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Advanced EPCRS Case Studies & VCAP – What’s That?

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• Joanne Pecina



• Maureen Pesek



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Your Presenters Today

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Advanced EPCRS/VCAP Agenda

- What's in our Toolbox?
- Case Studies in EPCRS
- Understanding When to Use VCAP
- VCAP Filing Procedures
- VCAP Case Studies





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Remember What's in Your Toolkit

- EPCRS gives us lots to work with
 - Self-Correction Program (SCP)
 - Voluntary Correction Program (VCP)
 - Audit Closing Agreement Program (Audit CAP)
- Voluntary Closing Agreement Program (VCAP)
- Delinquent Filer Voluntary Compliance Program (DFVCP)
- Voluntary Fiduciary Compliance Program (VFCP)



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Learning to Diagnose the Problems



- Fact gathering through interviews
- Document collection (AKA hunt & gather)
- Lay out the puzzle pieces
- Prioritize the corrections needed
 - Don't get overwhelmed by the size of the whole
- Make & communicate reasonable timetable



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Case Study #1: If I ignore it, maybe it'll go away

Just the Facts, Ma'am

- Plan started Jan. 1, 2015
- 401(k) Profit Sharing Plan
- Very low participation (<20%)
- Moved Jan. 1, 2016, to bundled provider
- Added Auto Enrollment Jan. 1, 2016



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Case Study #1 (cont.)

And then things go sideways

- 2015 Form 5500 filed without required audit
- Provider sends notices out and auto enrolls participants online
- May 2016, Plan Administrator stops downloading file from Provider's website with deferral percentages
- 2016 Form 5500 also filed without required audit
- Spoiler Alert – 2017 Form 5500 filed same way



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Case Study #1 (cont.)

The DOL comes knocking



- Client receives deficiency notices from the DOL for 2016 and 2017 Forms 5500
- Client ignores deficiency notices for months until it receives the \$40,000 penalty notice
- Legal counsel engaged late 2018
- Auditor brought in to start with 2015



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Case Study #1 (cont.)

Let's play Spot the Failures

- Auditor finds:
 - Entire Ohio location excluded in operation
 - Deferral elections not implemented timely pre-May 2016
 - ALL deferral election and auto enroll not implemented post-May 2016
 - Compensation done incorrectly (improper exclusion)
 - Random people simply never reported to Provider, so never allowed to enroll



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Case Study #1 (cont.)

Resolutions



- Each correction needs to be calculated separately using different method
- Earnings need to be calculated differently for each failure
- Failure to file means we go to Office of the Solicitor for court appearance
- Negotiated \$14,000 sanction for 5500's
- VP in charge of HR demoted
- Client terminating plan



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Case Study #2: But I Identify as SEP

Our Story Begins



- Calendar year Plan started 2005
- Plan changes service providers in 2008
- Plan has several participating employers operating as a Single Employer Plan (SEP)
- Employer match was suspended in 2010, and by 2015, they want to reinstate
- Plan changes service representative in 2015, who raises Multiple Employer Plan (MEP) possibility



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Case Study #2 (cont.)

What's the Diagnosis?

- Initially, two entities formed a controlled group, adopted plan (an actual SEP)
- During 2008 service provider change, the EGTRRA restatement (eff. 2009) was prepared, but not adopted
 - 2009 - change from 6 mos. service to 1 YOS included in unsigned document
- By 2015, there is a Lead Employer and 19 Adopting Employers
 - One large controlled group (11 entities) and several standalone entities (remaining 9)
- Plan document identifies the plan as a SEP, not a MEP
- Plan was always tested as a SEP=ADP failures



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Case Study #2 (cont.)

To the IRS on Bended Knee

- Adopt the ECTRRA restatement for nonamender failure
- Correct (and adopt) ECTRRA and PPA restatements to identify as MEP
- Re-test ADP for 2012 – 2014 due to data limitations and ask IRS to restrict correction to these years
- Late ADP refunds – ask the IRS to forego the one-to-one correction method and wave excise taxes under IRC Section 4979
- Retroactive amendment to allow Plan Sponsor to use the 1 YOS for eligibility



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Case Study #2 (cont.)

