EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS)

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(Generally, effective January 1, 2009, the applicable revenue procedure is Revenue Procedure 2008-50. Plan Sponsors are permitted, at their option to apply the provisions of Rev. Proc. 2008-50 on or after September 2, 2008).

Note: This outline is prepared for discussion/presentation purposes only. It is not an official reference source. Please refer to the prevailing revenue procedure for guidance.

Note: Items newly added by Revenue Procedure 2008-50 are featured in *italics*.

I. Advantages of a "qualified plan."

A. Tax savings to the employer:

1. Immediate deduction of employer contributions. (IRC § 404(a)(1),(2),(3),(6),(7))

2. Employer contributions are not considered wages and are not subject to FICA/FUTA/Income tax withholding. (IRC §§ 3121(a)(5), (v)(1); 3306(b)(5), (r)(1); 3401(a)(12))

B. Tax savings to the employee:

Employer contributions made on behalf of an employee are not taxable to the employee in the year in which they are made. Income recognition occurs during the year in which the employee takes a distribution from the plan. (Note: Distributions do not include eligible rollovers to other eligible retirement plans or IRAs) (IRC § 402(a), (c))

C. Tax exempt trust:

Earnings on contributions made to the trust that forms a part of the qualified plan are not taxable to the trust. The trust is exempt from taxation. (IRC §501(a))

II. Consequences of "plan disqualification."

Loss of tax advantages:

- Contributions are deductible to the employer, only to the extent that they are includible in the gross income of employees participating in the plan. (IRC §404(a)(5))
- Employer contributions to a disqualified plan are not exempt from FICA/FUTA/ income tax withholding.
- Contributions made to a trust on behalf of participating employees are includible as gross income to the employees, to the extent that the employees are vested in those contributions. (IRC §402(b)).
- Distributions from the trust are not eligible for tax favored rollover.
- Trust earnings are not exempt from taxation.

III. EPCRS.

EPCRS: Employee Plans Compliance Resolution System (currently addressed in Rev. Proc. 2006-27 and *when applicable, Rev. Proc. 2008-50*). It is a collection of programs, which allows "plan sponsors to correct qualification failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis." (See §1.01 of Rev. Proc. *2008-50*)

A. Programs include:

1. Self-Correction Program (SCP): Employer discovers failures and fixes problems without involving the IRS.

2. Voluntary Correction Program (VCP): Employer discovers failures and fixes them with IRS approval.

3. Audit Closing Agreement Program (Audit CAP): This program is an option that is available for the purpose of resolving qualification failures that are identified during the course of an IRS audit. This program may also apply, if qualification failures are identified by the IRS, during the course of an application for a favorable determination letter.

For a brief overview of the programs, see § 1.03 of Rev. Proc. *2008-50*.

IV. Types of Plans covered by EPCRS.

A. Qualified Plans under Internal Revenue Code ("IRC") § 401(a).

B. 403(b) Plans.

C. SEPs and SARSEPs under IRC § 408(k).

D. SIMPLE IRAs under IRC § 408(p).

E. § 457(b) eligible governmental plans (while not specifically covered under EPCRS) can have issues resolved pursuant to a closing agreement.

See §§ 1.01 and *4.09* of Rev. Proc. *2008-50* for information on types of plans covered by EPCRS.

V. What can EPCRS accomplish?

A. For a Qualified Plan, if the eligibility requirements (both with respect to the failures and the manner in which the failures are corrected) for any of the applicable EPCRS programs are satisfied, the IRS will treat the Qualified Plan as if it continuously complied with the provisions of IRC § 401(a). (See § 3 of Rev. Proc. *2008-50*.)

B. Similar provisions in the revenue procedure for SEPs, SIMPLE IRAs and 403(b) Plans. (See § 3 of Rev. Proc. *2008-50*.)

C. <u>Excise taxes</u>:

(1) For VCP applications and Audit CAP, waiver of IRC § 4974 excise taxes for the failure to make the minimum distributions required under IRC § 401(a)(9). (See § 6.09(2) of Rev. Proc. *2008-50*.)

(2) For VCP applications: relief from IRC § 4972 excise tax for nondeductible contributions made to correct failures identified in the submission. (See § 6.09(3) of Rev. Proc. *2008-50*)

(3) For VCP applications: relief from IRC § 4979 excise tax for failed ADP/ACP test. (See § 6.09(4) of Rev. Proc. *2008-50*)

(4) For VCP applications: relief from IRC §4973 excise tax for excess contributions made to an IRA, provided improperly rolled over amounts are returned to the plan; also, in some situations, relief from IRC §4973 excise tax is possible if excess amounts are removed from the IRA and recognized by the employee as income.(See § 6.09(5) of Rev. Proc. 2008-50). Rollovers from plans sponsored by ineligible employers (corrected under VCP) are treated as if they were rollovers from plans sponsored by eligible employers for purposes of IRC 4973. (See §6.03(4) of Rev. Proc. 2008-50)

D. <u>Income taxes:</u>

(1) <u>For VCP applications, the income tax reporting option</u>. As part of VCP, in the event of a failure relating to a loan to a participant made from a Qualified Plan or a 403(b) Plan that is treated as received as a distribution for purposes of § 72(p) (a deemed distribution), the distribution may be reported on Form 1099-R for the year of correction with respect to the affected participant. (See § 6.07(1) of Rev. Proc. *2008-50*) *Note: If the plan loan does not comply with IRC §72(p), the loan can be addressed under VCP. It does not have to be a qualification failure. See last sentence of §4.01(2) of Rev. Proc. 2008-50.*

