May 2017

PENSION ANALYST

Important information—Plan administration and operation

IRS updates correction programs

Who's affected

These programs are available to sponsors of qualified pension, profit sharing and stock bonus plans to correct errors in plan operation, demographics, and documents that might otherwise disqualify a plan. They are also available to ERISA and non-ERISA 403(b) plans, simplified employee pension (SEP) plans and SIMPLE IRA plans. The programs available to correct a mistake depend upon the type of error being corrected and the timing of the correction.

Background and summary

Under the Employee Plans Compliance Resolution System (EPCRS), the IRS provides plan sponsors with the ability to identify and correct errors in both plan operation and plan documents while avoiding potential plan disqualification.

The IRS issued Revenue Procedure 2016-51, which includes the latest guidance governing EPCRS and replaces and supersedes Revenue Procedure 2013-12. The new Revenue Procedure incorporates previously issued guidance regarding corrective options for overpayments and employee elective deferral errors. The Revenue Procedure also has been updated to reflect changes to the determination letter program. These revisions do not affect the structure of the basic program, which continues to offer three correction options:

- Self-Correction Program (SCP);
- Voluntary Correction Program (VCP); and
- Audit Closing Agreement Program (Audit CAP).

This publication provides a summary of these revisions, as well as links to several useful tools for plan sponsors that have encountered errors.

Action and next steps

If errors in plan administration have occurred, plan sponsors should discuss the EPCRS options described in this *Pension Analyst* and related documents with their legal counsel to determine if any are appropriate for their situation.

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In this issue

Related documents

IRS Employee Plans Compliance Resolution System (EPCRS) options
Glossary of special EPCRS terms
General correction principles under EPCRS
Errors and acceptable correction methods
Earnings adjustments for corrective contributions
Form 8950
Form 8951

EPCRS offers three types of correction programs:

- *Self-Correction Program.* SCP allows many plan sponsors to correct operational errors without having to make a formal filing with the IRS or pay a correction fee.
- *Voluntary Correction Program.* VCP allows plan sponsors to voluntarily correct errors before audit, pay a limited fee, and receive IRS approval of the correction. VCP contains special procedures for anonymous submissions and group submissions.
- *Audit Closing Agreement Program.* Under Audit CAP, plan sponsors may avoid plan disqualification if the IRS discovers an operational, plan document, demographic, or employer eligibility error upon audit.

Summary of EPCRS programs, including recent revisions

The latest version of EPCRS incorporates changes related to correction of overpayments and employee elective deferral failures, but also includes the following changes:

- Due to the elimination of the determination letter program for individually designed plans, the requirement to submit a determination letter application as part of an EPCRS correction, including a plan document failure, has been removed.
- Individually designed plans are no longer required to have a "current" determination letter to use SCP, but instead, the term Favorable Letter for these plans has been revised to "a determination letter issued with respect to the plan."
- The VCP user fees will no longer be included in the EPCRS Revenue Procedure. Instead, they will now be included in the annual revenue procedure regarding all user fees.
- In the case of a failure to reach resolution regarding an anonymous submission, the IRS will no longer refund 50% of the applicable user fee.
- The revised program adds a new rule for "egregious failures," under which the IRS reserves the right to impose a sanction that may be larger than the VCP user fee. For this purpose, an egregious failure would include any case in which the IRS concludes that the parties controlling the plan recognized that the action taken would constitute a failure and the failure either involves a substantial number of participants or beneficiaries or involves participants who are predominantly highly compensated employees.
- The model VCP submission documents and acknowledgement letter have been removed from the EPCRS Revenue Procedure and replaced by model forms available on the IRS website.

A brief summary of the EPCRS programs, including recent changes, is provided below. For more information about a particular program, refer to the document titled *IRS Employee Plans Compliance Resolution System (EPCRS) options*.

Self-Correction Program (SCP)

SCP allows plan sponsors to correct operational errors without making a formal submission to the IRS. As a result, the plan sponsor does not request or receive approval of its correction method from the IRS. The IRS has assured plan sponsors that it will not disqualify a plan due to an error that has been corrected under SCP.

Errors considered to be "insignificant" may be corrected under this program at any time without IRS review. "Significant" errors generally must be corrected by the last day of the second plan year following the plan year in which the error occurred. EPCRS lists factors that should be considered in determining whether an error is considered "insignificant" or "significant."

In order to self-correct significant operational errors, the plan must have a favorable determination letter. A 403(b) plan generally will be treated as having a favorable letter if either:

- The employer is an eligible employer and, on or before December 31, 2009 (or later date if the plan is established later), the employer adopted a written plan intended to comply with the final 403(b) rules, or
- The employer failed to adopt a written plan timely, and files a VCP submission to correct the failure.

Under the latest guidance, individually designed qualified plans are no longer required to have a "current" favorable determination letter to be eligible for a correction under SCP. Going forward, the favorable letter requirement can be satisfied with an initial or subsequent determination letter.

Certain errors (see details in document titled *Errors and acceptable correction methods*) may be corrected under SCP by adopting a retroactive plan amendment.

