PROMOTING COMPLIANCE IN RETIREMENT PLANS
OVERVIEW OF THE EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM

INTRODUCTION

The Internal Revenue Code (Code) provides significant tax incentives for employers that establish and maintain retirement plans that comply with the requirements of the Code. Such plans include **Qualified Plans**, Tax-Sheltered Annuity arrangements that satisfy the requirements of Code section 403(b) (**403(b) Plans**), Simplified Employee Pension Plans (**SEPs**), and Savings Incentive Match Plan for Employees (**SIMPLE Individual Retirement Account (IRA) Plans**). Generally, under these plans, income that is set-aside for retirement may be currently deductible by the employer, and is not currently taxable to the employee until distributed from the plan. By statute, an employer that does not properly maintain a Qualified Plan, 403(b) Plan, SEP or SIMPLE IRA Plan loses entitlement to those tax incentives, and the employees, whose funded benefits have enjoyed tax-free build-up, lose the right to protect those benefits from current taxation.

The Internal Revenue Service (IRS) is responsible for administering the provisions of the Code relating to Qualified Plans, 403(b) Plans, SEPs and SIMPLE IRA Plans. Employee Plans (EP) of the Tax-Exempt and Government Entities Operating Division of the IRS has established a system of programs designed to enable an employer that maintains a plan that has experienced a problem with an applicable Code requirement to correct the problem and simultaneously preserve the tax benefits available for employers and employees. This system is called the Employee Plans Compliance Resolution System (**EPCRS**).

EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS)

Description of the EPCRS
Effect of the EPCRS
Eligibility, Definitions and General Correction Principles
Self-Correction Program
Voluntary Correction Program
Audit Closing Agreement Program
Frequently Asked Questions (FAQ's)

Description of the EPCRS

The ECPRS is a comprehensive system of correction programs for sponsors of **Qualified Plans**, **403(b) Plans**, **SEPs** and **SIMPLE IRAs** that have not met applicable Code requirements for a period of time. This system permits **Plan Sponsors** to correct **Qualification Failures** and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The three components of the EPCRS are:

(1) the Self-Correction Program (**SCP**), which permits plan sponsors to correct certain plan failures without contacting the IRS,

(2) the Voluntary Correction Program (**VCP**), which permits a plan sponsor to, any time before audit, pay a limited fee and receive the Service's approval for correction of plan failures, and

(3) the Audit Closing Agreement Program (**Audit CAP**), which permits a plan sponsor to pay a sanction and correct a plan failure while the plan is under audit.

Effect of the Employee Plans Compliance Resolution System (EPCRS)

- Effect of EPCRS on **Qualified Plans**. If the applicable eligibility requirements are satisfied and the **Plan Sponsor** corrects a **Qualification Failure** in accordance with the applicable requirements of the correction program, the IRS will not treat the Qualified Plan as failing to meet § 401(a). Thus, for example, if the Plan Sponsor corrects the failures, the plan will be treated as satisfying § 401(a) for purposes of applying § 3121(a)(5) (FICA taxes) and § 3306(b)(5) (FUTA taxes).

- Effect of EPCRS on **403(b) Plans**. If the applicable eligibility requirements are satisfied and the **Plan Sponsor** corrects a failure in accordance with the applicable requirements of EPCRS, the Service will not treat the retirement plan as failing to meet § 403(b). Thus, for example, if the Plan Sponsor corrects the failures, the plan will be treated as satisfying § 403(b) for purposes of applying § 3121(a)(5) (FICA taxes) and § 3306(b)(5) (FUTA taxes).

  Excise taxes. Generally, Excise taxes, if applicable, that result from a failure are not waived merely because the failure has been corrected. However, **Rev. Proc. 2006-27** provides the following exceptions for Excise Taxes.

  1) As part of **VCP** and **Audit CAP**, if the failure involves the failure to satisfy the minimum required distribution requirements of § 401(a)(9), in appropriate cases, the Service will waive the excise tax under § 4974 applicable to plan participants. The Plan Sponsor, as part of the submission, must request the waiver and in cases where the participant subject to the excise tax is an owner-employee, the Plan Sponsor must also provide an explanation supporting the request.

  2) As part of VCP, if the failure involves a correction that requires the Plan Sponsor to make a plan contribution that is not deductible, the Service will waive the excise tax under § 4972 on such nondeductible contributions, in appropriate cases.

  3) As part of VCP, in appropriate situations, if a failure results in excess contributions as defined in §4979(c) or excess aggregate contributions as defined in §4979(d) under a plan, the Service will not pursue the excise tax under § 4979 in appropriate cases, e.g., where correction is made for any case in which the ADP test was timely performed but, due to reliance on inaccurate data, resulted in an insufficient amount of excess elective contributions having been distributed to HCEs.

- Effect of EPCRS on **SEPs** and **SIMPLE IRA Plans**. If the applicable eligibility requirements are satisfied and the **Plan Sponsor** corrects a failure to satisfy the requirements of § 408(k) for a SEP or § 408(p) for a SIMPLE IRA Plan in accordance with the applicable requirements of EPCRS, the IRS will not treat the SEP or SIMPLE IRA Plan as failing to meet § 408(k) or § 408(p), as applicable. Thus, for example, if the Plan Sponsor corrects the failures, the plan will be treated as satisfying § 408(k) or § 408(p), as applicable, for purposes of applying § 3121(a)(5) (FICA taxes) and § 3306(b)(5) (FUTA taxes).

Components of the Employee Plans Compliance Resolution System (EPCRS)

The EPCRS is currently set forth in **Rev. Proc. 2006-27**.

The correction programs that comprise the EPCRS are designed to encourage **Plan Sponsors** to be vigilant in properly maintaining their retirement plans. The programs may be divided into three tiers, which reward plan sponsors that prudently monitor their retirement plans, and ensure that participant benefits are properly paid, thereby minimizing harm to employees. The three tiers are:

(1) self-correction, for which there is no fee, submission, or reporting requirements (the Self-Correction Program (**SCP**));

(2) voluntary correction with IRS approval, for which there is a limited fee (the Voluntary Correction Program (**VCP**)); and

(3) correction on audit, for which there is a higher fee (sanction) that is negotiated with the IRS (the Audit Closing Agreement Program (**Audit CAP**)).

Eligibility, Definitions, and General Correction Principles

Eligibility Requirements

- EPCRS Correction Programs Chart

Definitions

- 403(b) Plans (Tax-Sheltered Annuities)
- Abusive Tax Avoidance Transaction (ATAT)
- Demographic Failures
- Egregious Failures
- Employer Eligibility Failures
- Favorable Letter
- Master or Prototype and Volume Submitter Plans
- Operational Failures
- Plan Document Failures
- Plan Sponsor
- Qualification Failures
- Qualified Plans
- SIMPLE IRA Plans
- Simplified Employee Pensions (SEPs)
- Under Examination

General Correction Principles

- Restoration of Benefits
- Reasonable and Appropriate Correction
- Correction Allocations and Corrective Distributions
- Special Exceptions to Full Correction
- Reporting
- Matters Subject to Excise Taxes

Eligibility Requirements

Eligibility under **EPCRS** is limited to failures under **Qualified Plans**, **403(b) Plans**, **SEPs** and **SIMPLE IRA Plans** that do not involve the misuse or diversion of assets from the plan. The eligibility requirements for each program, and the differences among the programs, are discussed in more depth within the context of each correction program. (See, **EPCRS Correction Programs Chart**, for a quick comparison of each correction program.)

Whether a particular plan is eligible for a particular correction program is a function of the interaction of different factors, including: (1) the type of plan involved, (2) whether the plan or plan sponsor is **Under Examination**, (3) the type of failure involved, (4) whether the failure is an **Egregious Failure**, (5) whether the plan or plan sponsor was, or may have been, a party to an abusive tax avoidance transaction (**ATAT**), (6) whether the plan is the subject of a **Favorable Letter**, (7) the type of correction proposed (e.g., correction through plan amendment), and (8) whether the failure involves a misuse or diversion of plan assets. The following chart illustrates the program eligibility requirements for each of the correction programs, and the interaction of these factors.

EPCRS CORRECTION PROGRAMS CHART

Program	Self-Correction Program-Insignificant Failures	Self-Correction Program-Significant Failures	Voluntary Correction Program	Audit Closing Agreement Program
Plans Eligible	Qualified Plans, 403(b) Plans, SEPs and SIMPLE IRA Plans	Qualified Plans and 403(b) Plans only	Qualified Plans, 403(b) Plans, SEPs and SIMPLE IRA Plans	Qualified Plans, 403(b) Plans, SEPs and SIMPLE IRA Plans
Eligible Failures	Operational	Operational	Operational, Plan Document & Demographic	Operational, Plan Document & Demographic
Egregious Failures Eligible	No	No	Yes	Yes
Abusive Tax Avoidance Transaction	Yes, if the failure is unrelated to the ATAT	Yes, if the failure is unrelated to the ATAT	Yes, if the failure is unrelated to the ATAT	Yes, if the failure is unrelated to the ATAT
Failures involving misuse or diversion of plan assets	Not eligible	Not eligible	Not eligible	Not eligible
Plan under EP exam or investigation by CI, or Employer under EO exam	Available if under EP exam	Available if under EP exam in limited instances	Not eligible	Eligible
Favorable Letter required	No	Yes	No	No
Fee/sanction	None	None	Generally a fixed fee depending on the size of plan Egregious failures - sanction up to 40% of maximum payment amt.	Negotiated sanction based on maximum payment amount
Written IRS Approval	No	No	Yes	Yes

You may submit questions about EPCRS via e-mail at RetirementPlanQuestions@irs.gov

Note: All questions submitted via e-mail must be responded to via telephone, so please remember to include your phone number in your message

You may also visit our Web site at www.irs.gov/ep

DEFINITIONS

403(b) Plans

A 403(b) plan is a retirement plan under which a public school or an organization described under IRC section 501(c)(3) and exempt from tax under section 501(a) purchases annuity contracts or contributes to custodial accounts for its employees. It also includes a retirement income account under which contributions are made by or on behalf of certain ministers and employees of a church. Section 403(b) plans are exempt from the requirements applicable to qualified annuity plans under IRC section 403(a) and are governed by their own separate requirements under IRC section 403(b) .