(2) <u>For VCP applications, relief from the income tax reporting option.</u> Certain loans that failed to comply with the requirements of IRC § 72(p) may be corrected under VCP and relieve the Applicant from the

responsibility of reporting the loans as deemed distributions to the participant. (See § 6.07(2); 6.07(3) of Rev. Proc. *2008-50.* Also see § 6.02(6) of Rev. Proc. *2008-50*). Generally, in order for a plan loan to eligible for relief from income tax reporting, the participant's failure to pay back the loan should have been caused by employer action and correction should have been accomplished within the maximum allowable duration for the loan provided for under IRC 72(p)(2)(B) (generally 5 yrs.) measured from the date of the loan. *Note: If the plan loan does not comply with IRC §72(p), the loan can be addressed under VCP. It does not have to be a qualification failure. See last sentence of §4.01(2) of Rev. Proc. 2008-50. Also see §6.07(2)(d) of Rev. Proc. 2008-50.*

(3) Availability of Audit CAP to address IRC §72(p) failures. Audit CAP is available to address the failure of plan loans to comply with the requirements of IRC §72(p)(2). The tax consequences arising from the failure of the loan(s) to comply with IRC §72(p)(2) may be incorporated into the Maximum Payment Amount used to determine the applicable sanction under Audit CAP. (See last sentences of §§4.01(3), 13.01 and 14.01 of Rev. Proc. 2008-50)

(4) As part of VCP, in the appropriate cases, the Service will not pursue the 10% additional income tax under § 72(t) (or will pursue only a portion thereof) if, as part of the proposed correction for Overpayments that were not made pursuant to a distributable event, the participant or beneficiary ("recipient")returns that amount to the plan. In appropriate cases, as a condition for not pursuing all or a portion of the additional tax, the Service may require the Plan Sponsor to pay an additional fee under VCP not in excess of the 10% additional income tax under § 72(t). (See § 6.09(6) of Rev. Proc. 2008-50)

VI. What is not covered.

A. Unless specifically provided for (see section III above), income or excise taxes cannot be mitigated under EPCRS. Thus, taxes such as those identified below would still apply even if related qualification failures are being addressed under EPCRS. Examples include:

1. IRC § 4971- Excise tax arising from the employer's failure to fund the Plan to satisfy its minimum funding requirement under IRC § 412.

2. IRC § 4975- Excise tax arising from "prohibited transactions" between a Plan and a "disqualified person."

B. Egregious failures cannot be addressed under SCP. They may be addressed under VCP for a higher fee. Audit CAP is also available to correct an egregious failure.(See §§ 4.11 and 12.06 of Rev. Proc. *2008-*

50). Examples of egregious failures include a plan: (i) that has consistently covered only highly compensated employees and excluded eligible non highly compensated employees; (ii)that provides more favorable benefits for an owner of the employer based on a purported collectively bargained agreement where there has in fact been no good faith bargaining between bona fide employee representatives and the employer. (See Notice 2003-24); or (iii) where contributions on behalf of one or more highly compensated individuals are well in excess of the applicable 415(c) limitation;

C. Failures arising from the diversion or misuse of Plan assets cannot be addressed under EPCRS. (See § 4.12 of Rev. Proc. *2008-50*.)

D. Abusive Tax Avoidance Transactions(ATATs): EPCRS is not available to correct failures that are related to ATATs. For unrelated failures, based on feedback from the Tax Shelter Coordinator, unrelated failures may be addressed. Referral to exam for ATAT issue, examination of plan for ATAT issue could still be done even if failures are being addressed in a VCP submission. Compliance statement cannot be relied on for the purpose of concluding whether the plan or the plan sponsor were parties to an ATAT (for additional details refer to section 4.13 of Rev. Proc. *2008-50*)

VII. Qualification Failures - IRC § 401(a) Plans (Categorized).

A. Plan Document Failure: A Plan provision (or the absence of a Plan provision) that on its face violates the requirements of IRC § 401(a).

Example: No provision for limiting compensation to the applicable IRC § 401(a)(17) limit OR Plan document provides for a compensation limit of $400,000.

B. Operational Failure: Plan document provisions comply with IRC § 401(a). The failure is caused by the failure to operate the Plan in accordance with its provisions, i.e., the provisions of the Plan document were not followed.

Example: Plan provides for applicable IRC § 401(a)(17) limit on a participant’s compensation. However, the provision is ignored and the participant’s allocation is determined on her entire compensation of $400,000.

C. Demographic Failure: Plan document terms were followed, but the Plan still failed to satisfy any of the following requirements:

1. Minimum participation requirements of IRC §401(a)(26).

2. Coverage requirements of IRC §410(b).

3. Nondiscrimination requirements of IRC §401(a)(4).

Note: ADP/ACP test failures are Operational Failures.

<u>Example</u>: Plan covers employees of Employer A and does not cover employees of any other employers in the controlled group. The Plan operates in accordance with these terms. However, upon running the applicable test it is found that the Plan fails to satisfy the coverage requirements of IRC § 410(b).

D. <u>Employer Eligibility Failure:</u> Situation where the Employer, not eligible under the relevant provision of the IRC, adopted a Qualified Plan. e.g. State/Local Government adopting a 401(k) Plan.

(See § 5.01 of Rev. Proc. *2008-50*)

VIII. Correction Principles.

A. Full correction includes all taxable years, whether or not the taxable year is closed, e.g., exclusion of an eligible employee for 10 years. His or her account balance would have to be restored to reflect the contributions or allocations he or she should have received had the employee participated timely. (See § 6.02 of Rev. Proc. *2008-50*.)

