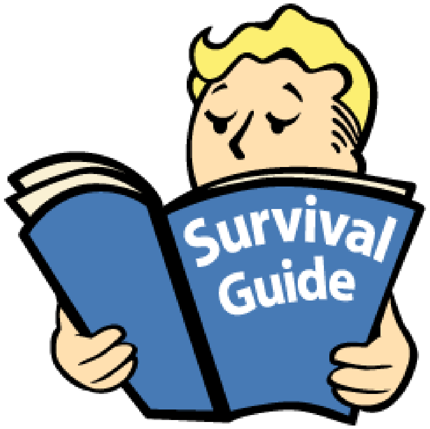
EPCRS PART I
Overview and Update



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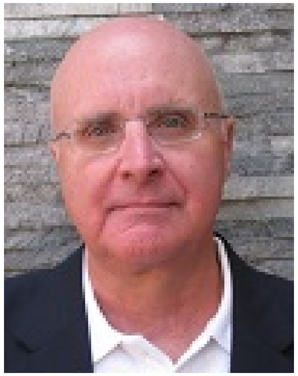
Your Presenters Today

- Ilene H. Ferenczy, JD, CPC, APA

- Tim McCutcheon, JD, CPA, MBA



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EPCRS PART I
Overview and Update

- Facilitator:

  Chuck Gouge

- Question Board Moderator

  Joanne Pecina

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During the Webinar

- All attendees' lines are muted
- Question board available and monitored
  - Please send in questions
  - We will answer as many submitted questions as possible
- Follow up questions and comments can be sent to:
  - support@erisapedia.com

Agenda

- ***Voluntary*** demo after presentation
- Covering Chapter 21 of the Qualified Plan eSource authored by Ilene Ferenczy

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INTRODUCTION TO EPCRS –

THE FIX-IT SYSTEM

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EPCRS

- Acronym for Employee Plans Compliance Resolution Program
- Issued by IRS as Revenue Procedure 2016-51
- Rev. Proc. 2016-51 is not well organized. We will take a functional approach
  - Overview in Part I
  - Correction techniques in Part II

EPCRS - Purpose

- Help plan sponsors ensure that daily administration activities match plan documentation
- Give plan sponsors a means by which to correct errors without losing tax benefits of the qualified plan

Advantages of Tax Qualification

- Contributions to the plan are deductible by the company
- Deferred taxation to employees
- Funds are held in a tax-exempt trust, so investment gains are not taxed
- Distributed benefits can be rolled over
- Assets are protected from creditors

Disqualification: Lose All Advantages

- Contributions for nonvested benefits are not deductible
- Vested benefits are taxed through to participants
- Trust is taxable
- Rollovers not permitted
- Creditors may be permitted to invade
- Potential exposure to participant claims

What Can Cause a Plan to Be Disqualified?

- Plan document failure
  - Something isn't in the plan document that must be (e.g., PPA restatements)
  - Something is in the plan that shouldn't be
- Operational failure: didn't follow the terms of the plan document

What Can Cause a Plan to be Disqualified?

- Demographic failure: failed coverage, participation, or nondiscrimination requirements
- Employer eligibility failure: e.g., governmental entities cannot sponsor 401(k) plans, for-profit organizations cannot sponsor 403(b) plans

Examples of Disqualifying Failures

- §415 violations
- Uncorrected ADP/ACP testing failures
- Failure to give top-heavy contributions
- Failure to comply with QJSA and spousal consent requirements
- Failure to include eligible participants
- Failure to make required minimum distribution

Historic IRS Audit Targets

- Terminated plans that haven't requested a determination letter
- Pension underfunding
- Improper valuations of assets
- Prohibited transactions
- 401(k) plans
- 403(b) plans
- Top-heavy violations
- SEPs

Alternative to Disqualification

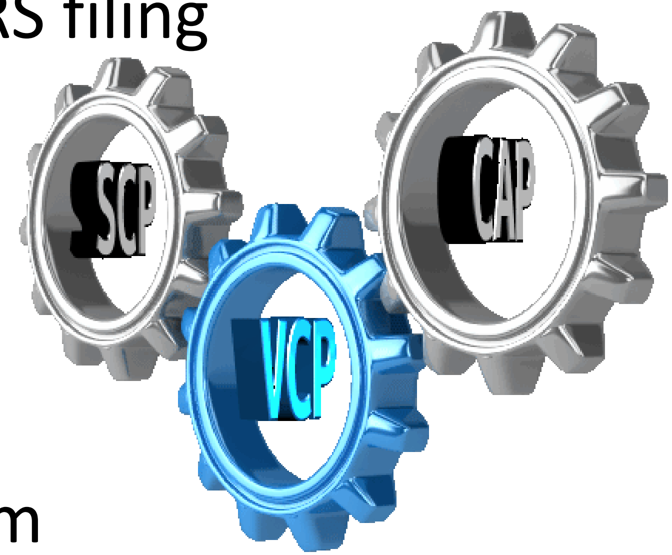
- **EPCRS**: Employee Plans Compliance Resolution Program – saves the plan's qualification
- Established in 1998 by Rev. Proc. 98-22, and modified and improved over the years
- Current procedure: Rev. Proc. 2016-51, effective 1/1/17
- If EPCRS is followed, a plan will not be disqualified