Section 403(b) plans are also known as:

- 403(b) arrangements
- tax-sheltered annuities
- tax-deferred annuities
- annuity contracts

Contributions to a 403(b) plan may consist of:

- salary reduction,
- non-salary reduction,
- after-tax employee contributions, or
- some combination of the above.

In a salary reduction 403(b) plan, an employer gives participants a choice between receiving an amount in cash or having the employer contribute that amount to the 403(b) plan. Contributions made to a 403(b) plan are generally not includible for income tax purposes in participants' gross income until distributed. Earnings on contributions are also tax-deferred until distributed.

Note that proposed regulations for 403(b) plans are scheduled to become effective for tax years beginning on or after December 31, 2006.

Abusive Tax Avoidance Transaction (ATAT)

An abusive tax avoidance transaction (ATAT) means any listed transaction under § 1.6011-4(b)(2) and any other transaction identified as an abusive transaction in the IRS web site entitled “EP Abusive Tax Transactions”.

(see http://www.irs.gov/retirement/article/0,,id=118821,00.html)

Demographic Failure

A Demographic Failure means the failure to satisfy the nondiscrimination requirements of the Code (e.g., Code sections 401(a)(4), 410(b), or 401(a)(26)) with respect to a **Qualified Plan**, **403(b) Plan**, **SEP** or **SIMPLE IRA Plan**.

Egregious Failures

An egregious failure is one that involves a flagrant disregard of the applicable requirements under the Code. For example, any of the following would be considered egregious: (a) a plan has consistently and improperly covered only highly compensated employees; (b) a plan provides more favorable benefits for an owner of the employer based on a purported collective bargaining agreement where there has in fact been no good faith bargaining between bona fide employee representatives and the employer (see Notice 2003-24, 2003-18 I.R.B. 853, with respect to welfare benefit funds); or (c) a contribution to a defined contribution plan for a highly compensated individual is several times greater than the dollar limit set forth in § 415. **SCP** is not available to correct Operational Failures that are egregious. **VCP** is available to correct egregious failures; however, these failures are subject to the fees described in section 12.06. **Audit CAP** is available to correct egregious failures.

Employer Eligibility Failure

With respect to a **Qualified Plan**, an Employer Eligibility Failure means the adoption of a plan intended to be a Qualified Plan by an employer that was not eligible to maintain a qualified plan (e.g., a tax-exempt entity that adopted a 401(k) plan during the 1987-1996 plans years, inclusive, or a government entity).

With respect to a **403(b) Plan**, an **Employer Eligibility Failure** means any of the following:

(1) The adoption of a plan intended to satisfy the requirements of § 403(b) by an employer that is not a tax-exempt organization described in § 501(c)(3) or a public educational organization described in § 170(b)(1)(A)(ii);

(2) A failure to satisfy the nontransferability requirement of § 401(g);

(3) A failure to initially establish or maintain a custodial account as required by § 403(b)(7); or

(4) A failure to purchase (initially or subsequently) either an annuity contract from an insurance company (unless grandfathered under Rev. Rul. 82-102, 1982-1 C.B. 62) or a custodial account from a regulated investment company utilizing a bank or an approved non-bank trustee/custodian.

With respect to a **SEP** or **SIMPLE IRA Plan**, an Employer Eligibility Failure means the adoption or maintenance of a plan intended to be a SEP or SIMPLE IRA Plan by an employer that was not eligible to maintain such plan (e.g., an employer that has more than 100 employees who adopts a SIMPLE IRA Plan).

Favorable Letter

Many employers desire advance assurance that the terms of their plans satisfy the qualification requirements. The Internal Revenue Service provides such advance assurance by means of the determination letter program. A favorable determination letter indicates that, in the opinion of the IRS, the terms of the plan conform to the requirements of IRC section 401(a). A favorable determination letter expresses the IRS's opinion regarding the form of the plan document. However, to be a qualified plan under IRC section 401(a) entitled to favorable tax treatment, a plan must satisfy, both in form and operation, the requirements of IRC section 401(a), including nondiscrimination and coverage requirements. A favorable determination letter may also provide assurance, on the basis of information and demonstrations provided in the application, that the plan satisfies certain of nondiscrimination and coverage requirements in form or operation. A plan sponsor may also receive assurance that the terms of the plan satisfy the requirements of the Code through the adoption of a **Master or Prototype or Volume Submitter Plan**.

Master or Prototype and Volume Submitter Plans

Master or Prototype and Volume Submitter Plans are retirement plans that have been pre-approved by the government for use by adopting employers. In certain cases, if an employer adopts a prototype or volume submitter plan, the employer is not required to submit for a determination letter in order to have reliance as to the qualified status of the plan document. (See "**Favorable Letter**" for more information on determination letters.)

Operational Failure

With respect to **Qualified Plans**, **SEPs** and **SIMPLE IRA Plans**, an Operational Failure is generally the failure to follow the terms of the plan document. Some of the more common Operational Failures include: (1) the failure to permit employees to participate in the plan on a timely basis, (2) the failure to limit contributions made to the plan to the level permitted by law, and (3) the failure to apply the correct plan definition of compensation when determining benefits owed under the plan.

An **Operational Failure in a 403(b) Plan** is any failure to satisfy the requirements of section 403(b) that is listed in section **5.02(2)(a) of Rev Proc. 2006-27**. Some of the more common operational failures include: (1) the failure to satisfy the universal availability of salary reduction contributions, (2) failures involving contributions or allocations of **Excess Amounts**, and (3) the failure to pay minimum required distributions at, generally, age 70 1/2.

Plan Document Failure

A **Plan Document Failure** is the failure of any plan provision, on its face, to satisfy the Code requirements for **Qualified Plans**, **SEPs** or **SIMPLE IRA Plans**. Currently, there is no Plan Document Failure under a **403(b) Plan**, as there is no Code requirement that a 403(b) Plan have a plan document.

Plan Sponsor

The term “Plan Sponsor” means the employer that establishes or maintains a **Qualified Plan**, **SEP**, or **SIMPLE IRA Plan** for its employees. With respect to a **403(b) Plan**, the term "Plan Sponsor" means the employer that offers a 403(b) Plan to its employees.

Qualification Failures

With respect to **Qualified Plans,** the EPCRS is available to correct any failure to satisfy the Code requirements that adversely affects the qualification of the plan.

There are four types of **Qualification Failures** in a Qualified Plan:

(1) **Demographic Failures,**

(2) **Employer Eligibility Failures**,

(3) **Operational Failures**, and

(4) **Plan Document Failures**.

With respect to a **SEP**, a **Qualification Failure** is a failure to satisfy the requirements of section 408(k) of the Code. A Qualification Failure for a **SIMPLE IRA Plan** is a failure to satisfy the requirements of 408(p) of the Code. There are generally four types of Qualification Failures that apply to SEPs and SIMPLE IRA Plans. They include: (a) **Plan Document Failures**, (b) **Operational Failures**, (c) **Demographic Failures**, and **Employer Eligibility Failures**.

With respect to **403(b) Plans**, the EPCRS is available to correct the following failures:

(1) **Operational Failures in a 403(b) Plan**,

(2) **Demographic Failures**, and

(3) **Employer Eligibility Failures in a 403(b) Plan**.

Qualified Plans

A Qualified Plan is, generally, a funded retirement plan that satisfies the requirements of Code § 401(a) or § 403(a). Qualified plans include pension plans, profit-sharing plans (including section 401(k) plans), and annuity arrangements. Contributions to a 401(a) plan may consist of salary reduction, non-salary reduction, after-tax employee contributions, or some combination of the above. Under a Qualified Plan, employer contributions to the plan may be deductible by the employer, and accrue tax-free until distributed from the plan to the employee. In certain instances, such as elective contributions to a § 401(k) plan, contributions are not currently includible in the employee's taxable income. In general, to be qualified under Code § 401(a) or § 403(a), a plan must be in writing and satisfy requirements relating to the timing and amount of contributions and distributions, the timing and number of employees participating in the plan, nonforfeitability requirements, nondiscrimination requirements, and rules pertaining to the entitlement of the participant's spouse to benefits under the plan. Thus, a qualified plan must satisfy the requirements of the Code both in form and in operation. If the plan does not satisfy Code section 401(a) for any reason, it is disqualified.

Under EP's Determination Letter Program, **Plan Sponsors** may submit their retirement plans to the IRS for review of the terms of their plans. If the plan meets the qualification requirements under IRC section 401(a), a favorable determination letter is issued to the plan sponsor. (For more information, see **Pub 794**.) In certain instances, an employer may adopt a **Master or Prototype or Volume Submitter Plan** and obtain reliance that its plan meets the requirements of the Code without having to submit to the IRS for a determination letter.

Although a **Favorable Letter** from the IRS is not required for a plan to be qualified under Code section 401(a), under certain instances, it is required in order to be eligible for relief under the EPCRS. (See **Significant Operational Failures under the Self-Correction Program for when a Favorable Letter** is required for relief under EPCRS).

SIMPLE IRA Plans

A SIMPLE IRA Plan is a Savings Incentive Match Plan for Employees. It provides small employers with a simplified method to make contributions toward their employees' retirement and, if self-employed, their own retirement. Under a SIMPLE IRA plan, employees may choose to make salary reduction contributions to the plan rather than receiving these amounts as part of their regular pay. In addition, the employer makes matching or nonelective contributions. All contributions are made directly to an Individual Retirement Account or Annuity (IRA) set up for each employee (a SIMPLE-IRA).

Contributions made to a SIMPLE IRA Plan are generally not includible for income tax purposes in participants' gross income until distributed, even if, in the case of salary reduction contributions made to a SIMPLE IRA Plan, participants had the ability to receive the contributions as taxable wages in the year of the contributions. Earnings on contributions are also tax-deferred until distributed.

