

## Correction Primer 1: Ways to Correct Plans

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### Your Presenters Today



Alison J. Cohen



Ilene H. Ferenczy



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### Agenda

- Plan Correction History
- Understanding EPCRS
  - Self-Correction Program
  - Voluntary Correction Program
  - Audit CAP
- Voluntary Closing Agreement Program (VCAP)
- Voluntary Fiduciary Correction Program (VFCP)
- Delinquent Filer Voluntary Compliance Program (DFVCP)
- Rev. Proc. 2015-32 (for solo plans)



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Plan Correction History

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Plan Correction History

- The IRS recognizes that mistakes happen
- Because a plan needs to comply with the many rules outlined in the Internal Revenue Code to get all the benefits of tax qualification, even a simple error could be catastrophic in terms of its effect
- Between 1991 and 1998, the IRS created and maintained several different correction programs for various plan types and situations
- In 1998, the IRS introduced a comprehensive plan correction system: the Employee Plans Compliance Resolution System (“EPCRS”) – Rev. Proc. 98-22

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Plan Correction History (cont.)

- Since 1998, EPCRS went through 12 iterations, the last one being Rev. Proc. 2021-30
- Every time the IRS changes EPCRS, we do speeches about the changes
- It occurs to us, however, that there may be some folks out there who are too young to have lived through all the history ... so they feel like they are always “starting in the middle” or “have missed the boat” when discussing plan corrections.
- If this is you: THIS PRESENTATION IS FOR YOU!

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### What EPCRS Is For ...

- Actions by the plan sponsor or the plan administrator that violate Code section 401(a) risk the plan losing its tax-qualified status ("disqualification") ...
- EPCRS allows those actions to be corrected to avoid disqualification



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### If the Plan is Disqualified

- The **employer loses deductions** for nonvested contributions for "open" tax years (but will regain them when the participant vests)
- The **participant is taxed** on vested contributions in the year made for open years (if nondiscrimination or coverage, HCEs are taxed on *full accounts*)
- The **trust is no longer tax-exempt**, and must pay taxes on investment earnings

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### If the Plan is Disqualified

- Creditors of participants with money in qualified plans that become disqualified have argued (sometimes successfully) that the **funds in the plan are no longer protected** from their claims
  - [see, e.g., *Private Capital Investments v. Schollard and Schentag* (2014 case in New York)]

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## EPCRS Structure

- Three programs in increasing difficulty and cost:
  - The Self-Correction Program (SCP): Do it Yourself
  - The Voluntary Correction Program (VCP): Do it with the IRS
  - The Audit Closing Agreement Program (Audit CAP): Do it or else!

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## Correction Programs Other Than EPCRS

- Voluntary Closing Agreement Program (VCAP) – for errors that are related to taxes but not plan qualification
- Voluntary Fiduciary Correction Program (VFCP) – DOL program for certain fiduciary breaches
- Delinquent Filing Voluntary Compliance Program (DFVCP) – DOL program for late Form 5500 filings
- Revenue Procedure 2015-32 – IRS program for late Form 5500-EZ filings

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# EPCRS





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## Self-Correction Program

- EPCRS – Rev. Proc. 2021-30, Sections 7-9
- Updated with SECURE 2.0, Section 305
  - Notice 2023-43 provided some clarity on the new SCP rules
- IRS permits certain qualification failures to be resolved by the plan and its sponsors without IRS involvement
  - If done right, discovery of the failure in a later IRS audit will not cause the plan to be disqualified
  - SCP is popular because you don't have to file with the IRS
  - BUT, documentation is required for the plan's files



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## Self-Correction Program (cont.)

- SCP should only be used to correct an Eligible Inadvertent Failure
- Defined by the law to be:
  - A failure that occurs
  - Despite the existence of practices and procedures
  - That satisfies the standards of Section 4.04 of Rev. Proc. 2021-30 (which requires that the established practices and procedures be "reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements")



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### Self-Correction Program (cont.)

- Eligible Inadvertent Failures do not include:
  - Egregious failures – EPCRS examples:
    - Plan that consistently and improperly covers only HCEs
    - Plan that provides more favorable benefits to owners based on purported collective bargaining agreement
    - DC plan where contributions for HCE are several times greater than \$415 limit
  - Diversion or misuse of plan assets; or
  - Failures related to an abusive tax avoidance transaction



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### Self-Correction Program (cont.)

- Notice 2023-43 specifically excludes:
  - Failures to initially adopt a written plan or post-2008 403(b) plan
    - What about participating employers in CG/ASG plans? (We'll discuss.)
  - Failures in orphan plans
  - Significant failures in terminated plans
    - BUT: does not define "terminated plans"
  - Failure involving excess contributions to a SEP or SIMPLE IRA where the correction leaves the excess in participant's IRA
  - Failures in SEP/SIMPLE that do not use model or prototype plan document
    - Does that mean they needed to be on model/prototype document when the failure happened or upon correction?
  - Failures under IRC §409 in ESOPs (and, especially §409(p)) that involve tax consequences other than disqualification



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### Self-Correction Program (cont.)

