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Practical Tips For Plan Corrections Under EPCRS

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Agenda

- ♦ What is the EPCRS?
- ♦ Hypothetical Situations
- ♦ Helpful Hints

What is the EPCRS?

- ★ “Employee Plans Compliance Resolution System”
- ★ A program created by the IRS to permit plan sponsors and administrators to correct document and operational failures
- ★ Composed of three “programs”
 - > Self Correction Program
 - > Voluntary Correction Program with Service Approval
 - > Audit CAP
- ★ Most recent edition: Revenue Procedure 2008-50

Hypothetical #1: Excess Allocations

- ◆ Employer A sponsors a profit sharing plan with Code Section 401(k) and 401(m) features
 - > Participant 1 is allowed to make salary deferrals in excess of the Code Section 402(g) limit (\$16,500 for 2011)
 - Employer A makes a matching contribution on behalf of Participant 1
 - > Employer A makes a profit sharing contribution to Participant 2 that causes Participant 2's allocation to exceed the Code Section 415 limit (\$49,000 for 2011)
- ◆ How do you correct these "operational failures"?

Hypothetical #1: Excess Allocations

- ✦ All of the excess allocations, adjusted for earnings or losses, must be removed from the participants' accounts
- ✦ The excess salary deferrals must be returned to Participant 1
 - > If \$100 or less, then it does not need to be returned to Participant 1
 - Participant 1 must be notified that the amount is not eligible for rollover, etc.

Hypothetical #1: Excess Allocations

- ★ The excess matching contributions made on behalf of Participant 1 are placed into an unallocated suspense account and used to reduce future employer contributions
 - > Employer A cannot make employer contributions to the Plan until this amount is used
- ★ The excess profit sharing contribution is removed from Participant 2's account and
 - > Allocated to other eligible participants (if the Plan so provides) or
 - > Placed into an unallocated suspense account and used to reduce future employer contributions

Hypothetical #2: Earnings Calculations

- ✦ Same facts as Hypothetical #1
- ✦ How do you calculate the earnings or losses?
- ✦ If it is feasible to calculate actual investment results, then Employer A must do so
- ✦ Earnings or losses must be calculated from the date of the error to the date the correction is made

Hypothetical #2: Earnings Calculations

- ✦ If calculating the actual investment results is not feasible, then Employer A can use the DOL's Voluntary Fiduciary Correction Program Online Calculator to calculate a rate of interest
 - > This approach is deemed reasonable
 - > <http://www.dol.gov/ebsa/calculator>

Hypothetical #3: DC Plan Overpayment

- ✦ Employer B sponsors a profit sharing plan with Code Section 401(k) and 401(m) features
 - > Employer B matches 100% up to 5% of eligible compensation
 - > Participant 3 elects to defer 3% of his \$100,000 eligible compensation
 - Should have received \$3,000 in salary deferrals and \$3,000 in matching contributions
 - > Employer B makes an error and deposits \$5,000 in salary deferrals and \$5,000 in matching contributions to Participant 3's account
- ✦ How do you correct this “operational failure”?

Hypothetical #3: DC Plan Overpayment

- ◆ If Participant 3 is still working for Employer B
 - > \$2,000 in salary deferrals are returned to Participant 3
 - > \$2,000 in matching contributions are forfeited from Participant 3's account
 - Used to reduce future employer contributions
- ◆ If Participant 3 is no longer working for Employer B, then Participant 3 is notified that
 - > The \$2,000 in excess salary deferrals is not eligible to be rolled over
 - > The \$2,000 in excess matching contributions, plus interest, must be returned to the Plan

Hypothetical #3: DC Plan Overpayment

- ✦ If Participant 3 does not return the overpayment of matching contributions, then Employer A must contribute \$2,000, plus earnings at the Plan's earnings rate
- ✦ This amount will be used to reduce future employer contributions
- ✦ If this amount were a profit sharing contribution, it would be
 - > Allocated to other participants who would have been eligible to receive an allocation in the year of the operational failure or
 - > Placed into an unallocated suspense account and used to reduce future employer contributions

Hypothetical #4: DB Plan Overpayment

- ✦ Employer C sponsors a defined benefit plan
 - > Participant 4 elects to receive her benefits in the form of a 50% joint and survivor annuity
 - Her monthly payments should have been \$500
 - > Employer C makes an error and pays \$1,000 per month to Participant 4 for 3 years before the error is found
 - > Total overpayment is \$18,000
 - $\$500 * 36$ months
- ✦ How do you correct this “operational failure”?