See IRS ***Publication 560***, IRS ***Publication 590***, **Notice 98-4** and the Instructions for the Employer and Employee in ***Form 5304-SIMPLE*** and ***Form 5305-SIMPLE*** for detailed information on SIMPLE IRA plans.

Simplified Employee Pensions (SEPS)

A SEP is a plan intended to satisfy the requirements of § 408(k). A SEP is a Simplified Employee Pension plan that an employer may use to make contributions to a retirement plan for its employees. Instead of setting up a qualified plan with an attendant trust, an employer may adopt a SEP plan and make contributions directly to a traditional Individual Retirement Account (IRA) set up for each employee.

A Salary Reduction Simplified Employee Pension (SARSEP) is a SEP that was established before 1997 that includes a salary reduction arrangement. Under a SARSEP, employees can choose to have the employer contribute part of their pay to their Individual Retirement Account or Annuity (IRA) set up under the SARSEP. A SARSEP may not be established after 1996. However, for SARSEPs set up before 1997, employees hired after 1996 may participate.

Contributions made to a SEP or SARSEP are generally not includible for income tax purposes in participants' gross income until distributed, even if, in the case of salary reduction contributions made to a SARSEP, participants had the ability to receive the contributions as taxable wages in the year of the contributions. Earnings on contributions are also tax-deferred until distributed.

See IRS ***Publication 560*** and IRS ***Publication 590*** and the Instructions for the Employer and Employee in ***Form 5305A-SEP*** and ***Form 5305-SEP*** for detailed information.

Under Examination

Some of the correction programs are not available if the **Plan Sponsor** has received verbal or written notification that the plan sponsor or its plan is Under Examination.

The term Under Examination means, generally,

(1) a plan that is under an Employee Plans examination (EP Exam), that is, an examination of a Form 5500 series or other Employee Plans examination,

(2) a plan sponsor that is under an Exempt Organizations examination (EO Exam), that is, an examination of a Form 990 series or other Exempt Organizations examination, or

(3) a plan that is under investigation by the Criminal Investigation Division of the Internal Revenue Service (CI).

For purposes of EPCRS, a plan may be considered to be Under Examination, and thus not eligible for some of the voluntary correction procedures, if, during the review process of a determination letter application, an agent notifies the Plan Sponsor of possible **Qualification Failures** or requests information from the plan sponsor that results in the plan sponsor discovering a Qualification Failure.

Example: During the review of a determination letter application, an EP agent requests from the plan sponsor evidence of the timely adoption of prior plan amendments. As a result of the agent's inquiry, the plan sponsor discovers that the plan was amended after the applicable amendment deadline. The failure to timely amend the plan was discovered as a result of an inquiry of the EP agent, and, for purposes of the Voluntary Correction Program **(VCP)**, is not considered to have been voluntarily discovered by the plan sponsor. Therefore, the failure is not eligible for submission under the VCP.

Notification of EP or EO Exam

- EP Exams include cases where the plan sponsor has received verbal or written notification from the Employee Plans Division of an impending Employee Plans examination, or of an impending referral for an Employee Plans examination.

- EP Exams include those cases that were under an EP Exam and are now in appeals or litigation.

- EP Exams include cases in which the plan sponsor submitted a determination letter application and an Employee Plans Agent (EP Agent) notifies the plan sponsor of a possible failure.

- When plans or arrangements are aggregated for purposes of meeting the qualification requirements of Code section 401(a) or the requirements of Code section 403(b) with other plans or arrangements that are under an EP Exam, these plans and arrangements also are considered under EP Exam.

- EO Exams include cases where the plan sponsor has received verbal or written notification from the Exempt Organizations Division of an impending Exempt Organizations examination or of an impending referral for an Exempt Organizations examination.

- EO Exams include any plan sponsor that has been under an Exempt Organizations examination and is now in Appeals or in litigation for issues raised in an Exempt Organizations examination.

Insufficient Notification of an EP Exam

- An initial request for copies of Forms 5500 by an EP agent, in anticipation of conducting an examination, is not necessarily notification of an EP Exam for purposes of the **EPCRS**.

Note that it is a facts and circumstances determination as to whether a request for follow-up information (including a request for documents and records) reaches the level where the Plan Sponsor has received verbal or written notification of an EP, EO, or a CI Exam. To be considered sufficient notice, both the plan and the year of examination must be identified in the notification of impending examination.

Under Examination – Group Submission

A Sponsor of a master or prototype plan, a Volume Submitter practitioner, an insurance company or other entity that has issued annuity contracts or provides services with respect to assets for 403(b) Plans, or an entity that provides its clients with administrative services with respect to Qualified Plans, 403(b) Plans (an "Eligible Organization") may submit a VCP request for a Qualified Plan, a 403(b) Plan, a SEP, or a SIMPLE IRA Plan for Operational and Plan Document Failures under a **Group Submission Procedure**.

If a **Plan Sponsor** of a plan that is eligible to be included under the Group Submission Procedure is notified of an impending Employee Plans examination after the Eligible Organization filed the Group Submission Procedure application, the Plan Sponsor's plan will be included in the Group Submission Procedure. However, with respect to that plan, the Group Submission Procedure will not preclude or impede an examination of the plan with respect to any failures not identified in the Group Submission Procedure application at the time the plan comes Under Examination

General Correction Principles

To be eligible for the EPCRS, the IRS requires that the failure be corrected. The correction principles listed below are applicable to all of the correction programs comprising EPCRS. See **Rev. Proc. 2006-27, section 6,** for a more complete description of correction principles applicable under EPCRS.

- Generally, full correction is required with respect to all participants and beneficiaries, and for all taxable years (including closed years) but see **Special Exceptions to Full Correction**.

Restoration of benefits

- The plan should be restored to the position it would have been in had the failure not occurred
- Current and former participants and beneficiaries should be restored to the benefits and rights they would have had if the failure not occurred.

Reasonable and appropriate correction

- The correction should be reasonable and appropriate for the failure.
- There may be more than one reasonable and appropriate correction for the failure.
- Any correction method set forth in **Appendix A** or **Appendix B** of **Rev. Proc. 2006-27** is deemed to be a reasonable and appropriate method for correcting the related failure.
- The correction method should, to the extent possible, resemble one already provided for in the Code, Income Tax Regulations, or other guidance of general applicability.
- The correction method for failures relating to nondiscrimination should provide benefits for nonhighly compensated employees. (For example, the correction of a failure to satisfy the Actual Deferral Percentage (ADP), Actual Contribution Percentage (ACP), or Multiple Use Tests of Code section 401(k) and (m) solely by distributing **Excess Amounts** to highly compensated employees would not be the typical means of correcting such a failure.)
- The correction method should keep plan assets in the plan.

- The correction method should not violate another applicable specific requirement of the Code or a parallel requirement in Part 2 of Title I of ERISA (for plans that are subject to ERISA)

Corrective allocations and corrective distributions

- Corrective allocations under a defined contribution plan should be based upon the terms of the plan and other applicable information at the time of the failure.

- Corrective allocations under a defined contribution plan should be adjusted for earnings and forfeitures that would have been allocated to the participant's account if the failure had not occurred.

- A corrective allocation to a participant's account because of a failure to make a required allocation in a prior limitation year will be considered an annual addition for the limitation year to which the corrective allocation relates, as opposed to the year in which correction is made. (However, the normal rules of section 404, regarding deductions, apply.)

- Corrective allocations should come only from employer contributions.

- In the case of a defined benefit plan, a corrective distribution for an individual should be increased to take into account the delayed payment, consistent with the plan's actuarial adjustments.

Special exceptions to full correction

- Special exceptions to full correction exist regarding:

    - the use of reasonable estimates,
    - the delivery of small benefits,
    - recovery of small overpayments
    - locating lost participants,
    - small excess amounts,
    - failures related to orphan plans

Reporting

- Any distributions from the plan should be properly reported.

Matters subject to excise taxes

Generally, excise taxes, FICA taxes, and FUTA taxes (and corresponding withholding obligations), if applicable, that result from a failure are not waived merely because the failure has been corrected. However, **Rev. Proc. 2006-27** provides the following exceptions for Excise Taxes.

- As part of VCP and Audit CAP, if the failure involves the failure to satisfy the minimum required distribution requirements of § 401(a)(9), in appropriate cases, the Service will waive the excise tax under § 4974 applicable to plan participants. The Plan Sponsor, as part of the submission, must request the waiver and in cases where the participant subject to the excise tax is an owner-employee, the Plan Sponsor must also provide an explanation supporting the request.

- As part of VCP, if the failure involves a correction that requires the Plan Sponsor to make a plan contribution that is not deductible, the Service will waive the excise tax under § 4972 on such nondeductible contributions, in appropriate cases.

- As part of VCP, in appropriate situations, if a failure results in excess contributions as defined in §4979(c) or excess aggregate contributions as defined in §4979(d) under a plan, the Service will not pursue the excise tax under § 4979 in appropriate cases, e.g., where correction is made for any case in which the ADP test was timely performed but, due to reliance on inaccurate data, resulted in an insufficient amount of excess elective contributions having been distributed to HCEs.

The Self-Correction Program (SCP)

Links to Rev. Proc. 2006-27 with respect to the SCP
SCP -- General Description Qualified Plans and 403(b) Plans SEPs and SIMPLE IRA Plans
SCP -- Eligibility Requirements
Failures not eligible for the SCP
Insignificant Operational Failures under the SCP .
Significant Operational Failures under the SCP

Self-Correction Program (SCP) - Direct Links to Rev. Proc. 2006-27

- For an introduction to the Employee Plans Compliance Resolution System (EPCRS) and a description of the most recent enhancements, see Part I **(**sections 1 and 2**)**.
- For information relating to the effect of EPCRS and the extent of reliance provided by EPCRS, see **Part II, section 3**.
- For information relating to eligibility under the SCP, see **Part II, section 4**.
- For definitions, correction principles, and rules of general applicability, see Part III**, sections 5** and **6**.
- For a description of the SCP, see Part IV, Self-Correction **(Sections 7- 9)**.
- To view sample operational failures and acceptable correction methods for those failures, see **Appendix A** and **Appendix B**.

