

## IRS Makes Significant Improvements to EPCRS in Rev. Proc. 2019-19

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Effective April 19, 2019, new rules under the Employee Plans Compliance Resolution System (EPCRS) will greatly expand the types of disqualifying defects that may be corrected under the Self-Correction Program (SCP). SCP is a component of EPCRS under which certain types of disqualifying defects may be corrected without the need for an IRS filing or payment of a user fee. For many years, Congress and the private sector have urged the IRS to expand SCP. This expansion is a welcome update to EPCRS containing significant and beneficial improvements to the program.

### Background

A “qualified” retirement plan can run afoul of the qualification requirements of the Internal Revenue Code in many different ways. Among the most common are “operational” defects, which occur when the plan is not operated in accordance with its terms, and “plan document” failures, which occur when a plan document is not timely amended for changes in the laws or regulations. If a defect occurs, the procedures of EPCRS (as updated by Revenue Procedure 2019-19) provide a structure for correcting the mistake and maintaining the plan’s “qualified” status.

Disqualifying defects can generally be corrected through one of three EPCRS components: Audit CAP; the Voluntary Correction Program (VCP); or SCP. VCP and SCP are available to proactively correct a mistake and avoid the penalties applicable when a defect is uncovered during an IRS audit. Of these two components, SCP is generally the desired approach as it avoids the cost, delay and expense of an IRS filing. This is particularly true for smaller plans in light of the new user fee structure that became effective in 2018.

Under the new fee schedule, the user fees for EPCRS filings significantly increased for small plans (minimum \$1,500 and in most cases \$3,000) while they were reduced for larger plans (maximum \$3,500). Thus, the ability to use the expanded SCP will be particularly beneficial to the sponsors of smaller plans who will be able to correct a broader array of mistakes without having to actually file with the IRS and pay a user fee. It should be noted that the underlying rules to qualify to use SCP (such as having established compliance practices and procedures in place) still apply under the new procedure.

On May 23, 2019, at 11:00 AM PDT/2:00 PM EDT, we will present a complimentary webinar providing an in-depth analysis of the changes to EPCRS. Please click [here](#) to register.

Some highlights of the changes made by Revenue Procedure 2019-19 are set forth below.

## **What Has Changed?**

### ***Plan document failures***

In the past, failure to timely amend a plan document for changes in the law or regulations could only be corrected by filing a VCP application and paying a user fee (unless the correction was made during an IRS audit). The new procedure will now permit self-correction by retroactively adopting the required amendment. This self-correction approach is only available if the plan has a favorable determination letter or, for a pre-approved plan, a favorable opinion or advisory letter for the most recent expired six-year remedial amendment cycle. In addition, the corrective amendment must be adopted no later than the close of the second plan year following the plan year in which the amendment should have been adopted. So, for example, an interim amendment that should have been adopted by March 15, 2018, for a calendar year plan may be corrected through SCP no later than the end of 2020. Notwithstanding the limited window for self-correction, this change will be of great benefit as many plan document failures are discovered during this time period.

### ***Operational errors***

Mistakes are often made with regard to operating the plan strictly in accordance with its written terms. These operational mistakes can result in participants receiving higher benefits than were called for under the terms of the plan. If the plan sponsor is willing to provide for the higher benefit, this type of mistake can now be corrected through a retroactive conforming amendment. The amendment must result in an increase in a benefit, right or feature; the increased benefit, right or feature must be available to all eligible employees; providing the increased benefit, right or feature must not violate any other qualification requirement; and the correction must otherwise be in accord with the general correction principles of EPCRS. It remains to be seen how broadly this new provision may be applied, but it should be quite useful in correcting certain operational defects where participants benefited from the mistake and the plan sponsor is willing to live with this result.

### ***Plan loans***

The new rules (like the old rules) will allow for the self-correction of plan loan operational defects resulting from failure to repay the loan in accordance with the plan's terms (i.e., defaulted loans). What's new is the ability to self-correct without having to report the failure as a deemed taxable distribution to the participant. This is significant because in the past, the only way to correct a defaulted loan without tax consequences to the participant was by filing under the VCP and paying a user fee. Under the new procedure, a deemed taxable distribution may be avoided as long as the defaulted loan is corrected by either reamortizing the outstanding loan balance or by making a single corrective "catch-up" payment. However, it is important to note that the DOL will not issue a no-action letter under the Voluntary Fiduciary Correction program with regard to

a potential fiduciary breach in conjunction with the defaulted loan *unless* a VCP filing is made. For this reason, plan sponsors may want to consider a VCP filing depending on the circumstances and severity of the mistake.

An additional change with regard to plan loans is the ability to correct the failure to obtain spousal consent to a participant pledging his or her account balance as collateral for the loan. Very few 401(k) plans are required to obtain spousal consent in these circumstances because the plan doesn't offer an annuity distribution option. However, in cases where consent is required but not obtained, it will now be possible to self-correct this defect by simply notifying the spouse and obtaining consent retroactively. If the spouse will not retroactively consent to the loan, then the correction must be effected through negotiation with the IRS in a VCP filing (or in the context of an IRS audit).

A final change deals with operational defects that occur as a result of permitting a participant to obtain a number of plan loans that exceeds the number permitted by the plan's terms. In such a case, a retroactive conforming amendment may be adopted as long as the amendment doesn't violate the qualification requirements of IRC section 401(a) or the requirements of IRC section 72(p), and as long as plan loans (including plan loans in excess of the number permitted under the terms of the plan) were available either to all participants, or solely to one or more participants who were classified as "non-highly compensated employees." This type of amendment can now be adopted as part of an SCP self-correction.

## Conclusion

The changes made by Revenue Procedure 2019-19 will be welcomed by plan sponsors and practitioners alike. The improvements will facilitate compliance and simultaneously reduce the associated costs and burdens. The modifications that were made are a direct result of the partnership that exists between the private sector and the IRS with the joint goal of improving the employer based retirement system to the benefit of American workers.

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