EPCRS PART I
Overview and Update

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- Ilene H. Ferenczy, JD, CPC, APA
- Tim McCutcheon, JD, CPA, MBA
EPCRS PART I
Overview and Update

• Facilitator:  
  Chuck Gouge

• Question Board Moderator  
  Joanne Pecina
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
INTRODUCTION TO EPCRS –
THE FIX-IT SYSTEM
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
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)
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
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)
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
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)
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?
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
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
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
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
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
## VCP User Fees

<table>
<thead>
<tr>
<th>Number of Participants</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 or fewer</td>
<td>$500</td>
</tr>
<tr>
<td>21 to 50</td>
<td>$750</td>
</tr>
<tr>
<td>51 to 100</td>
<td>$1,500</td>
</tr>
<tr>
<td>101 to 1,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>1,001 to 10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Over 10,000</td>
<td>$15,000</td>
</tr>
</tbody>
</table>
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
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
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?
CE Credit

• ERPA/ASPPA/NIPA
  – Will receive certificate by email in several days
  – ERPA will take longer (please be patient)
  – Please check spam folder

• Any questions, email: support@erisapedia.com
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