Self-Correction Program (SCP) -- General Description

Qualified Plans and 403(b) Plans. The SCP permits sponsors of **Qualified Plans** and **403(b) Plans** for which sufficient compliance practices and procedures have been established to self-correct an insignificant operational problem at any time, preserve the tax-favored status of the plan, and pay no fee. Even where the problem is significant, a conscientious **Plan Sponsor** who, within two years of the year in which the problem occurs, both uncovers an operational problem and corrects it to a substantial degree, may preserve the tax-favored status of the plan and pay no fee. There are no application or reporting requirements under the SCP. The relief under the SCP is limited to **Operational Failures**.

SEPs and SIMPLE IRA Plans. The SCP permits sponsors of **SEPs** and **SIMPLE IRA Plans** for which sufficient compliance practices and procedures have been established to self-correct an insignificant operational problem at any time, preserve the tax-favored status of the plan, and pay no fee. There are no application or reporting requirements under the SCP. The relief under the SCP is limited to **Operational Failures**.

Under the SCP:

- The **Plan Sponsor** effects correction using the **General Correction Principles** set forth in **Rev. Proc. 2006-27**.

- A plan sponsor that corrects a failure listed in and in accordance with the correction methods included in **Appendix A** or **Appendix B** of **Rev. Proc. 2006-27** may be certain that the correction effected is reasonable and appropriate for the failure.

- If needed, the plan sponsor effects changes to its administrative procedures to insure the failures do not recur.

In addition, for Qualified Plans and 403(b) Plans:

- A plan sponsor may correct **Significant Operational Failures** within two years of the end of the plan year in which the **Operational Failures** occurred.

- If a plan sponsor does not correct **Operational Failures** in its plan(s) within the two-year self-correction period, the Self-Correction Program may be used if, considering all of the facts and circumstances, the failures, in the aggregate, are **Insignificant Operational Failures**.

When using SCP, the **Plan Sponsor** should maintain adequate records to demonstrate correction in the event of an audit of the plan.

Self-Correction Program (SCP) -- Eligibility Requirements

- To correct **Insignificant Operational Failures**, the plan must have been intended to be a **Qualified Plan**, **403(b) Plan**, **SEP**, or **SIMPLE IRA Plan**.

- To correct **Significant Operational Failures**, the plan must have been intended to be a **Qualified Plan** or **403(b) Plan**.

- Full correction must occur for all years of the failures, but see, "**Special Exceptions to Full Correction**."

- The failure must be an **Operational Failure**.

- The plan or arrangement must have established practices and procedures (see **SCP Q&A 2, "What practices and procedures are required to be in place in order for a plan to be eligible for correction under the SCP"**).

- Practices and procedures must have been followed, and the failure arose due to an oversight or a mistake in applying them, or due to an inadequacy in the procedures.

    - Additional eligibility requirements relating to Significant Operational Failures:

        - the **Plan Sponsor** must have received a **Favorable Letter** with respect to the plan

Neither the plan nor the Plan Sponsor (in the case of a tax-exempt employer) may be **Under Examination** (but see "**Substantial Completion of Correction**" under "**Significant Operational Failures under the Self-Correction Program**".)

Failures not Eligible for the Self-Correction Program (SCP)

- **Egregious Failures**.
- The plan or plan sponsor is, or was a party to an **ATAT**.
- **Plan Document Failures**
- **Demographic Failures**
- **Employer Eligibility Failures**
- Failures for which the **Plan Sponsor** corrects by a plan amendment that conforms the terms of the plan to the plan's prior operations – with limited exceptions (see **section 4.05(2) of Rev. Proc. 2006-27**).
- Failures involving the misuse or diversion of plan assets

Insignificant Operational Failures under the Self-Correction Program (SCP)

If a **Plan Sponsor** does not correct **Operational Failures** in its plan(s) within the two-year self-correction period, the plan may nevertheless be eligible for relief under the **SCP** if, considering all of the facts and circumstances, the failures are insignificant in the aggregate. **Insignificant Operational Failures** may be corrected any time up to and including the time the plan or plan sponsor comes **Under Examination**.

Questions to consider in determining whether failures are insignificant:

- How many Operational Failures occurred?
- For how many years did the Operational Failures occur?
- What percentage of plan assets and contributions were involved in the failures?
- What percentage of all the participants who could have been affected by the failures were affected by the failures?
- What percentage of all the participants in the plan or arrangement were affected by the failures?
- Was correction made within a reasonable time after discovery of the failure?
- Was correction of the failures completed or substantially completed prior to an audit of the plan (or, if applicable, the tax-exempt employer)?
- What were the reasons for the failures?

This list is not all-inclusive and no single factor is determinative. Failures will not be considered significant merely because they occur in more than one year. In addition, the IRS will apply these factors in a way so as to not preclude small businesses from being eligible for the SCP merely because of their size.

Significant Operational Failures under the Self-Correction Program (SCP)

Two-year correction rule. A **Plan Sponsor** may correct significant **Operational Failures** within two years of the plan year in which the Operational Failures occurred. Under this two-year self-correction rule, there is no limitation on the number of failures or the number of times SCP can be used; however, repetitive failures from year to year may be considered indicative of a lack of the appropriate practices and procedures that are requisite for eligibility under the program (see **SCP Q&A 2, "What practices and procedures are required to be in place in order for a plan to be eligible for correction under the Self-Correction Program"**). (See, also, "**Egregious Failures**.")

ADP, ACP, and Multiple Use Failures. In cases involving failures of the Actual Deferral Percentage (ADP), Actual Contribution Percentage (ACP), or Multiple Use Tests of Code section 401(k) and (m), the plan year for which the **Operational Failure** occurs is the plan year that includes the last day of the additional one-year statutory correction period permitted under Code section 401(k)(8) and or 401(m)(6). Thus, under the two-year correction period, a **Plan Sponsor** may correct by the end of the 2008 plan year a failure of the ADP test with respect to elective deferrals made during plan year 2005.

Effect of examination. In any event, the correction period for an Operational Failure that occurs for any plan year ends on the first date the plan or **Plan Sponsor** is **Under Examination** for that plan year (determined without regard to the ADP/ACP/Multiple Use test exception described in the prior paragraph).

Substantial Completion of Correction. However, if correction of an **Operational Failure** is substantially completed by the time the plan or **Plan Sponsor** becomes **Under Examination**, the plan sponsor may complete correction of the **Operational Failure**(s) after the expiration of the two-year period.

Correction of an Operational Failure is considered to be substantially completed by the last day of the correction period if either (1) or (2) applies:

(1) within the correction period, the Plan Sponsor has been reasonably prompt in identifying the Operational Failure, formulating a correction method, and initiating correction in a manner that demonstrates a commitment to completing correction of the Operational Failure as expeditiously as practicable, and within 90 days after the last day of the correction period, the plan sponsor completes correction of the Operational Failure.

(2) during the correction period, correction is completed with respect to 85% of all participants affected by the Operational Failure, and thereafter, the plan sponsor completes correction of the Operational Failure with respect to the remaining affected participants in a diligent manner.

Voluntary Correction Program (VCP)

Links to Rev. Proc. 2006-27 with respect to the VCP
VCP - General Description
VCP Fees
VCP - Eligibility Requirements
Failures not Eligible for VCP
Anonymous Submission Procedure
Group Submission Procedure
How the VCP and the Self-Correction Programs Differ

Voluntary Correction Program -- Links to Rev. Proc. 2006-27

- For an introduction to the Employee Plans Compliance Resolution System (EPCRS) and a description of the most recent enhancements, see Part I **(**sections 1 and 2**)**.
- For information relating to the effect of EPCRS and the extent of reliance provided by EPCRS, see **Part II, section 3 of Rev. Proc. 2006-27**.
- For information relating to eligibility under the **VCP**, see **Part II, section 4**.
- For definitions, correction principles, and rules of general applicability, see Part III, **sections 5** and **6**.
- For a description of the general requirements of the **VCP**, see **Part V, section 10**.
- To view sample operational failures and acceptable correction methods for those failures, see **Appendix A** and **Appendix B**.
- For a description of the application procedures under the **VCP**, see **Part V, section 11**.
- For a description of the fees applicable to the **VCP**, see **Part V, section 12**.
- For the **VCP** mailing address, see **Part V, section 11.12**.
- To view a checklist designed to assist **Plan Sponsors** and their representatives in preparing a complete and accurate VCP submission, see **Appendix C**.
- To view sample formats for submission of **Qualified Plans**, see **Appendix D**.
- For sample **Acknowledgement Letter**, see **Appendix E**.
- For the procedures applicable to **Group Submissions**, see **section 10.11**.
- For the procedures applicable to **Anonymous Submissions**, see **section 10.10**.

VCP - General Description

A **Plan Sponsor** that maintains a plan that experiences one or more **Qualification Failures** may seek to preserve the tax benefits of its retirement plan if the plan sponsor discovers the problems prior to the plan (or the plan sponsor, if the plan sponsor is a tax-exempt organization) coming **Under Examination** by bringing such failures to the attention of the IRS. In such cases, the plan sponsor pays a fee to preserve the tax benefit associated with properly maintained retirement plans, but in virtually all cases, the fee, which is based on the size of the plan, is equal to only a small fraction of the amount of tax benefit preserved.