Changes in Rev. Proc. 2016-51

- Updated procedure to conform to most recent guidance in relation to favorable determination letters
- Took the user fee part of EPCRS out of the procedure and added it to the annual user fee publication by the IRS
- Made some technical changes to CAP sanctions
- Unresolved Anonymous Submissions do not get refunds

EPCRS - Three Procedures

1. Self correction procedure – no IRS filing
   – Insignificant errors: anytime
   – Significant errors: time limited



2. Voluntary submissions to IRS
   – requires an IRS filing
3. Audit Closing Agreement Program ("CAP") – what happens when the IRS catches the problem on audit

Common Correction Principles

- Correction should restore plan to the position it would have been in had the error not been made
  - Restore participants and beneficiaries
  - Includes earnings
- Leave money in plan – e.g., can't reduce Key balance to make plan not top-heavy

Common Correction Principles

- Correction of operational errors must take into account the plan terms at the time the error was made
- The correction should be reasonable and appropriate for a given failure
  - May be more than one method
  - Procedure lists factors for determining if a correction method is reasonable and appropriate

Common Correction Principles

- Corrective allocations and distributions:
  - Based on terms of the plan
  - Adjusted for earnings
  - From employer contributions and forfeitures (if plan permits)
- Full correction must be made for all years

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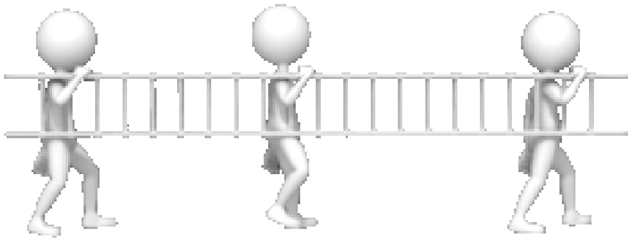
Common Correction Principles

- If someone was overpaid or made an excess deferral that needs to be distributed:
  - Excess amounts are not eligible for rollover
  - If previously rolled over to an IRA, subject to IRA annual contribution limits (and excise taxes if exceeds those limits)
  - Plan sponsor must notify the participant of the excess amount problem (new 1099R)



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Correction Principles - Exceptions

- Requirement:
  - No significant adverse effect on participants
  - No significant discrimination in favor of HCEs
- Not an exception: correction would be inconvenient or burdensome
- Estimates okay if:
  - Cost of precise calculation outweighs probable difference or
  - Precise calculation is not possible

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Correction Principles - Exceptions

- Corrective distribution of $50 or less is not needed if cost of processing and delivering exceeds the correction. Amounts not distributed are allocated to other participants
  - Applies only to distributions – not earnings calculation
- Must take reasonable actions to locate lost participants and beneficiaries (WWYDITWYM)

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EPCRS Not Available

- Failures for which the Code or regulations already provide a correction
- To resolve excise tax problems – except for:
  - Code §4972 (nondeductible contributions)
  - Code §4973 (excess contributions)
  - Code §4974 (RMD)
  - Code §4979 (excess 401(k) contributions)
  - Code §72(t) (early distributions)

SELF-CORRECTION –

NO IRS INVOLVEMENT, NO FEES, NO PROBLEM

Self-Correction Procedure

- The "Do-It-Yourself" procedure
- For operational (and demographic?) failures only
- Only limited corrections by plan amendment
- No "egregious" problems
  - Facts and circumstances determination
  - E.g., allocations to HCEs exceeded limits by several times

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Self-Correction - Eligibility

- Must be the subject of a favorable determination letter
  - Pre-approved plan
    - Current opinion or advisory letter
  - Individually designed plan
    - Existing plan: favorable letter at some time in the past
    - New plan: nothing clearly stated, but should be applying for determination letter

Self-Correction - Eligibility

- Must have "established practices and procedures"
  - Formal or informal
  - Reasonably designed to promote and facilitate overall compliance with IRC
  - Need more than just the plan document or a hired TPA
  - In place and routinely followed, but there was an oversight or mistake

Self-Correction - Insignificant Failures

- CORRECTION MAY BE MADE AT ANY TIME

- (EVEN IF THE PLAN IS UNDER AUDIT BY THE IRS)

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Self-Correction - Insignificant Failures

- What is "insignificant": balancing of factors:
  - Have other failures occurred?
  - % of plan assets and contributions involved
  - Number of years affected
  - Participants affected (as % of total in plan and as % of those who could have been affected)
  - Was correction made within a reasonable time after discovery?
  - Why did the failure happen?