- Time window to self-correct:
  - Notice 2023-43 requires that the failure be corrected within a reasonable period after identification
  - "Reasonable period" is facts and circumstances determination
  - Notice provides that time is "deemed reasonable" if correction occurs by last day of 18th month following failure identification
    - This should be a "safe harbor"
    - This means you're racing against the clock that the IRS won't catch the plan
- More to come in *Correction Primer 2*

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### Framing a Correction

- Rev. Proc. 2021-30 provides several proposed corrections for common errors
- If those corrections don't work for some reason, the procedure also provides:
  - Correction principles: considerations that should be taken into account when creating a correction
  - Some discussions of corrections that are not appropriate



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### Voluntary Correction Program (cont.)

- VCP filing must be submitted to the IRS for approval (EPCRS Sections 10-11)
  - Filings must be done electronically through [www.pay.gov](http://www.pay.gov)
  - Filing should contain all necessary forms and exhibits based on the type of failure
    - Subsequent classes will go into detail of the contents of each type of filing



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### Voluntary Correction Program (cont.)

- VCP filing must be submitted to the IRS for approval (EPCRS Sections 10-11) (cont.)
  - Must pay the required User Fee
    - User fees are announced annually by the IRS
    - Updates are usually done in Rev. Proc. 20XX-4
    - Current fee schedule (based on assets at the end of the prior year – pull from Form 5500):

– \$0 - \$500,000	\$1,500
– \$500,001 - \$10m	\$3,000
– \$10m+	\$3,500



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### Voluntary Correction Program (cont.)

- Reasons we see plans going through VCP:
  - Missing all plan documents
  - Doesn't fit in within SCP limitations
  - Correction proposed doesn't fit in nicely with approved corrections under EPCRS Appendices A & B
    - Coloring outside of the lines = VCP
  - Client likes a conservative approach or needed before prospective merger



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### Voluntary Correction Program (cont.)

- Plan Sponsor is required to fully correct the failure
  - Reminder: There are only very rare exceptions to fully correcting the failure
  - If the Plan Sponsor is not prepared to fully correct (either emotionally or financially), need to consider whether to file or not
    - Read the Penalty of Perjury statement carefully



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### Voluntary Correction Program (cont.)

- Plan Sponsor is required to fully correct the failure (cont.)
  - IRS may go radio silent for over a year (currently only at Sept. 2022 for review)
  - Negotiations need to be handled timely and carefully
  - Final Compliance Agreement includes Form 14568 and any narrative created to explain the details of the failure
  - Plan Sponsor has 150 days to complete correction, if not already done



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### Voluntary Correction Program (cont.)

- VCP has a group option (SCP doesn't)
- Suitable option for situations where there are multiple employers affected by the same failure
  - Example – Institution realizes that, due to a programming error, clients with automatic increase provision did not have participants timely/correctly increased
  - Rather than file 2,000 separate, identical VCP submissions (costing \$3,000 each), it is easier to file a single VCP submission covering all 2,000 plans at the same time



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### Voluntary Correction Program (cont.)

- Suitable option for situations where there are multiple employers affected by the same failure (cont.)
  - Cost for Group VCP - \$10,000 for the first 20 affected plans and an additional \$250 per plan thereafter. Maximum user fee is \$50,000
- We'll get into the details of VCP in Corrections Primer 2



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### Audit CAP

- Where you end up when failures are found during an IRS audit
  - EPCRS Sections 13-14
- SCP may be available at the discretion of the IRS agent
- If the failure was already being corrected within the last 18 months, still eligible for self-correction
  - No definition of what it means to be 'already being corrected'
  - Is hiring an attorney enough? Start of calculations? Basic funding?



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### Audit CAP (cont.)

- The Closing Agreement Process includes:
  - Identification of a qualification or tax issue about which you and the IRS will negotiate a resolution
    - The Closing Agreement is not needed if there is no “deal” being made – e.g., if the client is just going to pay all the taxes due
  - Negotiation of a sanction amount – a payment to the IRS in exchange for the settlement of the matter
  - A written contract whereby the client agrees to correct the error in the agreed-upon fashion and to pay the sanction and the IRS agrees to accept the correction and the sanction and to waive its rights to more money and plan disqualification



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### Audit CAP (cont.)

- Sanction Negotiations
- EPCRS provides that the sanction:
  - Is a negotiated amount;
  - Not excessive;
  - Bears a reasonable relationship to the nature, extent, and severity of the failures
  - Usually not less than the VCP fee would have been had the client filed under that program before the audit; and
  - Should consider the various factors shown on the next slides



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### Audit CAP (cont.)

- Factors for sanction negotiation:
  - Compliance culture:
    - Steps taken by Plan Sponsor to ensure no failures;
    - Steps taken to identify failures that may have occurred;
  - Extent to which correction progressed before audit was initiated;
  - Reason for the failure



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### Audit CAP (cont.)

- Factors for sanction negotiation:

- Extent of the failure:

- Number and types (HCE vs. NHCE) of employees affected;
    - Number of NHCEs who would be adversely affected if the plan was disqualified;
    - Is the failure one of discrimination, coverage, or (for DBs) §401(a)(26)?
    - How many years are involved?