Generally, under the VCP:

- The Plan Sponsor identifies the failures.
- The plan sponsor proposes correction using the **General Correction Principles** set forth in **Rev. Proc. 2006-27, section 6**.
- The plan sponsor proposes changes to its administrative procedures to insure the failures do not recur.
- The plan sponsor pays a compliance fee that generally is based on the number of plan participants (see **VCP Fees**).
- The IRS issues a Compliance Statement with respect to the plan detailing the qualification failures identified by the plan sponsor and the applicable correction methods approved by the IRS.
- The plan sponsor corrects the identified failures within 150 days of the issuance of the Compliance Statement.
- While the submission is pending, the plan will not be examined by Employee Plans, except under unusual circumstances.
- If the plan is a **403(b) Plan**, if necessary for correction, the employer must obtain assurances from other entities that they will cooperate in correcting the failures.
- Under **SEPs** and **SIMPLE IRA Plans**, correction of **Excess Amounts** may be effected by retaining the excess amounts in the plan, (and, in certain cases reducing future limits), provided the employer pays to the IRS an additional fee equal to an amount that is not less than 10% of the excess amounts retained in the plan.

The VCP procedures may be used by **Plan Sponsors** who cannot, or do not, wish to resolve their plans' **Qualification Failures** under the **Self-Correction Program**.

Voluntary Correction Program -- Fees

With respect to **Qualified Plans** and **403(b) Plans**, for failures that are not **Egregious Failures**, the **Plan Sponsor** pays a compliance fee that is determined in accordance with the following table:

Number of Participants/Employees	Fee
20 or fewer	$ 750.00
21 to 50	$ 1,000.00
51 to 100	$ 2,500.00
101 to 500	$ 5,000.00
501 to 1,000	$ 8,000.00
1001 to 5,000	$ 15,000.00
5,001 to 10,000	$ 20,000.00
Over 10,000	$ 25,000.00

The fees in the table above also apply to applications under the **Anonymous Submission Procedure**. Under the Anonymous Submission Procedure, as with all fees under the **VCP**, the fee must be paid when the submission is sent to the IRS. Under the Anonymous Submission Procedure, if resolution cannot be reached, the IRS will refund to the Plan Sponsor an amount equal to one-half of the fee paid with the submission.

The compliance fee for plans that have not been amended for tax legislation changes within the plan's remedial amendment period (nonamenders) is determined in accordance with the chart shown above (See **section 12.02 of Rev. Proc. 2006-27**). The applicable fee is reduced by 50% for nonamenders that submit under VCP within a one-year period following the expiration of the plan's remedial amendment period for complying with tax law changes. For example, the fee for an "EGTRRA nonamender plan" with 700 participants submitted within the one-year period following the expiration of the plan's remedial amendment period for EGTRRA changes would be $4,000.

If the only failure in the VCP submission involves the failure to satisfy the minimum distribution requirements of § 401(a)(9) for 50 or participant and the failure would result in the imposition of the excise tax under § 4974, the fee is $500 regardless of the number of participants in the plan.

Generally, the fee with respect to applications for **SEPs** and **SIMPLE IRA Plans** is $500.00.

With respect to SEPs and SIMPLE IRA Plans, an additional fee equal to at least ten percent of a plan's **Excess Amounts** may apply where such excess amounts are retained in the plan instead of being distributed to the participant. The term "Excess Amounts" generally means contributions or allocations that exceed certain Code or plan limits on contributions and allocations. (See section **12.05 of Rev. Proc. 2006-27**.)

Fees may be waived for terminating orphan plans. The applicant should request the waiver with the submission.

For **Egregious Failures**, the Plan Sponsor pays a fee equal to the greater of the fee in the table above, or a negotiated amount that is limited to not more than 40% of the taxes the IRS could collect if the plan were disqualified.

> The amount of additional taxes the IRS could collect if the plan were disqualified is approximately equal to the sum of what would be the income tax on the trust, additional income tax on the employer because of reduced deductions for plan contributions and the additional income tax on highly compensated employees because of income inclusion.

VCP fee for **Group Submission**. The compliance fee for a Group Submission is based on the number of plans affected by the failure as described in the compliance statement. The initial fee for the first 20 plans is $10,000. An additional fee is due equal to the product of the number of plans affected in excess of 20 multiplied by $250, up to a maximum of $50,000.

VCP - Eligibility Requirements

- The plan must have been intended to be a **Qualified Plan**, **403(b) Plan**, **SEP**, or **SIMPLE IRA Plan**.
- Full correction must be made for all years of the failures (but see **Special Exceptions to Full Correction**).
- The failure must be a **Qualification Failure**.
- Neither the plan nor **Plan Sponsor** (if the plan sponsor is a tax-exempt organization) may be **Under Examination**.
- **Egregious Failures** may be eligible for correction under VCP.

Failures not Eligible for the VCP

- Plan failures that are not **Qualification Failures**.
- Failures for which the **Plan Sponsor** proposes correction by a plan amendment that conforms the terms of the plan to the plan's prior operations, if the amendment violates any other Code requirement.
- Failures involving the misuse or diversion of plan assets.
- In a **403(b) Plan**, failures related to the purchase of annuity contracts, or contributions to custodial accounts, on behalf of individuals who are not employees of the employer.
- A failure where the plan or plan sponsor is, or was a party to an **ATAT** unless the Service determines that the failure is unrelated to the ATAT.

Anonymous Submission Procedure

Rev. Proc. 2006-27 section 10.10 sets forth the provisions of the Anonymous Submission procedure. The Anonymous Submission procedure permits **Plan Sponsors** to submit **Qualified Plans**, **403(b) Plans**, **SEPs** and **SIMPLE IRA Plans** under **VCP** without initially identifying the applicable plan(s) or applicant. The submission requirements relating to VCP apply to anonymous submissions on the same terms they apply to submissions in which the plan and plan sponsor are identified. However, information identifying the plan or the plan sponsor may be excluded from the submission until the IRS and the plan representative reach agreement with respect to all aspects of the submission.

Until the plan(s) and Plan Sponsor(s) are identified to the IRS, an Anonymous Submission does not preclude an examination of the plan sponsor or its plan(s). Thus, a plan submitted under the Anonymous Submission procedure that comes **Under Examination** prior to the date the plan(s) and plan sponsor(s) identifying materials are received by the IRS will no longer be eligible under VCP.

Group Submission Procedure

Under the Group Submission procedure, an Eligible Organization (generally, a sponsor of a **Master or Prototype Plan**, an entity that either issues annuity contracts or provides services with respect to assets in 403(b) Plans, or an entity that provides its clients with administrative services) may submit a **VCP** request for a **Qualified Plan**, **403(b) Plan**, **SEP** or **SIMPLE IRA Plan** under the Group Submission procedure for **Operational Failures**, **Plan Document Failures** and **Employer Eligibility Failures**.

An Eligible Organization is not eligible to make a Group Submission unless the submission includes a failure resulting from a systemic error involving the Eligible Organization that affects at least 20 plans and that results in at least 20 plans implementing correction.

A Group Submission is subject to the same submission procedures as any VCP submission, except that the Eligible Organization is responsible for performing the procedural obligations normally imposed on the **Plan Sponsor**. In addition, the Eligible Organization must give notification of the submission to the affected plan sponsors.

Once the terms of the Compliance Statement are agreed upon, the Eligible Organization must submit to the IRS a list identifying the employers and plans subject to the Compliance Statement. The aforementioned list can be submitted at any stage of the submission process provided that the requirements of **section 10.11(3)(b) of Rev. Proc. 2006-27** have been satisfied. If a Plan Sponsor of a plan that is eligible to be included in the Group Submission is notified of an impending Employee Plans examination after the Eligible Organization filed the Group Submission application, the Plan Sponsor's plan will be included in the Group Submission. However, with respect to such plan, the Group Submission will not preclude or impede an examination of the plan with respect to any failures not identified in the Group Submission application at the time the plan comes Under Examination.

How the Voluntary Correction Program (VCP) and the Self-Correction Program (SCP) Differ:

- The **SCP** permits **Plan Sponsors** to voluntarily identify and correct failures without notifying the IRS, while the **VCP** requires the submission of an application to the IRS.

- The SCP does not require the payment of a fee, while the VCP requires payment of a fixed fee, depending upon the size of the plan.

- Eligibility under the SCP is limited to **Operational Failures** that are not **Egregious**, while the VCP provides relief for all **Qualification Failures**, including **Egregious Failures**.

- The VCP provides the Plan Sponsor with assurance that the correction methods employed by the plan sponsor are acceptable to the IRS, while the SCP does not provide a guarantee of acceptance by the IRS (however, see **Appendix A** and **Appendix B** for sample failures and correction methods that are deemed to be reasonable and appropriate).

- If the failure is insignificant, the SCP is available even if the plan or Plan Sponsor is **Under Examination**.

- If the failure is significant, the SCP is not available for correction for **SEPs** and **SIMPLE IRA Plans**, while the VCP is available for **Qualified Plans**, **403(b) Plans**, SEPS and SIMPLE IRA Plans.

- A Plan Sponsor may correct an Operational Failure by a plan amendment that conforms the terms of the plan to the plan's prior operations (provided no other Code section is violated by such amendment) in more instances under VCP than under the SCP.

- A **Favorable Letter** is required to correct a **Significant Operational Failure** under the SCP, while a Favorable Letter is not required in order to submit an application under the VCP.

- A plan that is submitted under the VCP prior to the plan or Plan Sponsor becoming Under Examination will not be subject to examination until the submission process is complete and the plan sponsor has been issued a signed Compliance Statement. A plan that is corrected under the SCP is subject to examination at any time during the correction process (but see, "**Substantial Completion of Correction**" under "**Significant Operational Failures under the Self-Correction Program**" for an exception to this rule).

The Audit Closing Agreement Program (Audit CAP)

Links to Rev. Proc. 2006-27 with respect to the Audit CAP
Audit CAP - General Description
Audit CAP - Eligibility Requirements
Failures not Eligible for the Audit CAP
How Audit CAP Differs from Other Correction Programs

The Audit Closing Agreement Program (Audit CAP) - Links to Rev. Proc. 2006-27

- For an introduction to the Employee Plans Compliance Resolution System (EPCRS) and a description of the most recent enhancements, see Part I **(**sections 1 and 2**)**
- For information relating to the effect of EPCRS and the extent of reliance provided by EPCRS, see **Part II, section 3**.
- For information relating to eligibility under the Audit CAP see **Part II, section 4**.
- For definitions, correction principles, and rules of general applicability, see Part III, **sections 5** and **6**.
- To view sample operational failures and acceptable correction methods for those failures, see **Appendix A** and **Appendix B**.
- For a description of the general requirements of the Audit CAP, see **Part VI, section 13**.
- For information relating to the determination of the sanction under Audit CAP, see **Part VI, section 14**.

