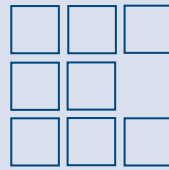


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A non-technical review of qualified retirement plan legislative and administrative issues

October 2013

How Do You Spell Relief? E-P-C-R-S

Retirement plans are complicated beasts. The Pension Protection Act of 2006 was more than 1,000 pages long; one of the main reference books that retirement plan professionals use is more than 7,000 pages long; and there are countless other sets of rules and regulations that add tens of thousands more pages. All those pages mean a lot of moving parts, and all those moving parts mean that sooner or later, something is going to fall through the cracks no matter how much attention to detail is paid.

Fortunately, the IRS recognizes that honest mistakes sometimes happen, and they have established a program that allows for correction of those mistakes. It is called the Employee Plans Compliance Resolution System or EPCRS.

A Brief History

The IRS established the first correction program back in 1991. Over the next several years, it created several other programs for different types of plans and errors. Finally in 1998, all of the various programs were consolidated into EPCRS.

Since then, the IRS has updated the program nine times, adding new corrections and adjusting methodologies along the way. Not only does this 20+ year history show the IRS commitment to voluntary correction, but it has also resulted in a mature program that provides many practical solutions.

Overview of EPCRS

The program is divided into three main parts—the Self Correction Program (SCP), the Voluntary Correction Program (VCP) and the Audit Closing Agreement Program (Audit CAP). SCP allows plan sponsors to correct certain types of mistakes on their own without seeking formal approval from the IRS, while VCP requires other types of corrections to be submitted to the IRS for its review and approval. In other words, these first two components are focused on helping plan sponsors identify and fix errors before the IRS gets involved.

Audit CAP, on the other hand, deals with the correction of mistakes once the plan is under IRS audit. Since it is preferable to address any issues before the IRS comes knocking, the remainder of this article will focus on SCP and VCP.

General Principles

Before getting into some of the specifics of how SCP and VCP work, it is helpful to understand some of the general principals of EPCRS. Essentially, the program is designed to place plan participants in the position they would have been in had the error in question not occurred in the first place. This may involve making additional contributions, revising compliance testing or reversing improper payouts.

EPCRS does include a number of sample corrections; however, it also offers the flexibility to craft custom fixes in unique situations or when one of the samples is not practical. One question that comes up from time to time is what to do about errors that go back multiple years. Although it can be inconvenient, EPCRS does require that full correction be made, including errors that may go back multiple years.

Types of Failures

EPCRS defines the following four broad categories of failures:

- **Operational Failures:** By far the most common category, an operational failure is simply a failure to follow the terms specified in the plan documents. In other words, it is an error to operate the plan in a manner that is in any way inconsistent with its provisions, even if you are being more generous.
- **Plan Document Failures:** This type of failure occurs when a plan document does not include certain mandatory language and often arises when a plan sponsor does not timely update its plan document after a law change.
- **Employer Eligibility Failures:** When a company sponsors a type of plan it is not permitted to have, an employer eligibility failure occurs. An example of this would be a for-profit company sponsoring a 403(b) plan since those plans can

only be sponsored by certain tax exempt organizations and public schools.

- **Demographic Failures:** Last but not least is the failure to satisfy certain nondiscrimination tests such as the minimum coverage test.

The type of failure is an important factor in determining which part of EPCRS can be used. For example, SCP only allows for the correction of operational failures. All other failures must be corrected using VCP.

Self Correction Program

As discussed above, SCP allows plan sponsors to correct certain operational failures on their own, without submitting anything to the IRS for approval. For operational failures that are insignificant, there is an unlimited time frame for using SCP, even if the plan is being audited.

Significant failures, however, can only be corrected via SCP within two years following the year of the failure. In other words, a significant operational failure that occurs in 2013 would have to be corrected no later than December 31, 2015. If not corrected by that date, SCP is no longer available, leaving VCP as the only option. There are also limitations on when SCP can be used to correct significant failures once the plan is under IRS audit.

You are probably wondering who gets to make the call on significance. The answer is the IRS; however, they do provide some factors to consider. These include such items as the number of participants affected by the failure, the amount of plan assets/contributions involved relative to total plan assets and whether other failures occurred.

Although there is no formal approval process, it is strongly recommended that any SCP corrections be well-documented so there is clear proof in the event of a subsequent IRS audit.

