Major EPCRS Changes: Revenue Procedure 2019-19

Ilene H. Ferenczy, Esq., CPC, APA
S. Derrin Watson, Esq., APM
Stephen W. Forbes

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Your Presenters Today

Ilene H. Ferenczy, JD, CPC, APA
S. Derrin Watson, JD, APM
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Three Major Changes

1. Self-correct plan loan failures
   – With 1099-R forgiveness
2. Self-correct plan document failures
   – If you're quick about it
3. Self-correct certain document issues relating to benefits, rights, and features

Requirements to Self-Correct (Anything)

• Plan must have in place practices and procedures “reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements”
• If failure is “significant”
  – Must correct by end of second plan year after year of failure (and before audit)
  – Must have “favorable letter”
Practices and Procedures

• If these requirements have always been there, what’s the big thing?
  – The self-corrections permitted under the new procedures are more extensive in nature
  – It is possible (likely?) that the IRS will be more critical in reviewing self-corrections under audit
• What are practices and procedures regarding:
  – Plan documents?
  – Plan loans?

Practices and Procedures

• This is a huge opportunity for TPAs!
  – Help your clients establish internal policies with regard to the plan (improves compliance and sets up eligibility for self-correction)
  – Give your clients a “who to call” list so that they are primed to come to you when errors occur

Plan Loan Failures
Old Rules: Correction of Plan Loan Failures

- If you don’t go through VCP or Audit CAP:
  - Plan must issue Form 1099-R for year of failure
- If you do go through VCP or Audit CAP, plan may:
  - Request no 1099-R for deemed distribution (if within five-year period)
  - Request 1099-R be issued for year of correction, rather than year of failure (if outside five-year period)
  - Use VCP compliance statement as basis of DOL VFCP filing regarding fiduciary breaches and prohibited transactions

New Rules: Guidance Issued for Specific Situations

- Situation 1: QJSA plan was required to get consent from spouse to make loan and failed to do so
  - Fix: Notify the participant and the spouse and get consent
  - If Cannot Get Consent: Talk to IRS under VCP or Audit CAP
- Situation 2: Plan limited number of loans to a participant but made loans to a participant in excess of that limit
  - Fix: Retroactively amend plan to conform to operations
- Both problems can be self-corrected
  - No deemed distribution or Form 1099-R

New Rules: Self-Correction of Defaulted Loan

- Situation
  - Loan terms comply with IRC §72(p)
  - Loan defaulted because of failure to timely pay
  - Corrected within maximum repayment period (normally five years)
- Fix
  1. If company’s fault, company pays additional interest
  2. Employee must either:
     - Make lump sum payment to bring loan up to date, or
     - Reamortize loan and accrued interest over remaining loan term (or five-year limit), or
     - Combination of 1 & 2
New Rules: Self-Correction of Defaulted Loan (cont.)
• New rule: You can self-correct and avoid the deemed distribution
  – No Form 1099-R
  – Even if you don’t self-correct, you can issue 1099-R for year of “correction”

Other Loan Failures
• You cannot self-correct (but must use VCP or Audit CAP):
  – Loans in excess of loan limits
  – Loan terms in excess of maximum repayment period (normally five years)
• Under VCP or Audit CAP:
  – Can ask for forgiveness of deemed distribution
  – If not, delay of Form 1099-R to year of correction is automatic
• You still cannot self-correct if you want to use DOL VFCP to correct fiduciary breaches/prohibited transactions
  – You must use IRS VCP if you want DOL VFCP

Case Study #1
• ABC Plan made a participant loan to Mary
• The loan was for $60,000
• Mary’s vested accrued benefit was $200,000 at the time
• Can we self-correct?
Case Study #1

• Answer: Cannot use SCP
• Loan failures still must be corrected under VCP (i.e., cannot be self-corrected) if they relate to:
  – Excessive amounts
  – Excessive loan periods (i.e., > five years/reasonable time for home loan)
  – Failure to fully amortize
• If not corrected under VCP, employer liable for payroll taxes on $10,000 and plan must issue Form 1099-R for $10,000
• If corrected under VCP:
  – No payroll taxes
  – No 1099-R (or issued for year of correction)

Case Study #2

• ABC Plan made a participant loan to Sam
• The loan was for $50,000 (and Sam’s vested interest was sufficient to support that loan)
• Sam made three payments and then forgot to do more
• Can ABC self-correct to help Sam avoid taxation in year of default?

• Answer: Yes
• The correction:
  – Sam must either make a payment equal to the principal and interest to bring him up to date; or
  – The loan may be reamortized over the remaining period of the loan (or up to five-year maximum)
• No Form 1099-R!
Case Study #3

• Same facts as Case #2 except that the reason why Sam’s loan went into default is that there was a glitch in ABC’s payroll program, and it ceased to take the payments out of Sam’s paycheck
• Still self-correctable?