Hypothetical #4: DB Plan Overpayment

- ✦ If Participant 4 is still receiving benefit payments
 - > Employer C notifies Participant 4 of the error
 - > Future monthly payments to Participant 4 are reduced in order to recover the overpayment
- ✦ If Participant 4 is no longer receiving benefit payments
 - > No action can be taken against her joint annuitant
 - > Employer C must put the overpayment (with appropriate interest) into the plan

Hypothetical #4: DB Plan Overpayment

- ✦ If Participant 4 had elected to receive a lump sum instead of a joint and survivor annuity
 - > Employer C would request her to return the lump sum payment, plus interest, to the plan
- ✦ If Participant 4 does not return the money
 - > Employer C must put the overpayment (with appropriate interest) into the plan

Hypothetical #5: Participant Election Failure

- ★ Employer D sponsors a profit sharing plan with Code Section 401(k) and 401(m) features
 - > Employer D matches 100% up to 5% of eligible compensation
 - > Participant 5 files an election form to defer 4% of her \$100,000 eligible compensation, plus the maximum amount of catch-up contributions
 - > Employer D fails to implement Participant 5's salary deferral and catch-up contribution elections
- ★ How do you correct this "operational failure"?

Hypothetical #5: Participant Election Failure

- ✦ Employer D must make the following contributions to the Plan on behalf of Participant 5, along with earnings or losses
 - > Salary deferral: 50% of the amount Participant 5 elected to defer (\$2,000)
 - > \$4,000 in matching contributions
 - > For catch-up contributions, the “missed opportunity” is deemed to be 50% of the annual maximum (\$5,500 for 2011)
 - Employer D must contribute 50% of the missed opportunity (\$1,375 = 25% * \$5,500)

Hypothetical #5: Participant Election Failure

- ✦ If Participant 5 had elected to make a Roth contribution to the Plan, then Employer D would have had to make the same corrective contribution
 - > However, the contribution would not receive Roth treatment (e.g., it is not immediately taxable and earnings will be taxed when distributed)
- ✦ Exception to correction
 - > If there are at least 9 full months left in the plan year after the operational failure occurred, then no corrective contributions need to be made on behalf of Participant 5

Hypothetical #6: Plan Amendment Failure

- ✦ Employer E sponsors a profit sharing plan with Code Section 401(k) and 401(m) features
- ✦ Employer E fails to timely amend the Plan to comply with
 - > EGTRRA
 - > Code Section 401(k)/401(m) Final Regulations
 - > Code Section 415 Final Regulations
 - > Code Section 401(a)(9) Final Regulations
 - > PPA of 2006
- ✦ How do you correct this “plan document failure”?

Hypothetical #6: Plan Amendment Failure

- ✦ Employer E should file a VCP Application with the IRS
 - > The Application should include copies of the executed amendments
 - > Employer E pays a reduced user fee of \$375 to use the streamlined application procedures

Hypothetical #6: Plan Amendment Failure

- ✦ Employer E will usually receive a “Compliance Statement” within a few weeks
- ✦ The Plan will be deemed to have timely adopted the amendments
- ✦ The Compliance Statement will not
 - > Determine whether the amendment complies with the applicable law or specific provisions of the Code
 - > Address whether the amendment conforms the terms of the Plan to its prior operations

Hypothetical #7: Plan Loan #1

- ✦ Employer F sponsors a profit sharing plan with a Code Section 401(k) feature and a loan program
 - > Participant 6 receives a \$60,000 loan from the Plan with a repayment period of 5 years
 - The maximum amount permitted for a loan is \$50,000
 - > Participant 7 receives a \$10,000 non-primary resident purchase loan from the Plan with a repayment period of 7 years
 - The maximum repayment period for this loan is 5 years
- ✦ How do you correct these “operational failures”?