B. The correction method should restore the Plan and its participants to the position it would have been in had the failure not occurred.
(See § 6.02(1) of Rev. Proc. *2008-50*.)

C. The correction should be reasonable and appropriate for the failure.
(See § 6.02(2) of Rev. Proc. *2008-50*.)

1. Methods specified in Appendices A and B of the Revenue Procedure are "deemed to be reasonable." Any correction method permitted under Appendix A or Appendix B applicable to a 403(b) Plan, a SEP, or a SIMPLE IRA Plan is similarly deemed to be a reasonable and appropriate method of correcting the related failure. *If a plan has a different but analogous failure to one set forth in Appendix A or B (such as the failure to provide a matching contribution by a governmental plan that is not subject to § 401(m)), then the analogous correction method under Appendix A or B is generally available to correct any failure. (See §6.02(2) of Rev. Proc. 2008-50.)*

2. Other methods used would be evaluated for reasonableness based on the following criteria:

(a) Consistency with the IRC. To the extent possible, the correction method should resemble a method already provided for in the IRC, e.g., Income Tax Regulations (IT Reg.) § 1.415-6(b)(6) to correct annual additions made in excess of the applicable 415(c) limit; IT Reg. 1.402(g)-1(e), to correct deferrals made in excess of the applicable 402(g) limit.

(b) Correction method for failures relating to nondiscrimination should provide benefits for nonhighly compensated employees (NHCEs), e.g., ADP test failure, solely distributing the excess to HCEs, would not be a "typical" means of correcting such a failure.

(c) Correction method should keep assets in the Plan unless Code, Regs or other guidance requires that correction be made by distribution to participants or that money be returned to the Plan sponsor

(d) Correction method should not violate another applicable specific requirement of IRC § 401(a), e.g., § 401(a)(4), 411(d)(6)); or in the case of 403(b) Plans, the applicable correction should not violate a provision of IRC § 403(b). In the case of SEPs/SARSEPs, the applicable correction should not violate a provision of IRC § 408(k); or in the case of SIMPLE IRAs, the applicable correction should not violate a provision of IRC § 408(p).

D. Where more than one correction method is available to correct an Operational Failure for a plan year, the correction method <u>should be applied consistently</u> with respect to corrective contributions or allocations for a particular type of Operational Failure for a plan year. (See § 6.02(3) of Rev. Proc. *2008-50*.)

E. If a correction method is one which another government agency has authorized with respect to a violation of legal requirements within its interpretive authority and that correction relates to a violation for which there is a failure to which this revenue procedure applies, then the IRS may take the correction method of the other governmental agency into account for purposes of this revenue procedure. e.g. taking into account the provisions of Department of Labor Regulation 2578.1 (relating to abandoned plans) while evaluating corrections for a plan where the employer either has ceased to exist or is no longer maintaining the plan.(See §6.02(2)(e) of Rev. Proc. 2008-50)

F. Excess Allocations in situations where the Code/Regs. do not provide for a specific correction mechanism,(including IRC § 415 excess (see expanded definition for Excess Amounts in §5.01(3) of Rev. Proc. 2008-50 and applicable corrections in §6.06 of Rev. Proc. 2008-50):

1. Depending on plan provisions: excess is either reallocated among other participants OR to an unallocated account, to be used to reduce employer contributions. Excess amounts attributable to elective deferrals, employee contributions are distributed to the participant.

2. If the excess allocation that results in a IRC § 415 excess, and the excess is attributable to employee contributions, elective deferrals and employer contributions, then the excess is corrected in the following order:

(a) distribute unmatched employee contributions, elective deferrals; (b) distribute employee contributions, elective deferrals that are matched; (c) forfeiture of matching, employer contributions

G. Exceptions to full correction (See § 6.02(5) of Rev. Proc. *2008-50*):

1. Reasonable estimates, instead of precise calculations, because the difference between the approximate and precise restoration of a participant's benefit is insignificant and the administrative cost of determining precise restoration would exceed the difference. *For this purpose, the interest rate used by the Department of Labor's Voluntary Fiduciary Correction Program Online Calculator ("VFCP Online Calculator") is deemed to be a reasonable interest rate. The VFCP Online Calculator can be found on the web at http://www.dol.gov/ebsa/calculator.*

2. Delivery of small benefits ($*75* or less).

3. Recovery of small overpayments ($100 or less).

4. Participants cannot be located and reasonable efforts have been made, including mailings to the last known address and use of a locater service, e.g., the IRS letter forwarding program.

5. Small Excess Amounts ($100 or less)

6. At the discretion of the Service, full correction may not be required for terminating Orphan Plans.

IX. Correction for Certain Specific Situations.

Failure to include an eligible employee in a 401(k) or (m) plan-
Rev. Proc. *2008-50* requires that the employer contribute to the plan on behalf of the excluded employee an amount that makes up for the value of the lost opportunity to the employee to have a portion of his or her compensation contributed to the plan accumulated with earnings tax free in the future. For purposes of the new revenue procedure, the value of the "lost opportunity" to the employee will be equal to 50% of the pre-tax deferrals that would have been made if the employee had been timely included in the 401(k) plan. Generally, the deferral is determined by using the ADP for determining

the employee's missed deferral for traditional 401(k) plans. For safe harbor 401(k) plans, the deferral percentage is assumed to be 3% (or higher, if the plan provides for at least 100% match for higher level of deferral). For after-tax employee contributions, the value of the "lost opportunity" will be equal to 40% of the after-tax employee contributions that would have been made if the employee had been timely included in the plan. ACP is used for determining the employee's after-tax employee contributions. For an employee excluded from a plan that provides for matching contributions, the corrective contribution for the excluded employee is equal to the matching contribution that the employee would have received had the employee made a deferral equal to the missed deferral. (Note: similar analogy applies if the plan matches after-tax employee contributions). For details and examples on the correction for an excluded employee in a plan that provides benefits subject to §§ 401(k) or (m) please see Section 6.02(7), App. A .05 and App. B 2.02 of Rev. Proc. *2008-50*.

