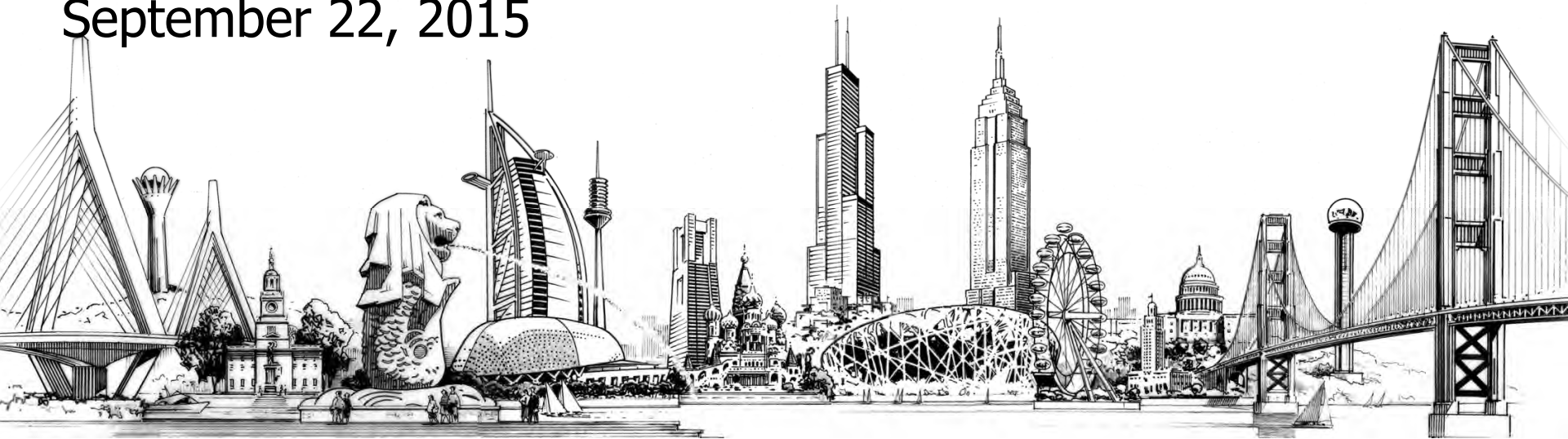


Morgan Lewis

**PLAN SPONSOR BASICS:
RETIREMENT PLAN
CORRECTION ISSUES**

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WHAT WE WILL COVER

Available Correction Programs

- The IRS Employee Plans Compliance Resolution System (“EPCRS”)
 - EPCRS governed by Revenue Procedure 2013-12, modified by Revenue Procedure 2015-27, and Revenue Procedure 2015-28
- IRS Form 5500 Delinquent Filer Voluntary Compliance Program
- DOL Voluntary Fiduciary Correction Program
- Presentation will also cover common failures and corrections

OVERVIEW OF EPCRS

EPCRS Program

- EPCRS contains three correction programs:
 - Self Correction Program (**SCP**)
 - Voluntary Correction Program (**VCP**)
 - Audit Closing Agreement Program (**Audit CAP**)
- Types of plans covered
 - Qualified Plans - 401(a)
 - Tax-Sheltered Annuity Plans - 403(b)
 - Governmental 457(b) plans

Qualification Failures

- Plan Document Failure
 - Plan provision (or absence of provision) that violates the Internal Revenue Code
 - Includes failure to timely adopt amendments or adopting amendments later than is required by law
- Operational Failure
 - Plan document complies with the Code but plan doesn't operate in accordance with its provisions
 - Includes loan failures, eligibility failures, safe harbor contribution failures, etc.
- Demographic Failure
 - Failure to satisfy requirements of:
 - Minimum participation – 401(a)(26)
 - Coverage – 410(b)
 - Nondiscrimination – 401(a)(4)
- Employer Eligibility Failure
 - Employer was not eligible to adopt plan

Self-Correction

- No disclosure to IRS, no fee, no sanctions
- Only operational failures
- Must have a determination letter (if an individually designed plan)
 - Will be interesting to see how this changes as the IRS determination letter program changes
- Must have established practices and procedures to ensure ongoing compliance
- Must document the correction in the event the IRS asks about the correction later

Eligibility for Self-Correction

- Plans may “self-correct” failures that are “insignificant” at any time or that are corrected by the end of the second plan year following the plan year of the failure
- Distinction between insignificant and significant errors
 - List of factors to consider
 - Percentage of assets/contributions involved
 - Number of years involved
 - Percentage of participants affected
 - Percentage of participants who could have been affected
 - Correction within reasonable period
 - Reason for the failure
- Uncertainty for plan sponsor unless one of the correction methods on Appendix A or B is followed

Voluntary Correction Program

- Single program and single admission process
- Process includes “proposing” correction methods to IRS and submission procedures
- Ends with a compliance statement
- Determination letter/retroactive plan amendment may result in filing of determination letter if plan is on cycle
 - This will likely change as soon as the determination letter cycle requirements change