Testing, Testing

- Required to go back to 2006
- Recreate census and re-do testing for all years
- The one-to-one correction method:
 - Goal is to minimize the creation of de minimis accounts for long-terminated employees
 - Netting contributions, distributions, and overpayments across HCEs
 - Use net distributions to determine amount funded to NHCEs
 - Only reallocate funds to NHCEs who were: a) eligible employees for that year of the failure, b) were NHCEs in the year of the failure, c) were NHCEs in the year of correction, and d) were employed during the year of correction



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Case Study #2 (cont.)

Where Do We Go from Here?



- Quarterly updates from Plan Sponsor on ownership
- Confirm controlled groups to TPA before each testing season
- 2019 move to basic safe harbor match



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Case Study #3: From Italy, with Love

In the Beginning, There Was an Audit

- IRS examination letter received September 2018
- Company's CFO is from Italy and tries to handle the audit alone
- July 2019, CFO leaves and moves back to Italy
- New CFO and HR Director have no idea what to do
- IRS issues 14-page findings letter



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Case Study #3 (cont.)

The Findings – Oh Boy!

- Audit covers 2011-2017 (originally, just 2017)
- Evidence shows former CFO funded nearly \$60k of deferrals for himself without any paycheck deductions
- Compensation used in operation and ADP testing wasn't even in zip code of correct
- Deferral changes not implemented timely
- Company acquired entity in 2011 with separate plan (merged 1/1/2014)



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Case Study #3 (cont.)

Where Do You Even Begin?

- You become engaged in September 2019
- Document Hunt – always step one
 - Audit files should be acquired ASAP (know what the IRS knows)
 - Data/documents from acquired entity's recordkeeper
 - Ask IRS for time to review and get caught up to speed
 - Based on IRS report, start assessing project and plan of attack



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Case Study #3 (cont.)

Where Do You Even Begin?

- Meeting with IRS to review strategy for correction
- IRS wants all ADP testing rerun using accurate census data
 - Need to agree on correct compensation
 - Requested all deferrals be recalculated based on what should have happened
 - Then use new ADP results for correction
- What challenges do you see this presenting?



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Case Study #3 (cont.)

Digging Through the Muck



- Funds CFO generously contributed for himself were actually returned
- Retests then have to be compared to original tests to determine additional correction needed
- *Oh* - did we mention the two new wholly-owned U.S. subsidiaries?
 - How/when to disclose to the IRS?
- Any guesses what other operational failures there are?



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Case Study #4: 403(b) Blues

Here's What Happened

- School started a 403(b) back in 1995 with a large service provider known for school plans
- School required to have an audit done for its 2018 Form 5500
- Auditor finds out a number of problems:
 - No signed documents, but it appears that there are (somehow) two plans
 - Universal Availability failure
 - Client using incorrect definition of compensation
 - Forms 5500 weren't prepared correctly



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Case Study #4 (cont.)

Let's Break It Down Into Bite-Sized Pieces

- Plan Document Failure
 - Evidence of both a Plan #001 & #002, but not 100% identical
 - Client didn't know it had a second plan and never operated as such
 - Both plans provided for deferrals and matching contribution
 - BUT - had different definitions of compensation
 - Nothing ever signed - so, we're into VCP no matter what



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Case Study #4 (cont.)

Universal Availability

- Excluded all part-time and substitute teachers likely since inception
- School has no proof as to who was offered the plan
- Rough calculations for the correction requires an MDO of \$15,000 each year, plus potential missed match of \$10,000
 - So, if we were to correct through VCP, correction would need to be complete and waaaaayyy more than the school could afford
- Client's census data files are somewhat sketchy and gets worse as you go further back
 - Even if the school did have the money, there isn't data to support the full correction



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Case Study #4 (cont.)

The Devil Is in the Form 5500!



- The CPA firm that prepared the Forms 5500 only prepared filings under #001
- CPA firm additionally missed that there were FOUR investment accounts
 - Mutual fund and annuity accounts at each of the two service providers
 - Technically, two accounts were linked with #001 and two accounts were linked with #002. CPA just reported three accounts
 - CPA never looked at census data and only relied on what service provider reported
- Once you add in the participants missed through Universal Availability, the School reached audit size back in 2016



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Case Study #4 (cont.)



Wrapping it All Up With a Bow

- CPA refusing to fix the Forms 5500 it incorrectly prepared
- Service Provider has claimed no responsibility for anything
- Good news about missed ACP testing – no HCE ever participated
- School is only going to VCP to fix document
- Introductions happening to get a TPA to act as ringmaster and financial advisor to determine best investment platform for the plan



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Case study #5: Don't Walk Away - RUN!