Audit CAP - General Description

A **Plan Sponsor** that does not come forward to the IRS, but which is instead discovered on audit to have significant problems in its plan, is also entitled under the audit correction program to preserve the tax benefits associated with properly maintained retirement plans. Under this program, the plan sponsor pays a reasonable sanction that is based on an amount that is directly related to the amount of tax benefits preserved. The sanction imposed will bear a reasonable relationship to the nature, extent and severity of the failure, taking into account the extent to which correction occurred before audit.

Generally, under the Audit CAP:

- The plan sponsor or plan is **Under Examination**.
- The plan sponsor enters into a Closing Agreement with the IRS.
- The plan sponsor effects correction prior to entering into the Closing Agreement.
- The plan sponsor pays a sanction negotiated with the IRS.
- For plans intended to be qualified, the sanction under Audit CAP is a negotiated percentage of the Maximum Payment Amount.
    - The Maximum Payment Amount is the approximate amount of tax the IRS could collect if the plan were to be disqualified. For a qualified plan, this amount includes for the open tax years:
        - the tax on the trust (Form 1041) (and any interest or penalties applicable to the trust return),
        - additional income tax resulting from the loss of employer deductions for plan contributions (and any interest or penalties applicable to the Plan Sponsor's return),
        - additional income tax resulting from income inclusion for participants in the plan (Form 1040), including the tax on plan distributions that have been rolled over to other qualified trusts (as defined in § 402(c)(8)(A)) or eligible retirement plans (as defined in § 402(c)(8)(B)) (and any interest or penalties applicable to the participants' returns), and

- any other tax that results from a Qualification Failure that would not be imposed as a result of correction under Rev. Proc. 2006-50.

- For **403(b) Plans**, the sanction under Audit CAP is a negotiated percentage of the Maximum Payment Amount. The Maximum Payment Amount is approximately equal to the tax the IRS could collect as a result of the failure. Taxes included in determining Maximum Payment Amount are

  - any additional income tax resulting from income inclusion for employees or other participants (Form 1040), including the tax on distributions that have been rolled over to other qualified trusts (as defined in § 402(c)(8)(A)) or eligible retirement plans (as defined in § 402(c)(8)(B)) (and any interest or penalties applicable to the participants' returns), and

  - any other tax that results from a 403(b) Failure that would not be imposed as a result of correction under this revenue procedure.

- For **SEPs** and **SIMPLE IRA Plans**, the term "Maximum Payment Amount" means a monetary amount that is approximately equal to sum of (a) income tax resulting from the loss of employer deductions for plan contributions (and any interest or penalties applicable to the employer's return), and (b) income tax resulting from income inclusion for participants in the plan (Form 1040).

- Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures.

Audit CAP Eligibility Requirements

- The plan must have been intended to be a **Qualified Plan**, **403(b) Plan**, **SEP**, or **SIMPLE IRA Plan**.
- Full correction must be made for all years of the failures (but see **Special Exceptions to Full Correction**).
- The failure must be a **Qualification Failure**.

Failures not Eligible for Audit CAP

- Plan failures other than **Qualification Failures**.
- Failures that involve the misuse or diversion of plan assets.
- A failure where the plan or plan sponsor is, or was a party to an **ATAT** unless the Service determines that the failure is unrelated to the ATAT.

How Audit CAP Differs from Other Correction Programs

- Audit CAP is used when the plan is **Under Examination**. All of the other correction programs are voluntary and, except for certain instances under the **Self-Correction Program**, may not be used when the plan or **Plan Sponsor** is **Under Examination**.
- Like the **Voluntary Correction Program**, and when correcting insignificant failures under the Self-Correction Program, Audit CAP does not require that a **Favorable Letter** be issued with respect to the plan.
- Unlike under the Self-Correction Program, Audit CAP may be used for any type of **Qualification Failure**.
- The fee (sanction) paid under the **Audit CAP** should be greater than the fee paid under the Voluntary Correction Program (there is no fee under the Self-Correction Program).

Fees for Nonamenders Failures found by Service during Determination Letter Process

The fee for plans that have not been amended for tax legislation changes within the plan's remedial amendment period (nonamenders (includes EGTRRA nonamenders)) and where the failure is discovered upon the IRS' review of a **Plan Sponsor's** determination letter application is determined in accordance with the chart below. In addition, if the failure is discovered as the result of a question or inquiry from the IRS agent as part of the determination letter application process, the fee will be determined under the table below.

Number of Participants	EGTRRA/ subsequent legislation	GUST/ 401(a)(9) Regs	UCA/ OBRA '93	TRA '86	T/D/R	ERISA
20 or less	$ 2,500	$ 3,000	$ 3,500	$ 4,000	$ 4,500	$ 5,000
21-50	$ 5,000	$ 6,000	$ 7,000	$ 8,000	$ 9,000	$10,000
51-100	$ 7,500	$ 9,000	$10,500	$12,000	$13,500	$15,000
101-500	$12,500	$15,000	$17,500	$20,000	$22,500	$25,000
501-1,000	$17,500	$21,000	$24,500	$28,000	$31,500	$35,000
1,001-5,000	$25,000	$30,000	$35,000	$40,000	$45,000	$50,000
5,001 – 10,000	$32,500	$39,000	$45,500	$52,000	$58,500	$65,000
Over 10,000	$40,000	$48,000	$56,000	$64,000	$72,000	$80,000

The acronyms listed in the chart refer to the following laws:

(a) Employee Retirement Income Security Act of 1974 (ERISA),
(b) Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA); Deficit Reduction Act of 1984 (DEFRA); and Retirement Equity Act of 1984 (REA) together (T/D/R),
(c) Tax Reform Act of 1986 (TRA '86),
(d) Unemployment Compensation Act of 1992 (UCA); Omnibus Budget and Reconciliation Act of 1993 (OBRA '93);
(e) The Uruguay Round Agreements Act; the Uniformed Services Employment and Reemployment Rights Act of 1994; the Small Business Job Protection Act of 1996; the Taxpayer Relief Act of 1997; the Internal Revenue Service Restructuring and Reform Act of 1998; and the Community Renewal Tax Relief Act of 2000 (collectively known as "GUST");
(f) Final and temporary regulations under § 401(a)(9), 74 FR 18987, published on April 17, 2002 ("401(a)(9) Regs")
(g) The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")

FREQUENTLY ASKED QUESTIONS AND ANSWERS ON EPCRS

Self-Correction Program (SCP)

Voluntary Correction Program (VCP)

Audit Closing Agreement Program

SCP FAQ's

Q & A 1 **Is there a way to attain IRS approval prior to audit regarding the appropriate way to correct a failure under the SCP?**

The SCP is a voluntary employer-initiated program that does not involve IRS approval; therefore, the IRS will not approve a **Plan Sponsor's** method of correction prior to audit. However, **Rev. Proc. 2006-27** sets forth **General Correction Principles** designed to assist a plan sponsor in determining the appropriate method of correction for a failure. In addition, **Appendix A** and **Appendix B** of Rev. Proc. 2006-50 provide plan sponsors with sample correction methods for certain failures. To the extent the plan sponsor applies the applicable correction method set forth in either of these appendices, the correction is deemed to be reasonable and appropriate correction for the failure. Upon examination, the IRS has the right to review whether the taxpayer made the correct determination that such failure(s) were eligible under the SCP as well as whether the correction method is acceptable.

Q & A 2 **What practices and procedures are required to be in place in order for a plan to be eligible for relief under the SCP?**

The IRS is concerned that the practices and procedures of a plan foster compliance with the requirements of the Code.

- Practices and procedures may be formal or informal.
- Practices and procedures must be routinely followed.
- Practices and procedures need not be in place for a specific failure (as long as practices and procedures exist that evidence an overall effort on the part of the **Plan Sponsor** to maintain the plan in compliance with the Code requirements).
- A plan document alone is not sufficient to establish evidence of good practices and procedures.

- An example of an acceptable practice or procedure outside of the plan document is a checksheet routinely followed for determining whether an employee is a key employee for purposes of meeting the top-heavy requirements.

Q & A 3 **If a plan sponsor discovers a failure of the Actual Deferral Percentage (ADP), Actual Contribution Percentage (ACP), or Multiple Use tests in the plan sponsor's profit-sharing plan, may the failures be corrected under the SCP?**

Yes. A failure of the ADP, ACP or Multiple Use Tests is treated as an Operational Failure for purposes of EPCRS. Under Code section 401(k) and (m), a **Plan Sponsor** has until the end of the plan year following the plan year in which an excess contribution or excess aggregate contribution was made to correct the failure; under the SCP, the two-year correction period applicable to Significant Operational Failures does not begin under the expiration of the statutory correction period. (Note that the Multiple Use Test has been repealed for plan years beginning after 12/31/01.)

Example – In 2006, a Plan Sponsor discovers that in 2005, when testing the contributions made in its section 401(k) plan during 2005 for the ADP test, mistakes were made in determining the correct amount of compensation that should have been taken into account under the test. When the ADP test was rerun with the correct data, the plan sponsor discovers that the ADP test was failed. Assuming the other eligibility requirements of Self-Correction Program are satisfied, if the ADP failure is a **Significant Operation Failure**, the

plan sponsor may correct the failure to satisfy the ADP test by the end of the 2008 plan year. If the ADP failure is an **Insignificant Operational Failure**, the plan sponsor has even longer to correct the failure, and may correct even upon audit of the plan.

Q & A 4 What are Insignificant Operational Failures under the SCP?