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Self-Correction - Significant Failures

- Defined: anything that's not insignificant
- Rule: must be "substantially" corrected during the "correction period"
  - General rule: last day of 2nd plan year following year of occurrence
  - ADP/ACP: last day of 3rd plan year following year for which testing is failed
- BUT => Correction period ends if the plan comes under IRS audit

Note

- Because any error, except something that is egregious, can be corrected within the two/three-year period after the year of the error, the “significant” vs. “insignificant” issue is relevant only if correction occurs after that period
- As significance (or not) is a subjective analysis, you will never know (unless there’s an audit) whether your analysis of the error’s status is correct
  - Therefore, if outside self-correction period, it becomes a risk/reward analysis as to whether to self-correct or file with IRS

Self-Correction - Significant Failures

- What constitutes substantial correction during correction period:
  - Either:
    - Promptly identified error, formulated correction
    - Initiated correction in manner that demonstrated commitment to completion expeditiously
  - Or:
    - Completed with regard to 85% of all participants, and
    - Diligently completes correction for the rest

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Self-Correction – Plan Amendment

- Plan amendment must conform the terms of the plan to the plan's prior operations
- Available for:
  - Section 401(a)(17) Failures (added contributions to others)
  - Hardship Distribution Failures and Plan Loan Failures
  - Early Inclusion of Otherwise Eligible Employee Failure

VCP – *NEGOTIATIONS WITH A FRIENDLY IRS FOR A SET USER FEE*

Voluntary Correction With Service Approval (VCP)

- Submit issue to the IRS for its review
- Negotiate correction process
- Set user fee usually based on number of participants in the plan
  - Special reduced fees for some situations
- Everyone goes home happy

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Voluntary Correction With Service Approval (VCP)

- Plan may not be “under examination”
  - under audit
  - received verbal or written notice that an audit is forthcoming
  - a plan may be considered to be “under examination” if a related plan is being audited

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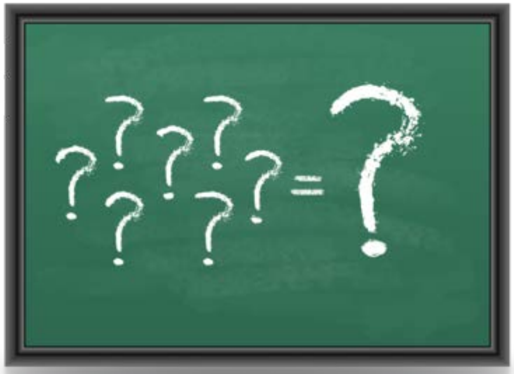
VCP - When To Use

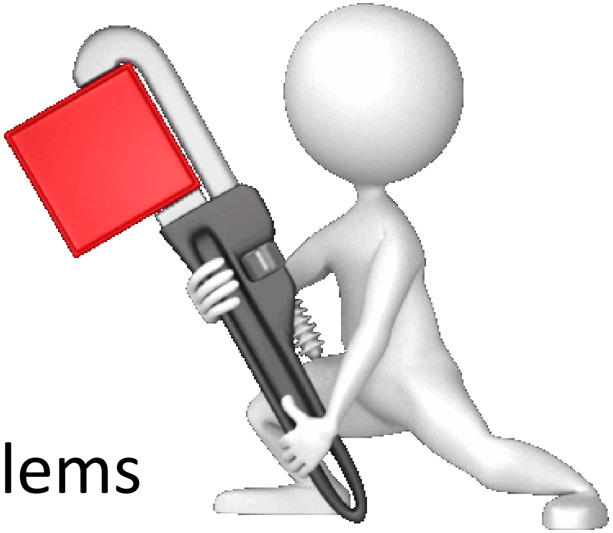
- Self-correction not available (too late)
- Correction method is suspect
- Failure is not operational
- Want to correct by plan amendment
- Involved in sale of company and buyer is squeamish



VCP General Procedure

- File with the IRS
- Pay user fee
- Negotiate with the IRS as to correction method
- IRS issues compliance statement with agreed-upon correction
- Correct within 150 days of compliance statement