As Bad As it Gets

- 401(k)/SHNE/Rate Group PS
- No valuation or work done since 9/30/2012
- Assets are employer-directed pool of CDs
- Employer has roughly 30-40 employees
- Plan allows participant loans
- Where do you start?



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Case study #5 (cont.)



Hunt and Gather

- Plan documents – nothing since 2001!
- Trust reports – balance doesn't seem to match last Form 5500/valuation
 - So, do you start with 9/30/2012?
- Payroll reports – Wahoo! Deposits done timely
- Loan documents and amortization schedules
 - 61 loans outstanding in one year (11 for just one person)
- Distribution form – Nope not a one



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Case study #5 (cont.)

When You Have to Eat an Elephant

- Attack one year at a time
- Knock out the easy stuff – documents are generally quick to do
- Hold all Forms 5500 until all done and then file through DFVCP
- Keep clean exhibits/data for each year's corrections
- Fund as you go – STOP accruing earnings



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Case study #5 (cont.)

Summary of Failures Found

- Preparing your summary as you go makes the VCP preparation easier
 - Non-amender failure
 - Failure to distribute safe harbor notice
 - Improper in-service distributions
 - Defaulted loans
 - Loans in excess of 72(p) Limits
 - Incorrect Required Minimum Distributions



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Case study #5 (cont.)

What Isn't an EPCRS Issue?

- Late Forms 5500
- Late deposit of 6 pay periods (2-4 days late)
- Investment of plan assets
- Do we have any notice problems besides safe harbor?
 - QDIA, 404a-5, SPDs, SARs
- Failure to file Forms 1099R



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Case Study #6: Shh...I'm Incognito
When Bad Things Happen to Good People

- Calendar year plan started 1994
- In 2006, plan was amended to add an enhanced safe harbor matching contribution (100% up to 4%) and an additional 4% discretionary matching contribution
- At same time, TPA removed the top paid group election
- For 10 years, the Employer calculated an 8% safe harbor matching contribution
 - Not caught until plan was subject to audit for 2016
 - No ACP testing for 10 years



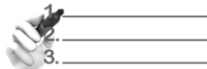
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Case Study #6 (cont.)

Goals Beyond Just Correction

- Employer wants to keep as much money in the plan as possible
 - IRS wants this, too! See Rev. Proc. 2019-19 Section 6.02(2)(b)
- Large population of HCEs who are not owners, managers, or officers – want to minimize the impact of the correction on these employees
- Avoid having to amend prior filings (of the Plan and the Plan Sponsor)

Goals



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Case Study #6 (cont.)

We'll Go to the IRS and Ask Nicely

- Retroactively amend the plan to provide a 6% safe harbor match
 - Employer did this going forward, as well
- Only perform ACP testing on the remaining 2%
- Use the top paid group election for the ACP testing
- Use the one-to-one correction method, so money is redistributed to NHCEs instead of removed
- Waive excise taxes under Code Section 4979



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Case Study #6 (cont.)

Why Go Incognito?

- Financial concerns – the Plan Sponsor would be unable to make the necessary contributions to correct the failure
- Political concerns – Large corrective distributions are not an option as they will upset many participants who are top executives



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Case Study #6 (cont.)

The Results Are In!

- IRS agrees to retroactively amend the Plan to provide a 6% safe harbor match
- IRS approves the proposed testing
 - Only test the remaining 2% of contributions and use the top paid group election
 - Result is that Plan passes ACP test for all years
- Waiver of excise tax under Code Section 4979 only applicable if ACP test was timely performed
 - Cannot receive waiver if, due to mistaken belief, the testing was not performed
 - Luckily, with our correction, this is moot as there will be no corrective distributions



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What Is VCAP?