Voluntary Correction Program (VCP)

Plan sponsors may use VCP to correct operational errors, plan document errors, demographic errors, or employer eligibility errors. To use this program, the plan sponsor voluntarily discloses the error(s) to the IRS. The plan sponsor must also submit a proposed correction method and pay a correction fee. Once the IRS and plan sponsor agree on the appropriate correction, the IRS issues a Compliance Statement. The IRS may require a plan sponsor to sign and return the Compliance Statement within 30 calendar days. If this approach is taken and the Compliance Statement is not returned within 30 days, the IRS will close the VCP submission and the plan may be referred to Employee Plans Examination.

In an anonymous ("John Doe") submission, the VCP procedures apply, but the plan sponsor is not identified in the submission itself. After the correction method is agreed upon in writing, the plan and plan sponsor must be identified within 21 calendar days from the date of the letter of agreement.

All VCP submissions must include:

- Form 8950, "Application for Voluntary Correction Program (VCP) Under the Employee Plans Compliance Resolution System (EPCRS)," and
- Form 8951, "User Fee for Application for Voluntary Correction Program (VCP) Under the Employee Plans Compliance Resolution System (EPCRS)."

A VCP submission must also include a description of the failures, a description of the proposed methods of correction, and other procedural items. Historically, the IRS has provided model documents to help applicants satisfy these requirements. The model VCP forms (Form 14568 series of forms) required for submissions are now available on the IRS website.

The correction of Interim Amendment and Nonamender Failures must now be made by the date of submission. Corrective plan amendments required as a part of a VCP submission must be adopted no later than 150 days after the date of the compliance statement with special timing rules applicable to governmental plans.

The IRS also removed the user fee schedule from the EPCRS Revenue Procedure. Instead, user fees, including exceptions, will be included in the user fee revenue procedure published by the IRS annually. In addition, in the case of a failure to reach resolution regarding an anonymous VCP submission, the IRS will no longer refund 50 percent of the applicable user fee.

Audit Closing Agreement Program (Audit CAP)

Under Audit CAP, if the IRS discovers operational, plan document, demographic, or employer eligibility errors while performing a plan audit, the plan sponsor may enter into a closing agreement rather than face plan disqualification. Since errors are not voluntarily disclosed, the IRS historically imposed a penalty that was a negotiated percentage of the amount of tax the IRS would collect upon plan disqualification.

Under the new version of EPCRS, the penalty continues to be a negotiated amount, but is now based on facts and circumstances that include relevant factors related to the nature, extent, and severity of the failures. Sanctions will not be excessive, but will generally not be less than the applicable VCP user fee. The penalty may be reduced if correction is made before audit, even if that correction is made outside of the SCP or VCP.

Specific errors and methods of correction under EPCRS

In the EPCRS guidelines, the IRS provides a list of general correction principles that apply to all corrections. These guidelines are described in the document titled *General correction principles under EPCRS*. In addition, the IRS provides specific correction methods that may be used to correct certain errors under some of the programs.

The following errors may be corrected under SCP or VCP using the correction method(s) described in Appendices A and B of the EPCRS guidelines and the correction methods provided under EPCRS are deemed to be reasonable and appropriate methods of correcting a failure.

- Failure to properly provide the minimum top-heavy benefit to non-key employees.
- Failure to satisfy the ADP test, the ACP test, or the multiple use test (QNEC method or one-one method).
- Failure to distribute elective deferrals in excess of the section 402(g) limit.
- Exclusion of an eligible employee from contributions or accruals under the plan.
- Failure of a 403(b) plan to satisfy the universal availability rule.
- Failure to timely pay the required minimum distribution (RMD) under section 401(a)(9).
- Failure to obtain participant and/or spousal consent for a distribution subject to the participant and spousal consent rules.
- Failure to satisfy the defined contribution annual additions limit under section 415(c).
- Vesting errors.
- Failure to satisfy the defined benefit annual benefit limit.
- All overpayment errors.
- Failure to apply the $200,000 (as indexed) compensation limit.

The following errors may be corrected by a plan amendment under SCP or VCP.

- Failure to apply the $200,000 (as indexed) compensation limit.
- Hardship distribution and plan loan errors.
- Inclusion of an employee who has not met the plan's minimum age and service requirements or who was included too soon due to an incorrect plan entry date.

The following errors may be corrected only under VCP.

- Employer eligibility error.
- Loan amount exceeding the maximum permissible amount ($50,000/50% Limit).
- Loan repayment period exceeds the maximum permissible repayment period.
- Loans that do not meet the level amortization requirement.
- Loan default errors.

Descriptions of the correction methods allowed under the EPCRS programs for the above list of errors can be found in the document titled *Errors and acceptable correction methods*. Guidelines regarding the calculation of lost earnings for some of these correction methods can be found in the document titled *Earnings adjustments for corrective contributions*.

Plan sponsor next steps

Plan sponsors that discover operational, plan document, demographic, or employer eligibility errors either during the course of normal plan administration or as the result of a self-audit should review their EPCRS options with the plan's legal counsel.

Plan sponsors that are interested in reviewing the details of EPCRS may access Revenue Procedure 2016-51, as well as related information through the IRS's website at http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors.

Pension Analyst by Prudential Retirement
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