Note: The principle of determining corrective contributions based on "lost opportunity," with respect to elective contributions solely applies to the excluded employee failure. It cannot be used to correct other qualification failures.

<u>*Additional variations of the exclusion of ineligible employee issue. Rev. Proc. 2008-50*</u>*:*

A. <u>Improperly excluded employees in a plan that provides employees with the opportunity to designate elective contributions as Roth contributions</u>: The methodology for correcting the failure to provide an eligible employee with the opportunity to make elective deferrals does not change. The same general framework applies i.e. the employer makes a corrective contribution equal to 50% of the employee's missed deferral (adjusted for earnings). None of the corrective contributions made by the employer may be treated as designated Roth contributions (and may not be included in an employee's gross income) and thus may not be contributed or allocated to a designated Roth account (as described in § 402A(b)(2)). The corrective contribution must be allocated to an account established for receiving a QNEC or any other employer contribution in which the employee is fully vested and subject to the withdrawal restrictions that apply to elective deferrals. (See App. A .05(3) Rev. Proc. 2008-50).

B. <u>Failure to implement employee elections</u>: For eligible employees who filed elections to make elective deferrals under the Plan which the Plan Sponsor failed to implement on a timely basis, the Plan Sponsor must make a QNEC to the plan on behalf of the employee to replace the "missed deferral opportunity." The missed deferral opportunity is equal to 50% of the employee's "missed deferral." The missed deferral is determined by multiplying the <u>employee's elected deferral percentage</u> by the employee's compensation. If the employee elected a dollar amount for an elective deferral, the missed deferral would be the specified dollar amount. The employee's missed deferral amount is reduced further to the extent necessary to ensure that the missed deferral does not exceed applicable plan limits, including the annual deferral limit under § 402(g) for the calendar year in which the failure occurred. (See App. A. 05(5) Rev. Proc. 2008-50)

<u>Example</u>: [<u>NOTE</u>: This example is identical to Example 12 in App. B of Rev. Proc. 2008-50. However, Example 12 contains an error. The example says that an employee receives a matching contribution for deferrals up to the first 5% of compensation; but the solution is based on the premise that the employee receives a matching contribution for

deferrals up to the first 3% of compensation. The example in the outline corrects that problem by replacing "5%" with "3%"] Employer K maintains a § 401(k) plan. The plan provides for matching contributions for eligible employees equal to 100% of elective deferrals that do not exceed <u>*3%*</u> *of an employee's compensation. On January 1, 2006, Employee T made an election to contribute 10% of compensation for the 2006 plan year. However, Employee T's election was not processed, and the required amounts were not withheld from Employee T's salary in 2006. Employee T's salary was $30,000 in 2006.*

<u>*Correction*</u>*: Employer K uses the correction method described in Appendix A, section .05(5), to correct the failure to implement Employee T's election to make elective deferrals under the plan for the full plan year beginning January 1, 2006. Employer K calculates the corrective QNEC to be made on behalf of Employee T as follows:*

(1) <u>*Elective deferrals*</u>*: Employee T's election to make elective deferrals, pursuant to an election, in 2006 was not implemented. Thus, pursuant to section .05(5)(a) of Appendix A, Employer K must make a QNEC to the plan on behalf of Employee T equal to the missed deferral opportunity for Employee T, which is 50% of Employee T's missed deferral. The QNEC is adjusted for earnings. The missed deferral for Employee T is determined by using T's elected deferral percentage (10%) for 2006 and multiplying that percentage by Employee T's compensation for 2006 ($30,000). Accordingly, the missed deferral for Employee V, on account of the employee's improper exclusion from the plan is $3,000 (10% x $30,000). The missed deferral opportunity is $1,500 (i.e., 50% x $3,000). Thus, the required corrective contribution for the failure to provide Employee V with the opportunity to make elective deferrals to the plan is $1,500 (plus earnings).*

(2) <u>*Matching contributions*</u>*: Employee T should have been eligible for but did not receive an allocation of employer matching contributions because no elective deferrals were made on behalf of Employee T in 2006. Thus, pursuant to section .05(5)(c) of Appendix A, Employer K must make a QNEC to the plan on behalf of Employee T that is equal to the matching contribution Employee T would have received had the missed deferral been made. The QNEC is adjusted for earnings. Under the terms of the plan, if Employee T had made an elective deferral of $3,000 or 10% of compensation ($30,000), the employee would have been entitled to a matching contribution equal to 100% of first 3% of Employee T's compensation ($30,000) or $900. Accordingly, the contribution required to replace the missed employer matching contribution is $900 (plus earnings).*

The total required corrective QNEC, before adjustments for earnings, on behalf of Employee T is $2,400 ($1,500 for the missed deferral opportunity plus $900 for the missed matching contribution).