- The Voluntary Closing Agreement Program is not part of EPCRS
- Search every Rev. Proc. you can, and it won't be there
- Only guidance found on IRS website at <https://www.irs.gov/retirement-plans/employee-plans-voluntary-closing-agreements>
- Also IRS Manual Pt. 7, Chpt. 2, §4 https://www.irs.gov/irm/part7/irm_07-002-004



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To VCAP, or Not to VCAP



- Certain failures relating to qualified plan operations fall outside of EPCRS
- Fiduciary breach prohibited transactions may be resolved through VFCP
- Tax-related matters can potentially be resolved through VCAP
 - Certain types of prohibited transactions come with excise taxes, interest, and additional penalties
 - VCAP is not able to resolve excise taxes and interest
 - Penalties can really add up



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No Protection Under Examination



- There is no guaranteed protection against an audit for a plan that has filed VCAP
- Under Examination – like VCP, the IRS will not consider a VCAP submission if the plan, plan sponsor, or entity is under examination
 - If already in VCAP, and then examined, sponsor must notify IRS and the IRS will decide whether to reject the submission or not
- In our experience, however, IRS exams will defer to resolution by VCAP



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When Is VCAP Not Possible?

- IRS may decide, at its discretion, whether to enter into a Closing Agreement with a plan sponsor
- There are clearly listed circumstances under which the IRS won't entertain a VCAP application:
 - VCP is possible – If the issues needing to be resolved can be handled through VCP, then VCAP is not appropriate
 - What if there are multiple issues?
 - When you have a hodge-podge, it becomes up to the IRS' discretion to accept the VCAP or not



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When Is VCAP Not Possible? (cont.)

- 457(b) Plans – failures related to 457(b) plans should be resolved through VCP
- 457(f) Plans – Not eligible for relief under VCAP or VCP
- Abusive Tax Avoidance Transactions (ATAT) – VCAP can't bless intentional ATAT
 - If the failure is related to an ATAT, it is up to the IRS to determine whether the VCAP submission is appropriate
 - If the IRS deems the VCAP inappropriate, it may refer the matter to Examinations



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When Is VCAP Not Possible? (cont.)

- Willful Tax Avoidance – if there has been a willful or intentional plan to avoid or evade paying or reporting taxes, VCAP is inappropriate
 - Example: Plan sponsor withdraws all plan assets as a “loan” to himself. Never makes a loan repayment. Includes other participant’s money. Waits four years and then wants to put money back without paying taxes.
- Future Guidance – VCAP is not an end run-around to obtaining permission to engage in future activity that may cause tax-related issues
 - Example: Plan sponsor wants to use plan assets to run business during a rough patch, but wants to file VCAP to get permission from IRS and avoid excise taxes. NOT!



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Submission Contents

- Form 2848
- Written Request for Agreement
- Penalty of Perjury Statement
- Exhibits supporting application



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Form 2848

- VCAP is really not a do-it-yourself project for plan sponsors
- Issues are highly technical in nature and require a firm grasp of taxation rules
- Representative should complete Section 3 to cover “Voluntary Closing Agreement Program submission and potential excise taxes, interest, penalties, and sanctions”



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Written Request for Agreement

- This is where the majority of your time and effort will be spent
- Have separated, clearly titled sections:
 - Name, address, and title of person expected to sign the Closing Agreement
 - Name of Plan, EIN, Plan ID, type of plan, and NAICS Code
 - Detailed explanation of the problem including:
 - How and why it occurred
 - Number of people affected
 - Amount of contributions, distributions, etc., included



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Written Request for Agreement (cont.)

- An explanation of how you will correct the identified problem or issue
- An explanation of how you calculated the tax, interest, or penalties
- Calculations or any tax or corrective method included in the request
- Proposed sanction amounts and an explanation justifying the amount



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Submission Additions

- No fee is included with the original submission
 - There is no fee schedule
- Penalty of Perjury Statement – similar to VCP process
- Exhibits/spreadsheets should have header identifying the applicant details
- Unlike VCP, VCAP goes in through hard copy and not via the website www.pay.gov



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Anonymous Submissions

- Similar to VCP, there is an option to have a legal representative submit VCAP on behalf of the sponsor anonymously
- Power of Attorney and Penalty of Perjury statements should be signed at the start, but not submitted to the IRS
- All documents, exhibits, etc., should be redacted to remove the plan, plan sponsor, EIN, etc.
- Legal representative should give submission its EIN and unique Plan ID (e.g., 401)



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Anonymous Submission (cont.)