VCP - Correction By Plan Amendment



- May correct:
  - Plan Document
  - Demographic
  - Operational Failures
- Not favored for operational problems
  - Purpose: conform the terms of the plan to the plan's prior operations, rather than vice versa
  - Commonly used to try to fix errors made in documentation (scriveners' errors)
- Reflect the corrective action

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VCP - Anonymous

- Why:
  - Want to use a certain correction, but not sure the IRS will approve
  - The normal correction method is very unattractive (e.g., expensive), and sponsor does not want to use it if the IRS disapproves the desired method
- Benefit of Anonymous Program:
  - If IRS and plan representative do not come to agreement, rep revokes the filing and the IRS never knows the plan's identity

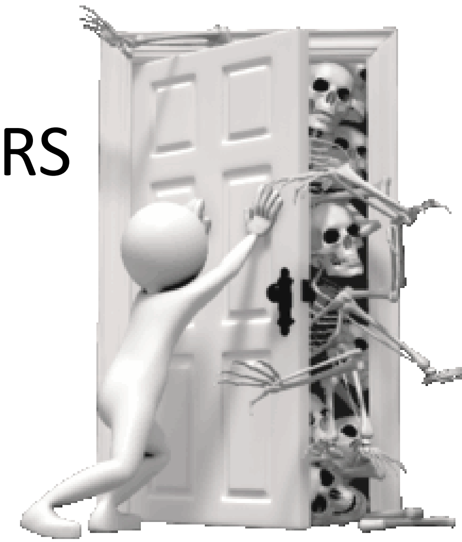
VCP - Anonymous

- Procedure:
  - Representative submits VCP with redacted documents
  - If agreement is reached, have 21 days to disclose identity

  - If agreement is not reached, representative revokes filing or just fades away …

VCP Group Submissions

- Available to service providers that have a systemic error affecting many plans
- Must disclose problem to plan sponsors
- Must identify affected plan sponsors to IRS
- Fees: $10,000 for first 20 plans, $250 for each additional plan, maximum $50,000



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VCP User Fees

Number of Participants	Fee
20 or fewer	$500
21 to 50	$750
51 to 100	$1,500
101 to 1,000	$5,000
1,001 to 10,000	$10,000
Over 10,000	$15,000

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VCP User Fees

- Lower fee schedule for
  – RMD failures
  – Loan failures
- Non-amenders:
  – Required amendments prior to end of remedial amendment period (RAP) - $375
  – FDL - Correction within three Months - $500
  – VCP only contains nonamender failures - 50% if it is submitted within one year of RAP

VCP Fees for "Egregious" Errors

- If the IRS determines that the situation of the VCP is egregious in nature, it reserves the right to charge a higher fee
- "Egregious" means: the parties controlling the plan recognized that the action taken would constitute a failure and the failure either involves lots of participants or involves participants who are HCEs

AUDIT CAP – *THE PROCESS OF NEGOTIATING A RESOLUTION WHEN THE IRS FINDS THE PROBLEM*

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Audit CAP

- IRS discovers problem on audit
- IRS and plan sponsor enter into a contract called a "Closing Agreement" to correct the problem
- Sponsor pays a sanction to the IRS

IRS Charges a Sanction

- Negotiated amount based on facts and circumstances plus identified factors
- IRS procedure says that it must:
  - Not be excessive
  - Bear a reasonable relationship to the nature, extent, and severity of the failures

Sanction Factors

- Steps taken by the Plan Sponsor to ensure that the plan has no failures;
- Steps taken by Plan Sponsor to identify failures that may have occurred;
- Extent to which correction had progressed before the IRS audit began;
- Number and type (HCE/NHCE) of employees affected;
- Number of NHCEs that would be adversely affected if the plan is disqualified;

Sanction Factors (cont'd)

- Whether the failure was one related to discrimination or plan coverage;
- Whether the failure was an employer eligibility failure;
- The period during which the failure occurred;
- The reason for the failure; and
- The taxes that would need to be paid if the plan were disqualified

Special Rules for Plans Involved in Company Acquisition

- Two effects on EPCRS if the error relates to "transferred assets" only:
  - Self-correction period extended: last day of first plan year following year of acquisition
  - Audit CAP sanction: calculated as if transferred assets were in a separate plan

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To Be Continued …

- Part II of the EPCRS Webcast will cover:
  - Common and Preapproved EPCRS corrections
  - Strategies for VCP submissions
  - Strategies for CAP negotiations
  - When you should get an attorney
  - Other tips of the trade …
- Join us on Thursday, August 3 @ 2:00 pm for the next session.

Questions?

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