C. <u>*Improperly excluded employees: catch up contributions only*</u> *:. If an eligible employee was not provided the opportunity to elect and make catch-up contributions to a § 401(k) plan, the employer must make a QNEC to the plan on behalf of the employee that replaces the "missed deferral opportunity" attributable to the failure to permit an eligible employee to make a catch-up contribution pursuant to § 414(v). The missed deferral opportunity for catch-up contributions is equal to 50% of the employee's missed deferral attributable to catch-up contributions. For this purpose, the missed deferral attributable to catch-up contributions is one half of the applicable catch-up contribution limit for the year in which the employee was improperly excluded. Thus, for example if* *an eligible employee was improperly precluded from electing and making catch-up contributions in 2006, the missed deferral attributable to catch-up contributions is $2,500, which is one half of $5,000, the 2006 catch-up contribution limit for a § 401(k) plan. The eligible employee's missed deferral opportunity is $1,250 (i.e., 50% of the missed deferral attributable to catch-up contributions of $2,500). The QNEC required to replace the missed deferral opportunity for the year of exclusion is adjusted for earnings to the date the corrective QNEC is made on behalf of the affected employee. For purposes of this correction, an eligible employee, pursuant to § 414(v)(5), refers to any participant who (i) would have attained age 50 by the end of the plan's taxable year and (ii) in the absence of the plan's catch-up provision, could not make additional elective deferrals on account of the plan or statutory limitations described in § 414(v)(3) and § 1.414(v)-1(b)(1). (See App. A .05(4) Rev. Proc. 2008-50)*

<u>*Example*</u>*: (FROM Example 11 App. B Rev. Proc. 2008-50). Employer H maintains a § 401(k) plan. The plan limit on deferrals is the lesser of the deferral limit under § 401(a)(30) or the limitation under § 415. The plan also provides that eligible participants (as defined in § 414(v)(5) may make contributions in excess of the plan's deferral limits, up to the limitations on catch-up contributions for the year. The plan also provides for a 60% matching contribution on elective deferrals. The deferral limit under § 401(a)(30) for 2006 is $15,000. The limitation on catch-up contributions under the terms of the plan and § 414(v)(2)(B)(i) is $5,000. Employee R, age 55, was provided with the opportunity to make elective deferrals up to the plan limit, but was not provided the option to make catch-up contributions. Employee R is a nonhighly compensated employee who earned $60,000 in compensation and made elective deferrals totaling $15,000 in 2006.*

<u>*Correction*</u>*: In accordance with the provisions of Appendix A, section .05(4), Employee R's missed deferral on account of the plan's failure to offer the opportunity to make catch-up contributions is $2,500 (or one half of the limitation on catch-up contributions for 2006). The missed deferral opportunity is $1,250 (or 50% of $2,500). Thus, the required QNEC for Employee R's missed deferral opportunity relating to catch-up contributions in 2006 is $1,250 adjusted for earnings. In addition, Employee R was entitled to an additional matching contribution, under the terms of the plan, equal to 60% of the missed deferral that is attributable to the catch-up contribution that the employee would have made had the failure not occurred. In this case, the missed deferral is $2,500 and the corresponding matching contribution is $1,500 (i.e., 60% of $2,500).*

X. Self-Correction Program (SCP).

This program is only available to correct Operational Failures. (See § 4.01(1) of Rev. Proc. *2008-50*.) "The Plan Sponsor must have established practices and procedures (formal/informal) reasonably designed to promote and facilitate overall compliance with applicable Code requirements." (See § 4.04 of Rev. Proc. *2008-50*)

Note: Simply having a Plan provision is not enough, e.g., if the Plan is to be tested for compliance with the top heavy rules, it is not enough to have a Plan provision that requires top-heavy testing. Additional procedures, e.g., procedures incorporated into the Plan administrator's operating manual, would be required.

A. <u>SCP- Insignificant Operational Failures</u> (see § 8 of Rev. Proc. *2008-50*):

1. Insignificant Operational Failures can be corrected at any time. The program is available even if the Operational Failure is discovered by an agent on examination.

2. SCP for insignificant failures is available for Qualified Plans (401(a)), 403(b) Plans, SEPs and SIMPLE IRAs).

B. <u>SCP- Significant Operational Failures</u>:

1. Not available for SEPs or SIMPLE IRAs. Available for Qualified Plans and 403(b) Plans. (See § 7 of *Rev. Proc. 2008-50*)

2. Favorable determination letter required for Qualified Plans (401(a)). (See § 4.03 of Rev. Proc. *2008-50*) Generally means either the Plan should have received a favorable determination letter for GUST. For details, see "Favorable Letter" definition in § 5.01(4) of Rev. Proc. *2008-50*.

3. Not available if the failure is not corrected (*or substantially corrected as provided under § 9.04 of Rev. Proc. 2008-50*) by the time the Plan comes "Under Examination". (See § *5.07 of Rev. Proc. 2008-50*.). "Under Examination" includes:

   (a) IRS audit of the Plan. This includes a plan being investigated by the Criminal Investigation Division of the Internal Revenue Service.

   (b) If the Plan sponsor is an exempt organization, IRS audit of the Plan sponsor.

   (c) Verbal/written notification from Employee Plans that the Plan will be examined or that the Plan will be referred for examination.

   (d) "Plan" includes all plans that are required to be aggregated for purposes of demonstrating compliance with coverage and non-discrimination rules. (See IRC §§ 410(b), 401(a)(4).)

   <u>Example</u>: Plans A and B are aggregated for purposes of coverage and non-discrimination. If Plan A is the subject of an IRS audit, then Plan B is also "Under Examination."