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### Audit CAP (cont.)

- Normal cost of disqualification: maximum payment amount
  - Tax due by sponsor on disallowance of deduction for unvested contributions;
  - Tax due by participants on taxation of vested benefits;
  - Tax due by trust on earnings;
  - Tax due (and penalties) on amounts distributed and rolled over (disqualification disallows all rollovers)
- Latest IRS sweet spot - \$12,500 for final penalty



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### Other Correction Programs



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VCAP



- IRS Voluntary Closing Agreement Plans (VCAP)
- Not in any Rev. Prov. - find it in the IRS Manual
  - [https://www.irs.gov/irm/part7/irm\\_07-002-004](https://www.irs.gov/irm/part7/irm_07-002-004)
- Resolution for matters that can't be handled through EPCRS
  - If there are multiple matters, can request to sweep in EPCRS failures within VCAP submission
- IRS has discretion to accept any VCAP submission
- Starting 1/1/2022, can also request pre-submission conferences



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VCAP (cont.)

- Things that you can't solve with VCAP
  - Negotiation of income or excise taxes amounts, including interest owed
    - Exception: waiver of 100% excise tax under 4971(b) and 4975(b)
  - Minimum funding deficiencies or correction of prohibited transactions
    - Reduction of minimum funding deficiency can't be asked for
    - Not require correction of prohibited transaction
  - Won't be open-ended, prospective, or relate to future periods



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Voluntary Fiduciary Correction Program

- Department of Labor's only corrective program outside of Form 5500
- Voluntary Fiduciary Correction Program (VFCP) is embodied in 71 Fed Reg 20262
  - Or go see the DOL website: <https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/correction-programs>
  - Used to correct fiduciary breach/prohibited transactions, but only those listed in the Reg



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### Voluntary Fiduciary Correction Program (cont.)

- Delinquent contributions & loan payments
- Fair market interest rate loans to Party in Interest
- Below market interest rate loans
- Participant loans failing to meet amount, interest, duration, or amortization requirements
- Defaulted participant loans
- Purchase of assets by plans from Parties in Interest
- Sale of assets by plans from PII
- Holding of illiquid asset
- Payment of duplicate, excessive or unnecessary compensation
- Improper payment or expenses by plan
- Sale of assets below market

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### Voluntary Fiduciary Correction Program (cont.)

- DOL proposed 'self-correction' version of VFCP in 2022
  - Hasn't been finalized yet
  - Limited to correction of only failure to timely deposit participant contributions and loan repayments
  - Still required submission of information to DOL (just as labor intensive as VFCP)
  - Limited to corrections with:
    - Interest must be less than \$1,000
    - Must have been deposited no later than 180 days after due date
    - Plan can't be under investigation



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### Delinquent Filer Voluntary Compliance Program

- DFVCP is a DOL program designed to correct late filed Forms 5500 and 5500-SF
  - It is not for solo plans that can file Form 5500-EZ
- Instructions online at DOL:  
<https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/correction-programs/dfvcp>
- Penalties are \$750 per year (max \$1,500) for small plans
- Penalties are \$2,000 per year (max \$4,000) for large plans



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### Delinquent Filer Voluntary Compliance Program (cont.)

- Program is only available for plans that have not received a Notice of Rejection (NOR) or Notice of Intent (NOI) from DOL
  - NOR/NOI historically came with a maximum \$50,000 penalty
  - Daily penalty is \$2,670 for missed filings
  - Currently, we have been seeing penalty letters of \$180k
- Once filing is completed, then settlement is now 5% of the original penalty amount
  - So, a \$180k penalty would mean a \$9,000 settlement



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### Delinquent Filer Voluntary Compliance Program (cont.)

- Notice of Rejection – Provides a 45-day response period
  - **MUST respond, even if you file the Form 5500**
- Notice of Intent – Provides a 30-day response period
- Notice of Determination – Provides a 30-day response period
  - Final DOL notice that a plan sponsor will receive
  - If filing isn't done by the end of this window, the plan sponsor will need an attorney to file with the Office of Administrative Judges (OALJ)
- Maximum period given by court after that is 5 months to properly file



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### Rev. Proc. 2015-32

- Not a catchy name for it, sadly, but used to correct late Forms 5500-EZ
  - Ineligible if plan sponsor gets Notice CP283 from the IRS
- Penalty amount is \$500 per late submission (\$1,500 max)
- For years prior to 2016, you must indicate at the top of the Form **in red** "Delinquent return submitted under Rev. Proc. 2015-32, Eligible for penalty relief."
- DB Plan are still required to have completed Schedule B or Schedule SB, as applicable
- Must include Form 14704 with submission package



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## OUR FINAL THOUGHTS AND YOUR QUESTIONS




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- Go to ERISApedia.com WEBCAST tab to retrieve previous certificates.
- After the webcast you will be presented with a short google forms survey. Please let us know how we are doing.
- Joanne Pecina will demonstrate how to find more information on today's topic from the ERISApedia.com resources

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