Hypothetical #7: Plan Loan #1

- ✦ Employer F must file a VCP Application in order to correct these operational failures (and not cause Employees 6 and 7 to have deemed distributions)
- ✦ Employee 6's loan
 - > He must repay the amount exceeding the maximum amount permitted (\$10,000)
 - > The remaining amount is re-amortized from the date the excess is repaid to the end of the original period of the loan
- ✦ Employee 7's loan
 - > The unpaid portion of the loan is re-amortized from the date the excess is repaid to the maximum period that is permitted for this type of loan (5 years)

Hypothetical #8: Plan Loan #2

- ✦ Employer G sponsors a profit sharing plan with a Code Section 401(k) feature and a loan program
 - > Participant 8 receives a \$20,000 loan for a period of 5 years
 - > Employer G fails to deduct any loan repayments from Participant 8's paychecks for a period of 5 months
- ✦ How do you correct this "operational failure"?

Hypothetical #8: Plan Loan #2

- ✦ Employer G must file a VCP Application in order to correct the operational failure (and not cause Employee 8 to have a deemed distribution)
- ✦ Correction can include
 - > A lump sum repayment by Participant 8 equal to the repayments that she would have made had there been no operational failure, plus accrued interest
 - > The outstanding balance of the loan, including accrued interest, can be re-amortized over the remaining payment schedule of the original term of the loan (up to the maximum allowable period)
 - > Any combination of these two approaches

Hypothetical #9: Failure to Adopt Plan

- ✦ Employer H sponsors a profit sharing plan with a Code Section 401(k) feature
- ✦ Employer H has three subsidiaries that are part of its control group of corporations
- ✦ Employees of Employer H and all of its subsidiaries have participated in the Plan since 2000
- ✦ The Plan document states that employees of Employer H and any affiliated employer is eligible to participate in the Plan if the affiliated employer adopts the Plan and Employer H approves the adoption
- ✦ None of the affiliated employers have adopted the Plan
- ✦ How do you correct this “Operational Failure”?

Hypothetical #9: Failure to Adopt Plan

- ✦ Employer H should file a VCP Application requesting approval of the adoption of the Plan by its related employers
 - > Adoption would be retroactive to 2000
- ✦ If the IRS does not approve the retroactive adoption of the Plan, then the salary deferrals (and related earning) of all affected participants would have to be distributed

Hypothetical #10: Failure to Timely Pay MRD

- ✦ Employer I sponsors a defined benefit plan
- ✦ Participant 9 was supposed to receive his Minimum Required Distribution (“MRD”) by April 1, 2010
 - > Due to an administrative error, the MRD was not paid to Participant 9
- ✦ How do you correct this “operational failure”?

Hypothetical #10: Failure to Timely Pay MRD

- ✦ Employer I must pay Participant 9 his MRD, plus interest (for Participant 9's loss of the use of the money)
- ✦ Participant I is subject to a 50% penalty because he did not receive his MRD on a timely basis
 - > Even though it was not his fault
- ✦ Employer I can file a VCP Application and request the IRS to waive the 50% penalty on behalf of Participant 9

Helpful Hints

- ✦ On a regular basis (at least annually), review your procedures and documentation to determine if you have any “operational” or “plan document” failures
- ✦ If you discover an issue, correct it as soon as possible
 - > Use “Self Correction” if available
- ✦ If you need to file a VCP Application, consider filing it on an “Anonymous” basis
 - > Be careful, because there would be no “audit protection”
- ✦ Throw in the “kitchen sink” if you must file a VCP Application

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