Methods for VCP Correction

- Model correction methods in Appendices A, B, and F
 - IRS also has certain corrections that it “generally” approves
- John Doe – anonymous submission is possible
- Group submissions

VCP Fee Structure

Number of Participants	Fee
20 or Fewer	\$750
21 to 50	\$1,000
51 to 100	\$2,500
101 to 500	\$5,000
501 to 1000	\$8,000
1,001 to 5,000	\$15,000
5,001 to 10,000	\$20,000
Over 10,000	\$25,000

Audit Cap

- Correction program when a failure is discovered under audit
- Higher sanction
- Factors used in determining sanction:
 - practices in place to identify and prevent plan failures
 - steps taken to correct the failures
 - reason for the failure
 - length of time that the failure(s) occurred
 - number of NHCEs affected if plan is disqualified
 - existence of a favorable determination letter
 - whether the error involves a demographic failure
 - whether the only failure is an employer eligibility failure

EPCRS – Failures Not Covered

- Form 5500 filing delinquencies
- Prohibited transactions
- Funding deficiencies (for defined benefit plans)

Common Failures

- Failure to include employees eligible for participation
- Failure to implement employee elections
- Failure to permit eligible employees to make catch-up contributions
- Excess allocations (above plan limits and/or 415 limits)
- ADP/ACP and minimum coverage testing failures
- Improperly administering vesting provisions
- Failure to timely distribute a minimum required distribution
- Improperly administering forfeitures
- Failure to comply with plan loan requirements
- Failure to timely transmit employee contributions
- Failure to timely amend plan for required legislative changes
- Improperly administering hardship distributions

Common Principles for Plan Amendments

- Correction of retroactive plan document failures that are “less favorable” must typically be accompanied with some proof of the “intent” of the plan sponsor
 - Examples include loan failures, matching contribution failures, changes to the definition of compensation, etc.
- Plan amendments may generally be adopted (unless the changes are not favorable to participants) by the end of the plan year during which the changes occur
 - Amendments that are less favorable (such as reducing a matching contribution formula, etc.) must generally be adopted prior to the effective date of the changes

Plan Loans

- Under VCP, the IRS will allow correction where plan loans did not comply with:
 - Limit on loans pursuant to IRC § 72(p)(2)(A) (e.g., participant borrows \$60K)
 - Plan term requirements of IRC § 72(p)(2)(B) or (C) (e.g., participant borrows \$10K over six-year period; should have been five years)
 - Plan repayment terms, resulting in default of loan (e.g., loan payments never begin)
- Correction permitted where “appropriate” and where statutory term of loan (generally 5 years) has not expired
- Reduced fee if the following requirements are met:
 - Plan loan failure is the sole failure of submission
 - Affected participants are < 25% of total participants in any plan year
 - Error entails failure to follow IRC § 72(p)

Missed Deferrals

- Exclusion of eligible § 401(k) employees: characterized as “missed opportunity to defer”
 - Missed § 401(k) contributions
 - Auto Enrollment
 - If the failure does not extend beyond the end of the 9½ month period after the end of the plan year of the failure, no QNEC is required
 - Notice and missed matching contributions (and earnings) are required
 - No Auto Enrollment
 - A contribution equal to 25% of the missed deferrals may be made if the failure does not extend beyond the earlier of (i) three months after the failure occurred, or (ii) the first pay period starting the month after the plan sponsor became aware of the failure
 - Notice and missed matching contributions (and earnings) are required

Matching Contribution

- Matching Contribution Correction
 - Based on match that would have been received had employee made deferral
 - Based on full amount of missed deferral, not missed opportunity cost
 - Depending on the type of failure, earnings may be calculated differently
 - If participant was auto-enrolled with no default investment, failure may be calculated based on earnings for the default investment
 - Otherwise, earnings are calculated in accordance with the self-correction procedure

Overpayments

- Overpayments are generally a defined benefit plan issue and can occur when a benefit is calculated improperly or some other operational issue occurs – such as during a termination and rehire situation
 - An overpayment may, depending upon the plan language, be recouped from a participant or repaid by the plan sponsor
 - Unclear to what extent offsetting current payments in order to recoup can create a “hardship” situation
 - IRS is soliciting comments about how to handle overpayments

CORRECTION OF IRS FORM 5500 FAILURES

Delinquent IRS FORM 5500 Filings

- Correction program provided by the Department of Labor's (DOL) Employee Benefits Security Administration (EBSA).
- Encourages plan administrators to voluntarily file overdue annual reports (Form 5500) by allowing for reduced penalties.
- **Eligibility:** Required filings under the DFVCP must be made *prior to* notice by the DOL of failure to timely file annual report under Title I of ERISA.
 - 5500-EZ filers not eligible
- Certain penalty relief from the IRS and Pension Benefit Guaranty Corp. for delinquent Form 5500s filed for Title I plans where the conditions of the DFVCP have been satisfied.