   (e) For Plans that are not aggregated to comply with coverage and non-discrimination rules, "Plan" includes all plans that are required to be aggregated for purposes of demonstrating compliance with the code section relating to the failure being corrected.

Example: Plans C and D are not aggregated for purposes of coverage and non-discrimination. However, they are aggregated for the purpose of demonstrating either Plan's compliance with the requirements of IRC § 415. If the failure being addressed is an IRC § 415(c) failure and if Plan C is under IRS audit, then Plan D is also considered to be "Under Examination". Alternatively, if Plan D is addressing a problem that involves the failure to provide spousal consents for distributions made from the Plan, then Plan D is not "Under Examination".

(f) Notification by Employee Plans of potential qualification failures resulting from the review of any Form 5300 series determination letter application. The plan remains "Under Examination" for the issues identified, even if the applicant withdraws the determination letter application. (*See § 5.07(3) of Rev. Proc. 2008-50)*

4. Time constraints for completion/substantial completion of correction:

(a) Generally the last day of the second plan year following the plan year in which the failure occurred.

Example: Failure occurs in 2006. For a calendar year Plan, correction must be completed by 12/31/2008.

(b) For 401(k) Plan ADP/ACP/multiple use failures, the last day of second plan year following the end of the correction period provided by statute and regs.

Example: Plan fails ADP test for 2005. IRC § 401(k)(8) allows for correction by 12/31/2007. Plan would be eligible for SCP if the failure is corrected by 12/31/2008.

(c) For transferred assets, correction must be completed by the last day of the first plan year that begins after corporate merger, acquisition or other similar transaction.

See Example 2 in § 9 of Rev. Proc. *2008-50*: Operational Failure occurs in 2003. Acquisition resulting in asset transfer occurs in 2007. With respect to the "transferred assets," the failure should have been corrected by December 31, 2008.

5. "Substantial completion of correction" requires satisfaction of one of the following conditions (See §9.04 of Rev. Proc. *2008-50*):

(a) During the correction period, the plan sponsor is prompt in identifying the failure, formulating a method for correction and initiating correction in a manner that indicates a commitment to expeditious correction. Correction is completed within *120* days following the end of the correction period. OR

(b) During the correction period, correction is completed with respect to *65%* of the participants affected by the failure and, the plan sponsor completes correction with respect to the remaining participants in a diligent manner.

6. Correction by retroactive Plan amendment. Under SCP, Plan amendments can only be used for situations and correction methods provided for in Appendix B § 2.07 of Rev. Proc. *2008-50*. They are:

(a) Failure to comply with IRC § 401(a)(17) limit. The employer contributes an additional amount on behalf of each of the other employees (excluding each employee for whom there was a § 401(a)(17) failure) who received an allocation for the year of the failure, amending the Plan (as necessary) to provide for the additional allocation.

(b) Contrary to the terms of the Plan document, the Plan provides for hardship distributions. The Plan is amended retroactively to provide for the hardship distributions that were made available. This amendment is permissible if the amendment does not cause the Plan to violate another 401(a) provision, e.g., benefits, rights and features issues under IT Reg. 1.401(a)(4)-4).

(c) Contrary to the terms of the Plan document, the Plan provides for participant loans. The Plan is amended retroactively to provide for the loans that were made available. This amendment is permissible if the amendment (i) satisfies § 401(a) and (ii) the plan as amended would have satisfied the qualification requirements of § 401(a) (and the requirements applicable to plan loans under § 72(p)) had the amendment been adopted when plan loans were first made available.

(d) Ineligible employees (age and service; entry dates). The Plan is amended retroactively to change the eligibility provisions to provide for the inclusion of the ineligible employee to reflect the Plan's actual operations. This amendment is permissible if the amendment does not cause the Plan to violate another 401(a) provision.

Ineligible employees include employees who either (i) have not completed the Plan's minimum age or service requirements; or (ii) have completed the Plan's minimum age or service requirements but became participants earlier than the applicable entry date.

C. <u>Significant v. Insignificant Failures</u> (see § 8.02 of Rev. Proc. *2008-50*). Factors considered when making that determination (not all-inclusive):

1. 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).

2. The percentage of Plan assets and contributions involved in the failure.

3. The number of years the failure occurred.

4. The number of participants affected relative to the total number of participants in the Plan.

5. 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.

6. Whether correction was made within a reasonable time after discovery of the failure.

7. The reason for the failure, e.g., data errors such as errors in the transcription of data, the transposition of numbers, or minor arithmetic errors.

<u>Example 1</u>:

Total # of participants = 250
# of participants potentially affected by 415(c) limit = 50
Contributions for 2003 = $3,500,000
3 participants exceeded 415(c) limit
Excess annual additions = **$4,550**

<u>Example 2</u>:

Total # of participants = 250
# of participants potentially affected by 415 (c) limit = 50
Contributions for 2003 = $3,500,000
18 participants exceeded 415(c) limit
Excess annual additions = **$150,000**

Rev. Proc. 2008-50 concludes that Example 1 is an example of an insignificant Operational Failure and Example 2 is an example of a significant Operational Failure.

XI. Voluntary Correction Program (VCP): (Program generally described in § 10 of Rev. Proc. *2008-50*; Submission procedures described in §11 of Rev. Proc. *2008-50 and* fee structure outlined in § 12 of Rev. Proc. *2008-50*).