- Special Penalty of Perjury Statement must be included, signed by the legal representative:
 - Under penalties or perjury, I declare that I am an authorized representative of the taxpayer who would be party to any closing agreement. I comply with the power of attorney requirements described in 26 CFR §§601.501 – 601.509. I will submit an executed Form 2848 upon the disclosure of the identity of the taxpayer to the IRS. I also declare that the issues and information included with this request are true, correct, and complete to the best of my knowledge and belief.
- Once the agreement with the IRS is reached, the client's Penalty of Perjury Statement and signed Power of Attorney will need to be disclosed, along with the updated forms and exhibits showing the plan sponsor's name



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Case Study #1: It Hath Frozen Over

- Employer has a DB Plan, originally established 2005
- Allegedly frozen in 2010, but no documentation/proof
- No plan documents except for original plan
- PBGC premiums not paid for past three years and now in collections with U.S. Treasury
- No valuations done in several years
- TPA has vanished like Casper



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Case Study #1 (cont.)

- Client tries for a year to find the freeze amendment
 - He swears he has it somewhere
- Plan is frozen while the search is on for the original
- No Forms 5500 done
- No AFTAP Certifications done
 - By 2015, the AFTAP percent lowers such that the plan would be frozen, but no notice done



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Case Study #1 (cont.)

- Actuary calculates benefit accruals through 2017 freeze date
- Plan is underfunded by more than \$3.5m
- Resulting required minimum contributions trigger excise taxes of nearly \$1m
- Client is quite distraught



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Case Study #1 (cont.)

- What can we fix through VCP?
 - Plan Document
 - AFTAP Failure
- Forms 5500 can be fixed through DFVCP
- What about everything else?



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Case Study #1 (cont.)

- Suggested solution for VCAP:
 - Consider owners frozen as of 2010 based on PBGC filings
 - Result of owner's freeze -> plan isn't underfunded and no RMC owed
 - Excise taxes are resolved by this one assumption
 - Otherwise, NHCEs would be subjected to the 2015 freeze due to AFTAP, and would have a loss of benefits
- These tax issues are bigger than VCP issues, so VCAP makes more sense



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Case Study #2: First Comes Bankruptcy



- Plan started in 2014
- Trustee invests plan in multiple real estate ventures – all of which benefit the Trustee's side real estate ventures (the "side hustle")
 - Co-Trustee (the Trustee's then- girlfriend) does nothing about this
- Side hustle fails and enters bankruptcy
- Bankruptcy court freezes plan assets in 2017 – Trustee finally alerts BOD



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Case Study #2: What Did We Learn?

- Trustee caused plan to enter into several notes and mortgages, all related to a real estate venture of the side hustle
 - Prohibited transactions under IRC Section 4975
 - Several of these were purchased after the lender had defaulted and would go on to default while held by the plan
- Real estate purchases also violated exclusive benefit rule of Code Section 401(a)(2)
- Failure to timely pay out RMD to Co-Trustee because we cannot value the plan assets
- Trustee/Co-Trustee did not offer the plan to call center employees in violation of the eligibility requirements



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Case Study #2: Then Comes VCAP

- Covered by VCP – RMD failure, eligibility failure
 - Pay out the RMD, plus earnings, and request waiver of excise taxes under Code Section 4974
 - Retroactively amend the plan to exclude call center employees (does not create coverage concerns)
- Why use VCAP?
 - Correction of prohibited transactions and resolution of any excise taxes due under Code Section 4975
 - Potential for plan disqualification due to violation of exclusive benefit rule



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Case Study #2: Then Comes VCAP (cont.)

- IRS cannot address excise taxes for prohibited transactions because the disqualified person (i.e., the Trustee) is liable and not the plan or employer
- RMD can be corrected through the method in Rev. Proc. 2019-19
- IRS is considering the employer eligibility failure and exclusive benefit violation
 - Eligibility – Seems to want proof the call center employees had no expectation of participating
 - Exclusive benefit – Seems unlikely to disqualify plan



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Case Study #2: V-F-C-P-I-N-G

- Simultaneously filed with the DOL seeking resolution of the prohibited transactions and various fiduciary breaches
- Result:
 - DOL conducted an investigation
 - Turned over plan documents, trust accounting, real property instruments, bankruptcy proceeding filings, etc.
 - DOL interviewed the current plan fiduciaries, as well as the former Trustee and Co-Trustee
- We are awaiting the final determination



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Questions?

When after your presentation someone asks a question you don't know the answer to but you gotta look credible so you answer anyway



Usually it works



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