Case Study #3

• Answer: Yes
• In this case, the employer should pay the increased interest due to the fact that payments stopped
• Sam is still responsible for making up the late principal payments, either in a lump sum or by reamortizing the loan

Case Study #4

• DEF Plan made a loan to Frank for $50,000
• Frank had sufficient vested interest to cover the loan
• Unfortunately, the DEF Plan does not permit loans
Case Study #4

• Plan is subject to disqualification
• Lucky for DEF, EPCRS permits this to be self-corrected through a retroactive amendment
• DEF amends its plan to permit loans, effective as of the date that Frank took the loan
• BUT, what if Frank is an HCE?
  – Can’t be used if it predominantly benefits HCEs

Self-Correcting Plan Document Failures

Correcting Plan Document Failures: Old Rules

• Plan document failures cannot be self-corrected
  – At all
  – Ever
• Must use VCP or Audit CAP
• Plan document failure:
  – Plan provision or absence of provision that, on its face, disqualifies plan
  • Includes failure to timely adopt required interim amendment
• Failure to adopt discretionary amendment is not plan document failure (it’s an operational failure)
New Rules: Some Plan Document Failures Still Need VCP

• VCP and Audit CAP still needed for failure to adopt plan
• Qualified plan example:
  — Employer establishes 401(k) plan effective 7/1/2019 and begins accepting deferrals
  — Employer doesn’t adopt written plan document until 2020
  — Cannot self-correct
• 403(b) plan example
  — Employer has been operating 403(b) plan since 2007
  — First written plan document signed in 2018
  — Must file under VCP

New Rules: You May Self-Correct Many Plan Document Failures ... If You Don’t Dawdle

• Primary issue: Failure to timely adopt interim amendment
• Self-correction limitations:
  — It is a treated as a “significant” failure
    • Must self-correct by end of second plan year after adoption deadline
    • If IRS audits you first, it’s too late
  — You must have a “favorable letter”
    — Plan must have practices and procedures

Favorable Letter: What Does That Mean?

• Individually Designed Plan: IRS has issued determination letter to the plan
  — It doesn’t matter how recent
• Preapproved Plan: Favorable opinion letter issued with respect to “most recently expired” six-year cycle
  — DC:
    • PPA Cycle ended 1/31/2017
    • Cycle 3 ends 1/31/2023
    • Expected that restatement deadline will be 4/30/2022
  — DB:
    • PPA Cycle ends 4/30/2020; same as restatement deadline
**Case Study #5**

- Congress passes the Garbage Retirement Act of 2020 (GRA20)
- All plans must be amended to conform to the provisions of the GRA20 by 12/31/2022
- JKL Corp. fails to amend its plan by the due date
- The failure is discovered during 2023

**Case Study #5**

- The GRA20 amendment is an interim amendment
- Failure to adopt subjects the plan to disqualification
- JKL may self-correct this error by adopting the amendment, retroactive to when it was supposed to be effective
- Because this is a plan document failure, the correction must happen within the self-correction period (i.e., by 12/31/2024, assuming the JKL plan is a calendar year plan)

**Case Study #6**

- Employer is late in adopting PPA defined benefit restatement
  - Signs restatement 5/15/2020
- DB PPA Cycle ended 4/30/2020
  - Plan no longer has a “favorable letter”
- Can only correct through VCP
  - We are checking with IRS to see if this is their intention
Case Study #7

- Individually designed calendar year DB plan erroneously amended in 2019 to permit hurricane distributions
- Plan has favorable determination letter and practices and procedures
- Employer can self-correct by retroactively repealing amendment by 12/31/2021

Wait! There’s More!

Expanded Correction of Operational Failures by Plan Amendment

New Self-Correction Retroactive Amendment to Conform to Plan Operations

- Conditions:
  - Normal self-correction requirements (not necessarily “significant")
  - Satisfy three requirements:
    a) Plan amendment results in increase of a benefit, right, or feature,
    b) The increase in the benefit, right, or feature is available to all eligible employees; and
    c) Providing the increase in the benefit, right, or feature is permitted under the Code and satisfies the correction principles of EPCRS, including:
       - Reasonable and appropriate
       - Keep assets in the plan
       - Not violate another specific rule
Case Study #8

- 401(k) Plan document does not allow in-service distributions
- Operationally, plan has been allowing all participants to take distributions at age 59½
  - Not predominantly HCEs
- Plan can self-correct by retroactively amending plan to add age 59½ distribution option

Case Study #9

- Plan document does not permit individual direction of investment
- Operationally, plan has permitted participants over age 45 to direct investments
  - Assume this is nondiscriminatory
- Cannot retroactively amend under new procedure:
  - Amendment wouldn’t apply to all participants
  - If employer expands amendment to cover all participants, it wouldn’t conform to prior operations
  - File under VCP

Other Issues

- Expect more examples of insignificant failures on IRS website:
  “The IRS plans to provide additional examples illustrating whether an Operational Failure is insignificant. The additional examples will be provided on the IRS.gov website. It is expected that a link to these examples will appear on the ‘Correcting Plan Errors’ webpage on the IRS.gov website.”
- IRS still considering practitioner comments on correcting Overpayments
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

Contact Information

Ilene H. Ferenczy
Author of the Qualified Plan eSource
(678) 399-6602
ilene@ferenczylaw.com

S. Derrin Watson
Author of Who’s the Employer?
(805) 451-8713
sderrin@gmail.com

Stephen W. Forbes
Author of the Plan Corrections eSource
(720) 799-7039
stephen.forbes32@gmail.com

Timothy M. McCutcheon
Publisher of ERISApedia.com
(612) 605-2266
tmm@erisapedia.com

sales@erisapedia.com