A. Key elements:

1. Employer identifies qualification failures to the Service.

2. Employer outlines methods used to correct the qualification failures to the Service.

3. Employer outlines changes in administrative procedures to the Service that would ensure that failures do not reoccur.

4. Employer and IRS agree to the methods of correction and the proposed revision of administrative procedures.

5. Employer pays a compliance fee. (Generally fixed under RP *2008-50* and payable up front along with the submission).

6. IRS agrees not to pursue the sanction of Plan disqualification with respect to the qualification failures provided that all corrective actions and changes to the administrative procedures are completed within 150 days of the execution of the "compliance statement".

B. Eligibility and Fees:

1. Qualified Plans, 403(b) Plans, SEPs and SIMPLE IRA Plans are eligible for consideration under VCP. See § 4.01(2) Rev. Proc. *2008-50.*

2. If the Plan or Plan sponsor is Under Examination, VCP is not available. See § 4.02 Rev. Proc. *2008-50* and discussion of the term "Under Examination" in Part VIII of this outline.

3. VCP can be used to correct all categories of qualification failures: plan document, operational, demographic, employer eligibility.

4. Fee is generally based on the number of participants in the plan. (see § 12.02(1) of Rev. Proc. *2008-50).*

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

# of participants used for 401(a) Plans; # of employees used for 403(b) Plans

5. Certain exceptions to fee structure above, outlined below:

- Sole failure: Failure to make required minimum distributions pursuant to IRC §401(a)(9) for 50 or fewer participants. Fee is $500. (see § 12.02(2) of Rev. Proc. *2008-50*)

- *Sole failure: Failure of participant loans to comply with the requirements of § 72(p)(2), and the loan failures affect no more than 25% of the plan participants during the year(s) in which the failure occurred, the fee is 50% of the fee schedule outlined in the table above. (see § 12.02(3) of Rev. Proc. 2008-50)*

- Terminating Orphan Plan: Possible waiver of compliance fee (see § 12.02(4) of Rev. Proc. *2008-50)*

- Sole failure: Nonamender failure, corrected within one year of the expiration of the applicable remedial amendment period. Fee is 50% of the fee schedule outlined in the table above. (see § 12.03 of Rev. Proc. *2008-50)*

- Sole failure: Failure to adopt interim amendments, certain discretionary amendments to implement optional law changes *(see App. F Sch. 1 of Rev. Proc. 2008-50. Also see §§6.05(3)(a) and 10.08 of Rev. Proc. 2008-50)*. Fee is $375. (see § 12.03 of Rev. Proc. 2008-50). <u>Primary purpose- Preserve the extended remedial amendment period.</u>

- SEPs/SIMPLE IRAs: $250 in most cases. (see § 12.05 of Rev. Proc. *2008-50*)

C. *<u>Streamlined Application Procedures</u> §11.02 of Rev. Proc. 2008-50 describes the information required for streamlined submissions- using App. F and related schedules; §11.03 of Rev. Proc. 2008-50 describes the information required for non-streamlined submission- using the sample submission format under App. D.*

<u>Appendix F</u>:

<u>Schedule 1</u>- Interim amendments or discretionary amendments relating to the implementation of optional law changes.
<u>Schedule 2</u>- Other nonamender failures
<u>Schedule 3</u>- SEPs/SARSEPs
<u>Schedule 4</u>- SIMPLE IRAs
<u>Schedule 5</u>- Loan failures for nonkey employees
<u>Schedule 6</u>- Ineligible employer failure: 403(b) or 401(k) plan
<u>Schedule 7</u>- Elective deferrals in excess of § 402(g)
<u>Schedule 8</u>- Failure to make required minimum distributions under §401(a)(9)
<u>Schedule 9</u>- Failures corrected by plan amendments allowable under SCP

Appendix D:

Sample format for submissions not covered by Appendix F

D. *Determination Letter Application submission requirements for VCP (See section 6.05 of Rev. Proc. 2008-50)*

If an application for a determination letter is required, then it will be reviewed in accordance with the procedures of Rev. Proc. 2007-44. Generally, the application will be reviewed for all items of the Cumulative List that would apply to the remedial amendment cycle during which the determination letter application is filed.

DL application is not required if correction is achieved by adopting an IRS approved model amendment or the adoption of a prototype/volume submitter plan with a current opinion/advisory letter.

- *Submission Required*
    - *Nonamenders (VCP and Audit CAP)*
    - *On-cycle corrections by plan amendment (VCP and Audit CAP)*
    - *SCP corrections by plan amendment to be submitted in next determination letter cycle.*
- *Submission not required*
    - *Correction of interim amendments, discretionary amendments relating to optional law changes*
    - *Off-cycle corrections by plan amendment (VCP and Audit CAP)* - *Amendment must be submitted in next determination letter cycle.*
- *Submission optional*
    - *Situations described in section 14.02 or 14.03 of Rev. Proc. 2007-44 e.g. urgent business need.*

E. Anonymous/Group Submissions:

1. Anonymous Submissions: (see §10.10 of Rev. Proc. *2008-50* for details). Key feature: An anonymous submission does not "preclude or impede 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 Service will no longer be eligible under VCP." (Compare with § 10.04 of Rev. Proc. *2008-50* for submissions made on a disclosed basis; the section generally provides that except in unusual circumstances, a plan will not be examined while the VCP submission for the plan is pending)

2. <u>Group Submissions:</u> (see § 10.08 of Rev. Proc. *2008-50* for details. Also see § 12.04 of Rev. Proc. *2008-50* for information on VCP fees for Group Submissions)

(i) <u>Generally:</u> An Eligible Organization may make a Group Submission to resolve failures, arising from a systemic error involving the Eligible Organization, that affect at least 20 plans and result in at least 20 plans implementing correction. The term "Eligible Organization" means either (a) a Sponsor (as that term is defined in section 4.07 of Rev. Proc. 2005-16, 2005-10 I.R.B. 674) of a master or prototype plan, (b) a Volume Submitter practitioner, as that term is defined in section 13.04 of Rev. Proc. 2005-16, (c) an insurance company or other entity that has issued annuity contracts or provides services with respect to assets for 403(b) Plans, or (d) an entity that provides its clients with administrative services with respect to Qualified Plans, 403(b) Plans, SEPs, or SIMPLE IRA Plans.

