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More Self-Correction Options in New EPCRS

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IRS' update to EPCRS responds to plan sponsor requests to allow more self-correction options, particularly for participant loan defects, and to allow more situations that can be corrected with plan amendments.

Background

Qualified retirement plans face a robust list of requirements under the tax Code and ERISA to obtain their favorable tax treatment and avoid challenges to their operations. For nearly 30 years IRS has offered a program for correcting plan document and operational errors that includes three structures — self-correction (SCP), voluntary corrections with IRS oversight (VCP), and constrained penalties where IRS discovers errors during plan audits (Audit CAP). Together the program goes by the acronym EPCRS, short for Employee Plans Compliance Resolution System. Costs under the program vary based on whether a submission is made to IRS for review (VCP) or whether the cost involves a penalty element for waiting for the IRS to find the problem (Audit CAP). Self-correction is the most desirable from a cost perspective, especially considering recently increased user fees under the VCP program.

Certain participant loan violations such as making loans in excess of the $50,000 limit or for a longer period than permitted and defaults due to loan administration failures raise issues for both the IRS and DOL. Plan administrators have been eager to expand the range of corrective options under the SCP, particularly for participant loans and document shortfalls. IRS latest update in 2018 (see our October 5, 2018 *For Your*

VFCP Program

The DOL also offers a correction program, the Voluntary Fiduciary Correction Program (VFCP) for addressing violations of ERISA, many of which stand to attract prohibited transaction penalties and excise taxes. The VFCP approach is a self-correction approach but requires the filing of documentation with a regional office to show evidence of the corrective action that has been taken. The DOL program focuses on how assets are handled — are participant contributions deposited to the plan timely, are assets correctly valued, and are transactions with parties in interest above board, for example. DOL does not charge a user fee for filing with them. But if they do not agree with the correction, or if they discover errors through plan audits, penalties and excise taxes may apply.

Information) announced that VCP submissions would be required electronically beginning April 1, 2019 and promised that more SCP options were under consideration.

2019 update to EPCRS

IRS characterizes Rev. Proc. 2019-19 as a limited EPCRS update published primarily to expand SCP eligibility to permit correction of certain plan document failures and plan loan failures. It also offers an additional method under SCP for correcting operational failures by plan amendment.

Required Amendments

IRS has issued the following Required Amendments lists: Notice 2016-80 provides the list for 2016 to describe the amendments generally due no later than December 31, 2018; Notice 2017-72 provides the list for 2017 to describe the amendments generally due no later than December 31, 2019; Notice 2018-91 reports on the list for 2018 — though there are no changes at all for this most recent list.

Self-correction of plan document failures

Under the updated EPCRS, plan sponsors can self-correct document failures other than the failure to initially adopt the plan. This type of failure is always treated as a significant failure, so the time for acting is limited to the end of the second plan year after the year the failure occurs with additional time allowed for transferred assets and merger and acquisition activity. In addition, the correction can only be made under SCP if the plan has a favorable determination letter. IRS publishes a list each year of Required Amendments (the “RA list”). These are the types of amendments contemplated here. There have been very few items listed on any of the RA lists since the cyclical determination letter program was halted.

Self-correction of operational failures with a plan amendment

Under the previous EPCRS rules, plans were permitted to correct certain operational failures with plan amendments if the amendment satisfied the qualification requirements and would have satisfied the requirements had it been adopted at the time the provisions were applied operationally. For example, a plan that allowed hardship withdrawals or participant loans despite lacking plan language saying so could be amended to add the language to memorialize what had actually been done. However, this was permitted under VCP and for limited situations under SCP (including failures related to the maximum compensation limit, hardship distribution and plan loan failures, and early inclusion of otherwise eligible employee failures).

The new EPCRS provides that SCP amendments can be made to address operation failures if:

a) the plan amendment would result in an increase of a benefit, right, or feature,

b) the increase in the benefit, right, or feature is available to all eligible employees, and

c) providing the increase in the benefit, right or feature is permitted under the Code and satisfies the general correction principles of EPCRS.

That is, EPCRS no longer restricts SCP corrective plan amendments to the previous short list. However, for the defects on that short list, EPCRS continues to limit the correction methods to be used for those errors.

Self-correction of loan failures

Most plan loan failures can be corrected under SCP as well as VCP, including with plan amendments to add provisions that had been applied operationally without plan language to support them.

Excess loans and defaults due to loan administrator error

DOL’s concern with loans generally focuses on violations of the maximum loan limit or the statutory repayment period and defaults due to loan administrator error as contrasted with loan defaults due to participant error or Form 1099-R reporting. IRS notes that the DOL’s VFCP requires submission of a VCP compliance statement and that DOL has advised the IRS that it will not issue a no-action letter unless the failures are corrected under VCP. Accordingly, IRS limits corrections to address the maximum limit and repayment period to VCP and Audit CAP. Although IRS does not limit SCP for defaults, plan administrators will need to consider the lack of VFCP cover if the default arises due to a payroll mistake as contrasted with a failure of a participant to mail a check.

Reporting

Under the new procedure, the approach available under VCP and Audit CAP to reporting deemed distributions is extended to SCP by eliminating the requirement to specifically ask IRS for that relief. Thus, deemed distributions can be reported on Form 1099-R for the year of correction instead of the year of the failure whether correction is made under SCP, VCP or Audit CAP.

Spousal consent

Plans are not required to obtain spousal consent for participant loans if the participant would not need spousal consent to take a distribution. In other cases, if spousal consent is required by the plan and is not obtained at the time of the loan, the defect can be corrected under SCP by currently obtaining spousal consent. If consent cannot be obtained, the failure must be corrected using VCP or Audit CAP.

Too many loans

If the plan allows a participant to take more loans than permitted by plan language, the error can be corrected by adopting a retroactive plan amendment that must satisfy the qualification requirements, would have satisfied those requirements [and loan requirements in section 72(p)] had it been adopted at the time the provisions were applied operationally, and multiple loans were made available to either all participants or only one or more non-highly compensated employees.

In closing

The updates expanding self-correction options are welcome news. However, recall that one of the limiting factors for SCP is that the plan must have established practices and procedures in place reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements. A plan document alone does not fill the bill for this requirement. The failure to be corrected must have occurred through an oversight or mistake in applying the practices and procedures. Plan sponsors should make sure they do have appropriate policies and procedures so that they can support their use of SCP if the need arises.

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