

## CLIENT ACTION BULLETIN

August 29, 2008

CAB 08-19

### IRS Updates Its Corrections Programs for Retirement Plans

**SUMMARY** The IRS recently updated its comprehensive correction program for retirement plans, providing clarifications and enhancements to the Employee Plans Compliance Resolution System (EPCRS). *Revenue Procedure 2008-50* also significantly expands the "streamlined" procedures for certain common failures and provides detailed examples of corrections made through EPCRS.

The revenue procedure is effective January 1, 2009, but plan sponsors may rely on the new procedures on or after September 2, 2008.

#### DISCUSSION **Background**

Since its launch more than a decade ago, the IRS has updated EPCRS to provide a strong incentive for plan sponsors to actively monitor their retirement plans to ensure continued compliance with the tax code. Last revised in 2006, EPCRS is designed to help plan sponsors voluntarily correct certain failures that, if discovered during an IRS audit, could lead to plan disqualification or adverse tax consequences. The programs available under EPCRS are currently applicable to tax-qualified defined benefit and defined contribution plans (e.g., 401(k)s and SIMPLE 401(k)s), as well as 403(b) tax-sheltered annuities and small employer plans such as SEPs, SARSEPs, and SIMPLE IRAs.

EPCRS offers three alternative correction programs:

- Self-Correction Program (SCP), which permits plan sponsors to correct both "insignificant" and certain significant operational failures without notifying the IRS or paying a fee;
- Voluntary Correction with Service Approval (more commonly known as the Voluntary Correction Program (VCP)), which permits plan sponsors, prior to an IRS audit, to request IRS approval of the correction method and pay a fixed fee (generally based on the total number of participants in the plan); and
- Correction on Audit (more commonly known as the Audit Closing Agreement Program (Audit CAP)), which applies when the IRS identifies a failure during an audit and requires a negotiated fee based on the severity of the failure.

#### **Clarifications and Enhancements**

Although the updated EPCRS retains the basic structure of the SCP, VCP, and Audit CAP, it offers some significant improvements:

- A plan sponsor may correct a failure to implement an employee's election by contributing 50% of the amount elected by the participant but not contributed. Previously, the remedy required a contribution of 50% of the average deferral or contribution percentage for the group—nonhighly compensated or highly compensated—to which the affected participant belonged.
- Any investment earnings adjustment for corrective contributions or distributions is calculated from the date the failure occurred. Earnings may be determined by using the Department of Labor's Voluntary Fiduciary Compliance Program's online calculator if making a reasonable estimate of actual investment results is not feasible.
- Correction methods are now available to address catch-up and designated Roth contributions when eligible employees are mistakenly excluded from a 401(k) plan.

### Operational Failures Newly Covered by Streamlined Procedures

The streamlined procedure that was available only for the correction of a failure to timely amend a plan for certain required amendments has been expanded. In addition to "nonamender" failures, the new guidance covers several common operational failures, including:

- loans in excess of the maximum dollar amount to employees who are not key employees or self-employed individuals;
- failure to distribute elective deferrals in excess of the maximum dollar limit;
- failure to pay required minimum distributions;
- certain corrections permitted to be made by plan amendment;
- plan sponsor eligibility failures; and
- certain SEP, SARSEP, and SIMPLE IRA failures.

### Other Key New Items

The revenue procedure also provides for the following:

- For plan sponsors to avail themselves of the SCP once the plan is undergoing an IRS audit, the correction of the error must already be substantially completed. Previously, one of the criteria was that the correction had to be at least 85% complete; this has been scaled back to 65%.
- The sample streamlined application form and the regular VCP application forms have been made more detailed and comprehensive, making the submission and review process easier.
- If the VCP submission only involves a violation of the maximum permissible loan amount and is limited to not more than 25% of participants in any given year, the compliance fee is reduced by 50%.
- A plan sponsor need not make a corrective distribution if the total corrective distribution is \$75 or less (increased from the previous \$50 threshold) and the cost of processing the distribution would exceed the amount of the corrective distribution.
- Specific rules for correcting failures in defined contribution plans for exceeding the tax code's section 415 contribution limits have been added. (These correction methods were included in regulations prior to their April 2007 revision.)

### Comments Sought for Future Improvements

In the interest of continuing to improve EPCRS and encouraging more plan sponsors to avail themselves of the opportunity to voluntarily correct failures, the IRS specifically requests comments on methods to correct certain failures in a 401(k) plan with automatic enrollment and certain failures regarding designated Roth contributions.

## ACTION

The newest update gives plan sponsors more opportunities to keep their plans in compliance by voluntarily correcting failures before an IRS audit. Plan sponsors should review the new guidance to determine whether errors may qualify for corrections under EPCRS. Legal counsel should always be consulted on the appropriate correction method and whether or not SCP or VCP is the appropriate course of action.

For additional information on the IRS's revenue procedure or for assistance with retirement plan compliance, please contact your Milliman consultant.