(ii) <u>Impact of examination</u>: "If a plan sponsor 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." (Result-Possible for plan sponsor to address failure in Group Submission, even if notification is received before the identity of the plan/plan sponsor was disclosed to the Service. Examination with respect to other issues can continue even while the Group Submission is in progress).

(iii) <u>VCP fees</u>: The compliance fee for a Group Submission is based on the number of plans affected by the failure as described in the compliance statement. *With respect to pre-approved plans, the fee is determined based on the number of basic plan documents submitted, irrespective of the number of accompanying adoption agreements.* 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 in excess of 20 multiplied by $250. The maximum compliance fee for a Group Submission is $50,000. *If additional plans are added following the Group Submission, the additional fee is paid subject to the $50,000 maximum compliance fee.* If more than one master or prototype plan is submitted as a Group Submission, each master or prototype plan is considered a separate Group Submission for purposes of the compliance fee.

XII. Audit Closing Agreement Program (see §§ 13 and 14 of Rev. Proc. 2008-50).

I. Non-amender failures discovered and corrected during the course of a determination letter submission (unrelated to VCP): Flat fee structure (ref: section 14.04 of Rev. Proc. *2008-50*) See 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

II. Audit CAP in other cases:

A. Closing agreements regarding sanction of qualification failures and applicable failure are negotiated as part of the examination process (or in some cases, part of the determination letter review process).

B. Correction will be consistent with the principles outlined for EPCRS.

C. The sanction is a negotiated percentage of the Maximum Payment Amount (which is meant to be an approximation of taxes that could be collected if the Plan is disqualified).

D. Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures, based on the factors below.

E. Factors include:

1. The steps taken by the Plan Sponsor to ensure that the Plan had no failures.

2. The steps taken to identify failures that may have occurred.

3. The extent to which the correction had progressed before the examination was initiated, including full correction

4. The number and type of employees affected by the failure.

5. The number of non-highly compensated employees who would be adversely affected if the Plan were not treated as qualified or as satisfying the requirements of §403(b) or §408(k).

6. Whether the failure is a failure to satisfy the requirements of §401(a)(4), §401(a)(26) or §410(b) either directly or through §403(b)(12).

7. The period over which the failure occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under § 401(b) for a Plan document failure).

8. The reason for the failure (for example, data errors such as errors in transcription of data, the transposition of numbers, or minor arithmetic errors).

F. Factors relating only to Qualified Plans also include:

1. Whether the Plan is the subject of a Favorable Letter.

2. Whether the Plan has both operational and other failures.

3. The extent to which the Plan has accepted transferred assets and the extent to which failures relate to transferred assets and occurred before the transfer.

4. If one of the failures discovered during an Employee Plans examination includes the failure to amend the plan timely for relevant legislation, it is expected that the sanction will be greater than the applicable fee described in section 14.04.

XIII. Web resources

(1) Correcting Plan Errors Link [Go to www.irs.gov; click on Retirement Plans Community; click on Correcting Plan Errors]

http://www.irs.gov/retirement/article/0,,id=96907,00.html

(2) Employee Plans newsletters. (Ability to subscribe electronically) [Go to www.irs.gov; click on Retirement Plans Community; click on Newsletters]

(a) Retirement News for Employers. (There is a regular article on plan correction issues entitled “The Fix Is In: Common Plan Mistakes”

http://www.irs.gov/retirement/article/0,,id=122823,00.html

(b) Employee Plans News

http://www.irs.gov/retirement/article/0,,id=96731,00.html

(3) Fix It Guides

- 401(k) Fix It Guide: Finding, Fixing and Avoiding Common Plan Mistakes

http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf

- SEP Fix It Guide: Finding, Fixing and Avoiding Common Plan Mistakes

http://www.irs.gov/pub/irs-tege/sep_fixit_guide.pdf

XIV. Contact Information.
(re: questions on correction issues)

A. Program Coordinators:

Name	Phone	E-mail address
Avaneesh Bhagat	(949)389-4420	Avaneesh.K.Bhagat@irs.gov
Paul Hogan	(206)220-6085	Paul.C.Hogan2@irs.gov
Wilbert Laird	(202)283-9630	Wilbert.G.Laird2@irs.gov
Maxine Terry	(202)283-9644	Maxine.B.Terry@irs.gov

B. Group Coordinators:

Name	Phone	E-mail address
Scott Feldman	(718)488-2255	Scott.M.Feldman@irs.gov
Al Dorevitch	(312)566-3833	Alexander.Dorevitch@irs.gov
George Patterson	(214)413-5525	George.C.Patterson@irs.gov
Vickie Walker	(626)312-2628 ext 5503	Vickie.L.Walker@irs.gov

C. "Where is my VCP submission?" question: Please call (626) 312-4921