The SCP permits **Plan Sponsors** to correct significant **Operational Failures** within two years of the year in which the failure occurred, provided the other requirements of the SCP are satisfied. A number of factors are considered in determining whether Operational Failures are insignificant. These include, but are not limited to:

- whether other failures occurred during the period being examined (for this purpose, a failure is not considered to have occurred more than once merely because more than one participant is affected by the failure);
- the percentage of plan assets and contributions involved in the failure;
- the number of years the failure occurred;
- the number of participants affected relative to the total number of participants in the plan;
- the number of participants affected as a result of the failure relative to the number of participants who could have been affected by the failure;
- whether correction was made within a reasonable time after discovery of the failure; and
- the reason for the failure (for example, data errors such as errors in the transcription of data, the transposition of numbers, or minor arithmetic errors).

This is not an exclusive list and no single factor is determinative. Failures will not be considered significant merely because they occur in more than one year. In addition, the IRS will apply these factors in a way so as to not preclude small businesses from being eligible for the SCP merely because of their size.

The following examples illustrate the application of insignificant failures. It is assumed, in each example, that the eligibility requirements relating to SCP have been satisfied and that no Operational Failures occurred other than the Operational Failures identified below.

Example 1: In 1991, Employer X established Plan A, a profit-sharing plan that satisfies the requirements of § 401(a) in form. In 2004, the benefits of 50 of the 250 participants in Plan A were limited by § 415(c). However, when the Service examined Plan A in 2006, it discovered that, during the 2004 limitation year, the annual additions allocated to the accounts of 3 of these employees exceeded the maximum limitations under § 415(c). Employer X contributed $3,500,000 to the plan for the plan year. The amount of the excesses totaled $4,550. Under these

facts, because the number of participants affected by the failure relative to the total number of participants who could have been affected by the failure, and the monetary amount of the failure relative to the total employer contribution to the plan for the 2004 plan year, are insignificant, the § 415(c) failure in Plan A that occurred in 2004 would be eligible for self-correction.

Example 2: The facts are the same as in Example 1, except that the failure to satisfy § 415 occurred during each of the 2003, 2004, and 2005 limitation years. In addition, the three participants affected by the § 415 failure were not identical each year. The fact that the § 415 failures occurred during more than one limitation year did not cause the failures to be significant; accordingly, the failures are still eligible for self-correction.

Q & A 5 **When correcting Significant Operational Failures under the SCP, what actions must be taken by a plan sponsor by the end of the two-year correction period in order to be entitled to relief?**

In general, correction must be completed by the end of the two-year correction period in order for a plan to be entitled to relief under the SCP. However, where a **Plan Sponsor** substantially completes correction within the correction period, the plan sponsor will not lose the relief provided under the SCP merely because correction wasn't completed during the correction period. There are two circumstances under which correction is considered to have been substantially completed:

(1) where,

- during the correction period, the Plan Sponsor is reasonably prompt in identifying the Operational Failure, formulating a correction method, and initiating correction in a manner that demonstrates a commitment to completing correction of the Operational Failure as expeditiously as practicable, and

- within 90 days after the last day of the correction period, the Plan Sponsor completes correction of the Operational Failure;

and (2) where,

- during the correction period, correction is completed with respect to 85% of all participants affected by the Operational Failure, and

- thereafter, the plan sponsor completes correction of the Operational Failure with respect to the remaining affected participants in a diligent manner.

In addition, a plan sponsor will not be considered to have failed to fully correct within the correction period where a plan sponsor takes reasonable action to find but has not located all current and former participants and beneficiaries to whom additional benefits are due. Reasonable action includes the use of the Internal Revenue Service Letter-Forwarding Program (see Rev. Proc. 94-22, 1994-1 C.B. 608) or the Social Security Administration Reporting Service. If an individual is later located, the additional benefits must be provided to the individual at that time.

If correction of an **Operational Failure** is being implemented through adoption of a plan amendment, the required application for a

determination letter must be submitted by the end of the employer's applicable remedial amendment period pursuant to Rev. Proc. 2005-66 in order for correction to be considered to have been timely implemented. The amendment related to self-correction must be clearly identified in the determination letter application.

Q & A 6 **Assume a plan sponsor discovers a vesting problem in which the plan terms were not followed, should the plan sponsor use the SCP or the Voluntary Correction Program to correct the problem?**

The decision of whether to use the **SCP** or **Voluntary Correction Program** to correct an **Operational Failure** depends on a number of factors, including: (1) the type of failure involved, (2) the practices and procedures under the plan, (3) whether, if the failure is an Operational Failure, it would be considered to be a **Significant Operational Failure**, (4) whether a **Favorable Letter** has been issued with respect to the plan, (5) whether the failure is an **Egregious Failure**, (6) when the failure is discovered, and (7) the amount of comfort the **Plan Sponsor** has with respect to the method used to correct the failure.

Although the SCP does not require the payment of a fee or notification to the IRS, it is limited to correcting Operational Failures that are not egregious. In addition, if the failure is a Significant Operational Failure, the Plan Sponsor must complete correction of the failure within two years of the year in which the failure occurred. Although a plan sponsor does not necessarily get assurance that the correction method employed under the SCP is acceptable to the IRS, the IRS has provided several examples of failures and acceptable correction methods under **Appendix A** and **Appendix B** in **Rev. Proc. 2006-27.** If a plan sponsor corrects a failure listed in Appendix A or Appendix B in accordance with the method of correction method set forth in the appendix, the plan sponsor may be assured that the IRS will find that correction method to be acceptable

In this example, an Operational Failure, a vesting failure, has occurred. **Appendix B, section 2.03** provides examples of acceptable correction methods for a vesting failure. Therefore, if there are acceptable practices and procedures under the plan (**See SCP Q&A 2, "What practices and procedures are required to be in place in order for a plan to be eligible for correction under the SCP?"**), and the failure is an **Insignificant Operational Failure**, the **Plan Sponsor** may use the **SCP** to correct the failure at any time, even if the plan is **Under Examination**. Further, if the plan sponsor uses one of the correction methods under Appendix B of the revenue procedure, it will have assurance that the plan would be entitled to relief under the SCP with respect to its correction method. If, however, the failure is a Significant Operational Failure, the plan would be entitled to relief under the SCP only if the failure is identified and corrected within the two-year correction period under the SCP. Also, if the failure is a Significant Operational Failure, the plan would be eligible for relief under the SCP only if a Favorable Letter has been issued with respect to the plan. If the failure would be considered an Egregious Failure, it would be eligible for correction under the Voluntary Correction Program but not under the SCP.

Voluntary Correction Program (VCP) FAQ's

Q & A 1 **Is there an application form plan sponsors must use to apply under the VCP?**

There is no application form applicable to the **VCP**; however, the IRS provides **Sample Submission Formats** in **Appendix D of Rev. Proc. 2006-27**, which facilitate the submission process. The IRS also provides a **Checklist** designed to assist **Plan Sponsors** and their representatives in preparing a submission that contains the information and documents required under each of those programs. The checklist must be completed, signed, and dated by the employer, plan sponsor, or the plan sponsor's representative, and should be placed on top of the submission.

Q & A 2 **What is the mailing address for applications submitted under the VCP?**

All **VCP** submissions and accompanying determination letter applications (if applicable) should be mailed to the following address:

Internal Revenue Service
Attention: T:EP:RA:VC
P.O. Box 27063
McPherson Station
Washington, D.C. 20038

Q & A 3 **Can a Plan Sponsor receive acknowledgement from the IRS after it files a VCP submission?**

The Service will acknowledge receipt of a submission if the Plan Sponsor or the Plan Sponsor's representative completes the Acknowledgement Form as found in **Appendix E of Rev. Proc. 2006-27**, and includes it in the submission. A photocopy of the Acknowledgement Form in Appendix E may be used.

Q & A 4 **Some employers have very little involvement in their employees' 403(b) Plans. Who should file a VCP application in these cases?**

The employer is the only one who can submit an application to correct failures under the **VCP**. Although insurers and custodians may have some liability to the employer, they have no liability under the VCP. The employer is responsible for identifying the failures, correcting the failures, and insuring that necessary changes are made to administrative procedures for operating the 403(b) plan. When necessary for correction, the employer must secure the cooperation of the providers prior to submitting an application under the VCP.

Q & A 5 **For a VCP submission, what information must the plan sponsor supply with respect to correction of the failures?**

The letter from the **Plan Sponsor** or the plan sponsor's representative must contain a detailed description of the method for correcting the failures that the plan sponsor has implemented or proposes to implement.

- Each step of the correction method must be described in narrative form.
- The description must include the specific information needed to support the suggested correction method, including:
  - the number of employees affected;
  - the expected cost of correction;
  - the years involved, and
  - calculations or assumptions the Plan Sponsor used to determine the amounts needed for correction.
- The number of employees affected and the expected cost of correction may be approximated if the exact number cannot be determined at the time of the request.
- A description of the methodology that will be used to calculate earnings or actuarial adjustments on any corrective contributions or distributions (indicating the computation periods and the basis for determining earnings or actuarial adjustments.
- Specific calculations for each affected employee or a representative sample of affected employees.
- The sample calculations must be sufficient to demonstrate each aspect of the correction method proposed. For example, if a Plan Sponsor requests a compliance statement with respect to a failure to satisfy the contribution limits of § 415(c) and proposes a correction method that involves elective contributions (both matched and unmatched) and matching contributions, the plan sponsor must submit calculations illustrating the correction method proposed with respect to each type of contribution. As another example, with respect to a failure to satisfy the actual deferral percentage (ADP) test in § 401(k)(3), the plan sponsor must submit the ADP test results both before the correction and after the correction.

- The method that will be used to locate and notify former employees and beneficiaries, or an affirmative statement that no former employees or beneficiaries were affected by the failures.

- A description of the measures that have been or will be implemented to ensure that the same failures will not recur.