Voluntary Correction Program

VCP allows for the correction of all types of errors at any time but, as we will discuss in this section, it includes a formal process for requesting IRS approval. One advantage is that while there is a properly submitted request pending, the failure in question becomes off limits if the plan is selected for audit. However, if the IRS audits the plan before the request is submitted, the plan can no longer use VCP.

Although the VCP process is usually straightforward, it can be a lengthy process and there are some traps for the inexperienced. Even the streamlined version of VCP requires a great deal of supporting documentation. Basically, the VCP package must include several IRS forms that require a narrative description of the failure(s) that occurred as well as the steps that have been taken to correct them.

If the correction requires calculations, the package should include, at a minimum, a description of the calculations, and sometimes the IRS will request a detailed participant-by-participant breakdown to confirm that all have been made whole.

Other items that must generally be included are copies of the plan document, any amendments, applicable nondiscrimination test results and the most recently filed Form 5500.

The IRS charges a fee to review the VCP application, based on the number of participants reported on Form 5500.

Number of Participants	Fee
20 or fewer	\$750
21 – 50	\$1,000
51 – 100	\$2,500
101 – 500	\$5,000
501 – 1,000	\$8,000
1,001 – 5,000	\$15,000
5,001 – 10,000	\$20,000
Over 10,000	\$25,000

On receipt of the application, fee payment and supporting documentation, the proposed correction is assigned to an agent for review, which may include requests for clarification or additional information. Once the review is complete, the IRS issues a compliance statement indicating its acceptance of the correction. Sometimes, the review process is as short as three or four months but, other times, it can take a year or more, depending on the complexity of the situation and IRS workload.

Sample Corrections for Common Failures

Exclusion of Eligible Employee from making 401(k) Contributions

Every now and then, a plan sponsor may overlook an employee who has met plan eligibility requirements or may forget to implement a deferral election. The correction is for the employer to make a contribution on the employee's behalf to compensate him or her for the missed deferral opportunity. To the extent there was a matching contribution, that amount must be made up as well.

The first step is to determine the missed deferral opportunity based on the type of plan and the circumstances involved.

Description	Missed Deferral Opportunity (MDO)
Election not implemented	Actual amount of election
Traditional 401(k) Plan	Average of group, i.e., HCE or NHCE*
403(b) Plan	3% or amount subject to 100% match
Catch-Up	50% of limit
Safe Harbor Match	3% or amount subject to 100% match
Safe Harbor Nonelective	3%
Qualified Automatic Contribution Arrangement	Based on escalation schedule
*Highly Compensated Employee or Non-Highly Compensated Employee	

The second step is to calculate the corrective contribution based on the missed deferral opportunity from step #1 and the type of deferrals in question.

Contribution	Formula	Form
Pre-Tax Deferral	50% of MDO	QNEC*
Roth Deferral	50% of MDO	QNEC*
After-Tax Contribution	40% of MDO	QNEC*
Match	Match formula × MDO	Nonelective
*Qualified Nonelective Contribution		

The contribution along with an additional amount to compensate for lost investment gains are then deposited into the participant’s account in the plan.

If the error is insignificant or is discovered and corrected within two years, the correction can be made using SCP. On the other hand, if the error is significant and is beyond the two-year correction window, the details of the correction should be submitted to the IRS for approval under VCP.

Failure to Timely Update Plan Document for Law Changes

When Congress passes new laws that impact the retirement plan rules or the IRS/DOL update regulations, it is usually necessary to amend plan documents to reflect those changes, and there are specific time frames in which those amendments

must be adopted. Occasionally, a plan will miss the deadline, causing a plan document failure.

Since SCP can only be used to correct operational failures, this failure must be corrected via VCP. The plan sponsor simply adopts the required amendment and submits it to the IRS along with copies of any related plan documents. Depending on the nature of the missed amendment(s), the plan sponsor may be eligible for a reduced user fee of \$375 rather than the fee based on the number of plan participants.

Conclusion

EPCRS is an invaluable tool for correcting plan failures before the IRS finds them. Although many plan corrections appear straightforward, it is important to work with an experienced professional when going through the plan correction process to make sure that fixing one error doesn’t accidentally create another. With more than 20 years and 33,000 corrections under its belt, EPCRS will continue to evolve to allow plan sponsors to bring their plans back into compliance.

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Compensation
Strategies Group, Ltd.

2920 Toccoa Road
Beaumont, TX 77703