no longer active participants, and took a rollover distribution of their entire account. Has Pat done what she needed to do?

401(k) Fix It Guide

Complete document can be found at:

http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf

- Potential mistake
- How to find the mistake
- How to fix the mistake
- How to avoid the mistake