Q & A 6 **Is a plan eligible for VCP if the plan or Plan Sponsor is or has been a party to an Abusive Tax Avoidance Transaction?**

If the Service determines that a plan or plan sponsor was, or may have been, a party to an abusive tax avoidance transaction, then the matter will be referred to the Internal Revenue Service's Employee Plans' Tax Shelter Coordinator. Upon receiving a response from the Tax Shelter Coordinator, the Service may determine that the plan or the Plan Sponsor has been a party to an abusive tax avoidance transaction, and that the failures addressed in the VCP submission are related to that transaction. In those situations, the Service will conclude the review of the submission without issuing a compliance statement and will refer the case for examination. However, if the Tax Shelter Coordinator determines that the plan failures are unrelated to the abusive tax avoidance transaction or that no abusive tax transaction occurred, the Service will continue to address the failures identified in the VCP submission, and may issue a compliance statement with respect to those failures. For a definition of Abusive Tax Avoidance Transaction, visit the IRS web site at: www.irs.gov/ep

Q & A 7 **If a plan with a Plan Document Failure is submitted under the VCP, is the plan sponsor required to concurrently submit an application for a determination letter?**

A determination letter submission is required if you are correcting for a "non-amender failure," other than through the adoption of an amendment designated by the Service as a model amendment or the adoption of a prototype or volume submitter plan for which the Plan Sponsor has reliance on the plan's opinion or advisory letter. A non-amender failure refers to the failure to amend the plan to reflect a change in a qualification requirement within the plan's applicable remedial amendment period.

In other situations (i.e. failures that are not non-amender failures), a determination letter submission will not be issued unless a Qualification Failure is being corrected by the adoption of a retroactive amendment during a year that coincides with the plan's cycle year or the year of the plan's termination, and the Plan Sponsor submits a determination letter request with its VCP filing. See **Q & A 2, "What is the mailing address for applications submitted under the VCP?"**

Q & A 8 **Is there an avenue for plan sponsors to negotiate correction under the VCP on an anonymous basis?**

Yes. **Rev. Proc. 2006-27, section 10.10** sets forth the provisions of the Anonymous Submission procedure. The Anonymous Submission procedure permits **Plan Sponsors** to submit **Qualified Plans**, **403(b) Plans**, **SEPs** and **SIMPLE IRA Plans** under **VCP** without initially identifying the applicable plan(s) or applicant. The submission requirements relating to VCP apply to anonymous submissions on the same terms they apply to submissions in which the plan and plan sponsor are identified. However, information identifying the plan or the plan sponsor may be excluded from the submission until the IRS and the plan representative reach agreement with respect to all aspects of the submission.

Until the plan(s) and Plan Sponsor(s) are identified to the IRS, an anonymous submission does not preclude an examination of the plan sponsor or its plan(s). Thus, a plan submitted under the Anonymous Submission procedure that comes **Under Examination** prior to the date the plan(s) and plan sponsor(s) identifying materials are received by the IRS will no longer be eligible under VCP.

Q & A 9 **Should a plan sponsor that discovers a Plan Document Failure in a plan that has been submitted for a determination letter raise the issue to the Employee Plans Agent or Specialist working the determination letter application?**

If the **Plan Sponsor** knows about the failure prior to submitting a determination letter application, the plan sponsor should submit under the **VCP** and include the determination letter application with the VCP submission. If the failure is identified and voluntarily raised by the taxpayer to the Employee Plans Agent or Specialist assigned to the determination letter application, the taxpayer will be given an opportunity to perfect a VCP submission and have the issue resolved under the VCP.

However, if the failure is discovered by the agent assigned the determination letter application or is discovered as the result of a question or inquiry from the IRS agent as part of the determination letter application process, the fee will be determined under the special fee schedule for Audit CAP. (See "**Fees for Nonamenders Failures found by Service during Determination Letter Process."**)

Q & A 10 **What happens if the IRS and plan sponsor fail to reach resolution regarding the appropriate correction of a failure?**

Under the **VCP**, if resolution cannot be reached (for example, where information is not timely provided to the IRS or because agreement cannot be reached on correction or a change in administrative procedures), the compliance fee will not be returned, and the case may be referred to the appropriate EP office for examination consideration.

Q & A 11 **May a plan sponsor receive an extension of the 150-day correction period under the VCP?**

In appropriate circumstances, a **Plan Sponsor** will be granted an extension of the 150-day correction period under VCP. The plan sponsor should submit a written request explaining the reason for the request to the agent working the case. The request must be made prior to the expiration of the 150-day correction period.

Q & A 12 **Can trust assets be used for the payment of the fee or sanction under the VCP?**

As a rule, fees or sanctions should be paid by parties other than the trust. Exceptions are allowed only in extremely narrow circumstances.

Q & A 13 **Has the IRS established a program to verify that plan sponsors are correcting failures in accordance with Compliance Statements that are issued under the VCP?**

Yes, the IRS has established a verification program. The program is not an examination of the **Plan Sponsor's** books and records. The IRS checks available information from the plan sponsor to insure that all corrections were made in accordance with the terms of the compliance statement. If necessary corrections or administrative changes were not timely made, the plan may be referred to EP Examinations.

Q & A 14 Are matters relating to excise taxes resolved under the EPCRS?

The correction programs are not available for events for which the Code provides tax consequences other than plan disqualification (such as the imposition of an excise tax or additional income tax). For example, funding deficiencies (failures to make the required contributions to a plan subject to § 412), prohibited transactions, and failures to file the Form 5500 cannot be corrected under the correction programs.

However, it should be noted that excise taxes and additional taxes, to the extent applicable, are not waived merely because the underlying failure has been corrected or because the taxes result from the correction. There are some exceptions to this general rule.

- As part of VCP and Audit CAP, if the failure involves the failure to satisfy the minimum required distribution requirements of § 401(a)(9), in appropriate cases, the Service will waive the excise tax under § 4974 applicable to plan participants. The Plan Sponsor, as part of the submission, must request the waiver and in cases where the participant subject to the excise tax is an owner-employee, the Plan Sponsor must also provide an explanation supporting the request.

- As part of VCP, if the failure involves a correction that requires the Plan Sponsor to make a plan contribution that is not deductible, the Service will waive the excise tax under § 4972 on such nondeductible contributions, in appropriate cases.

- As part of VCP, in certain situations, if a failure results in excess contributions as defined in §4979(c) or excess aggregate contributions as defined in §4979(d) under a plan, the Service will not pursue the excise tax under § 4979 in appropriate cases, e.g., where correction is made for any case in which the ADP test was timely performed but, due to reliance on inaccurate data, resulted in an insufficient amount of excess elective contributions having been distributed to HCEs.

- Any request for a waiver of one or all of the excise taxes discussed above, must be included as part of the VCP submission.

Under **Audit CAP**, excise taxes that are reportable on the Form 5330 (e.g., prohibited transactions) may be resolved by the agent securing a Form 5330 providing for 100% of the tax and interest outstanding. The agent may, in his or her discretion, recommend to the Service Center waiver of the failure to file and/or failure to pay penalty, under IRC §6651.

Q & A 15 **Assume a plan sponsor discovers a vesting problem in which the plan terms were not followed, should the plan sponsor use Self-Correction Program or the VCP to correct the problem?**

The decision of whether to use the **Self-Correction Program** or **VCP** to correct an **Operational Failure** depends on a number of factors, including: (1) the type of failure involved, (2) the practices and procedures under the plan, (3) whether, if the failure is an Operational Failure, it would be considered to be a **Significant Operational Failure**, (4) whether a **Favorable Letter** has been issued with respect to the plan, (5) whether the failure is an **Egregious Failure**, (6) when the failure is discovered, and (7) the amount of comfort the **Plan Sponsor** has with respect to the method used to correct the failure.

Although the Self-Correction Program does not require the payment of a fee or notification to the IRS, it is limited to correcting Operational Failures that are not egregious. In addition, if the failure is a Significant Operational Failure, the Plan Sponsor must complete correction of the failure within two years of the year in which the failure occurred. Although a plan sponsor does not necessarily get assurance that the correction method employed under the Self-Correction Program is acceptable to the IRS, the IRS has provided several examples of failures and acceptable correction methods under **Appendix A** and **Appendix B** in **Rev. Proc. 2006-27**. If a plan sponsor corrects a failure listed in Appendix A or Appendix B in accordance with the method of correction method set forth in the appendix, the plan sponsor may be assured that the IRS will find that correction method to be acceptable.

In this example, an Operational Failure, a vesting failure, has occurred. **Appendix B, section 2.03** provides examples of acceptable correction methods for a vesting failure. Therefore, if there are acceptable practices and procedures under the plan (**See SCP Q&A 2, "What practices and procedures are required to be in place in order for a plan to be eligible for correction under the Self-Correction Program?"**), and the failure is an **Insignificant Operational Failure**, the Plan Sponsor may use the Self-Correction Program to correct the failure at any time, even if the plan is **Under Examination**. Further, if the plan sponsor uses one of the correction methods under Appendix B of the revenue procedure, it will have assurance that the plan would be entitled to relief under the Self-Correction Program with respect to its correction method. If, however, the failure is a Significant Operational Failure, the plan would be entitled to relief under the Self-Correction Program only if the failure is identified and corrected within the two-year correction period under the Self-Correction Program. Also, if the failure is a Significant Operational Failure, the plan would be eligible for relief under the Self-Correction Program only if a Favorable Letter has been issued with respect to the plan. If the failure

would be considered an Egregious Failure, it would be eligible for correction under the VCP but not under the Self-Correction Program.

Audit Closing Agreement Program (Audit CAP)

Q & A 1 **What happens if the IRS and plan sponsor fail to reach resolution regarding the appropriate correction of a failure?**

Under **Audit CAP**, if the IRS and the **Plan Sponsor** cannot reach an agreement with respect to the correction of the failure(s) or the amount of the sanction, the IRS will pursue disqualification of the plan.

Q & A 2 **Can trust assets be used for the payment of the fee or sanction under the Audit CAP?**

As a rule, fees or sanctions should be paid by parties other than the trust. Exceptions are allowed only in extremely narrow circumstances.