DFVCP Filing

- **Participation in the DFVCP is a two-step process:**
 - File with EBSA a complete Form 5500, including schedules and attachments.
 - Submit a copy of Form 5500 to the DFVCP, without schedules and attachments, and the penalty amount.
 - Plan administrator is personally liable for penalty

Penalties and Cost to File

DOL's Civil Penalties

- **Late Filers:** \$50 per day, with no limit
- **Nonfilers:** \$300 per day, up to \$30,000 per year, until filed

DFVCP Penalties:

- \$10 per day
- Maximum penalty for small plan = \$750
- Maximum penalty for large plan = \$2,000
- "Per plan" cap regardless of number of late annual reports filed:
 - Small plan = \$1,500
 - Large plan = \$4,000

DFVCP Filing

- Special “per plan” cap of \$750 applies to small plans sponsored by tax-exempt organizations under IRC § 501(c)(3). Limit applies regardless of the number of late annual reports filed for the plan at the same time.
- Penalty amount for “top hat” plans and apprenticeship and training plans is \$750.
- There is an online DFVCP penalty calculator available to help accurately compute the amount owed to participate in the program.
- Payment of the penalty constitutes *waiver* of the right both to receive notice of the assessment from the DOL and to contest the DOL’s assessment of the DFVCP penalty.

**VOLUNTARY FIDUCIARY
CORRECTION
PROGRAM**

Purpose of Fiduciary Correction Program

- Encourage employers to voluntarily comply with ERISA by self-correcting certain “violations of the law”
- Increased benefits for some participants
- 15 specific transactions covered
- Relief from excise taxes, in some cases
- Avoid potential penalty that might be assessed if DOL found issue
 - ERISA 502(I) penalty
 - 20% of amount recovered in connection with a fiduciary breach

Eligibility for Fiduciary Correction Program

- Anyone who may be liable for fiduciary violations under ERISA
 - plan sponsors
 - plan officials
 - parties-in-interest
- Neither plan nor applicant “under investigation”
- No evidence of criminal violations
- EBSA has not referred the transaction to the IRS

“Under Investigation”

- EBSA
 - Pursuant to ERISA § 502(a) or any criminal law involving transactions affecting benefit plan
 - Plan has received oral or written notice from EBSA of investigation
 - Prior EBSA contact concerns transaction in application *and* correction hasn't been made
- Other
 - Any criminal investigation of plan or transaction involving plan
 - IRS conducting audit of plan
 - PBGC, state attorney general, or state insurance commissioner
 - Unless applicant notifies EBSA of such investigation with application

Covered Transactions

- Delinquent Participant Contributions to Pension Plans
- Delinquent Participant Contributions to Insured Welfare Plans
- Delinquent Participant Contributions to Welfare Plan Trusts
- Fair Market Interest Rate Loans with Parties-in-Interest
- Below Market Interest Rate Loans with Parties-in-Interest
- Below Market Interest Rate Loans with Non Parties-in-Interest
- Below Market Interest Rate Loans Due to Delay in Perfecting Security Interest
- Purchase of Assets by Plans from Parties-in-Interest
- Sale of Assets by Plans to Parties-in-Interest
- Sale and Leaseback of Property to Sponsoring Employers
- Purchase of Assets from Non Parties-in-Interest at Other Than Fair Market Value
- Sale of Assets to Non Parties-in-Interest at Other Than Fair Market Value
- Benefit Payments Based on Improper Valuation of Plan Assets
- Payment of Duplicate, Excessive, or Unnecessary Compensation
- Payment of Dual Compensation to Plan Fiduciaries

Correction

- If necessary, conduct valuations
 - generally recognized markets for the assets or
 - appraisal by qualified professionals
- Restore
 - principal amount involved, plus
 - the greater of:
 - lost earnings starting on the date of the loss and extending to the recovery date or
 - profits resulting from the use of the principal amount for the same period
- Pay related expenses, i.e., no expenses paid by plan
- Make supplemental distributions, if necessary
- Restore plan and participants to the condition they would have been in had the breach not occurred
- File amended returns to reflect corrected transactions or valuation, *i.e.*, corrected Forms 5500

Correction

- Must provide proof of payment
 - To participants
 - To the plan if unable to locate missing individuals
 - To the plan where distributions to separated participants would be less than \$20 and the cost of correction would exceed the distributions
- May use “blended rate” in calculating rate of return only for affected participants who have not made investment allocations

Exemption from Excise Tax

- Late remittance of participant contributions
 - *Provided* correction made within 180 days of the date amounts should have been contributed to the plan
- Loans made at fair market interest rate by plans with parties-in-interest
 - *Provided* no more than 10% of total plan assets involved
- Purchases or sales of assets between plans and parties-in-interest at fair market value
 - *Provided* no more than 10% of total plan assets involved.
- Sales of real property to plans by employers and leaseback of the property at fair market value and fair market rental value, respectively
- *Provided* no more than 10% of total plan assets involved

Notice Requirement

- Notice of the transaction and the correction must be provided to interested persons.

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QUESTIONS?

Register for upcoming webinar in this series:
October 14 | Fiduciary Issues for Defined Contribution Plans

<https://morganlewisevents.webex.com>

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