



# The New and Improved Self-Correction Alternatives Under EPCRS

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# **EPCRS SCP EXPANSION REVENUE PROCEDURE 2019-19**

## EPCRS

- ✦ A “qualified” retirement plan or IRC § 403(b) plan must satisfy requirements set forth in the Internal Revenue Code to qualify for favorable tax treatment
- ✦ A plan that fails in this regard is said to have incurred a “disqualifying defect”
- ✦ The Employee Plans Compliance Resolution System (EPCRS) is an IRS program that allows retirement plan sponsors to correct disqualifying defects with respect to their retirement plan
- ✦ Revenue Procedure 2019-19, which became effective on April 19, 2019, restates the rules of EPCRS and in doing so significantly expands the types of disqualifying defects that may be corrected under the Self-Correction Program (SCP) component of EPCRS

## Types of Qualification Failures

- ✦ Operational failure:
  - > Failure to follow plan terms
- ✦ Plan document failure
  - > Plan provision (or lack thereof) that violates the IRC
- ✦ Demographic failure
  - > Failure of coverage, nondiscrimination, and/or 401(a)(26)
- ✦ Employer eligibility failure
  - > Employer not eligible to adopt plan
    - Example: Government employer can't establish a 401(k)

## 3 EPCRS Programs Available

- ★ Voluntary Correction Program (VCP)
  - > IRS involvement and must pay fee
  - > Fix almost anything
  - > Must do before IRS audit
  - > Streamlined option
- ★ Self-correction (SCP)
  - > Free, other than cost of correction
  - > No need to file with IRS
  - > Few guarantees
  - > **Limited to certain types of defects**
- ★ Audit Closing Agreement Program (CAP)
  - > IRS has caught you
  - > Can be expensive
  - > But, better than DQ

In all cases, to avoid disqualification, participants must be made whole

## The Self-Correction Program (SCP)

- ★ Applicable to operational failures, except as modified under the new rules for certain document failures
- ★ Eligibility Requirement: Plan must have in place (at time of failure) practices and procedures reasonably designed to facilitate compliance with the qualified plan rules
- ★ If the failure is **significant**:
  - > Must correct by end of 2nd plan year after year of the defect, and before notice of an IRS exam
  - > Must have favorable determination letter or equivalent
- ★ **Insignificant** failures are not subject to the 2-yr rule or the favorable letter requirement

## How Do You Correct?

- ✦ EPCRS contains pre-approved, safe harbor correction methods
- ✦ If you use a listed method to correct a listed mistake, you have reliance that it was a valid correction
- ✦ In absence of a safe harbor correction method, plan sponsor needs to correct in a reasonable and appropriate manner
  - > Use Code, regs, and EPCRS general correction principles as a guide
  - > Correct discrimination failures by giving \$ to NCHes
  - > Keep \$ in plan rather than reverting to ER
  - > Don't create another failure
- ✦ **General rule:** The further you go away from the EPCRS pre-approved list of corrections, the more you want to use VCP

## Lost Earnings

- ★ Corrective contributions, allocations or distributions should be adjusted for earnings
  - > Don't have to adjust for losses, but permitted
- ★ Methods for determining earnings:
  - > Generally use actual earnings based on EE's investment choices;
  - > Reasonable estimates of investment returns; or
  - > If not reasonable to make an estimate, a reasonable interest rate must be used

## **EPCRS – Rev. Proc. 2019-19**

- ★ Rev. Proc 2019-19 significantly expands the type of disqualifying defects that can be self-corrected
- ★ This expansion comes at a very opportune time for smaller plans
- ★ This is due to the significant 2018 increase in VCP user fees for submissions by smaller plans 2018

## Old Fee Schedule

Plan Size	User Fee
0 - 20 Participants	\$500
21 - 50 Participants	\$750
51 - 100 Participants	\$1,500
101 – 1000 Participants	\$5,000
1001 – 10,000 Participants	\$10,000
10,001 or more Participants	\$15,000

## New Fee Schedule – Effective in 2018

Plan Size	User Fee
\$500,000 or less	\$1500
\$500,001 to \$10,000,000	\$3000
\$10,000,001 or more	\$3500

## EPCRS – What Has Changed

- ★ The expansion of self correction is in three areas:
  - > Operational errors;
  - > Plan loan errors; and
  - > Plan document failures

# OPERATIONAL ERRORS

## Operational Errors

- ★ A common disqualifying defect is the failure to operate the plan in accordance with its written terms
- ★ Many times, these operational mistakes 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

## Operational Errors

- ✦ However, the retroactive conforming amendment must meet certain requirements:
  - > The amendment **must result in an increase in a benefit, right or feature (BRF)**;
  - > The increased BRF **must be available to all employees eligible to participate**;
  - > Providing the increased BRF must not violate any other qualification requirement (such as IRC sections 401(a)(4), 410(b), 411(d)(6) etc.); and
  - > The correction must be permitted under the tax code and satisfy the correction principles of EPCRS

## Case Study No. 1: Using SCP to Correct an Operational Failure

- ★ A 401(k) plan, based on a pre-approved prototype document, has long provided for discretionary employer contributions, which are allocated in proportion to compensation
  - > In 2018, the plan is restated and the new adoption agreement inadvertently fails to check the box for discretionary PS contributions
  - > In 2019, the employer makes a PS contribution (for 2018), which is allocated in proportion to compensation
- ★ Can the resulting operational failure be corrected under SCP?
  - > Answer: **maybe**

## Case Study No. 1: Using SCP to Correct an Operational Failure

- ✦ Are the basic SCP eligibility requirements satisfied?
- ✦ Does the 2019 PS contribution represent an **increase** in a **benefit, right or feature (BRF)**, as contemplated by Section 4.05(a)(2) of Rev. Proc 2019-19?
- ✦ Assume the PS contribution **does** amount to an increase in a BRF, can it be corrected under SCP if it were subjected to a condition such as a last day requirement? That is, would the SCP requirement that the **increase must apply to all eligible employees** be satisfied in this instance?

## Case Study No. 1: Using SCP to Correct an Operational Failure

- ✦ Assume the PS contribution does amount to an increase in a BRF, by what date would the corrective amendment need to be signed? What should be the effective date of that amendment?
- ✦ What if instead of failing to check the box for PS contributions, the plan restatement failed to check the box for age 59.5 in-service distributions and/or matching contributions? Would the case for SCP be easier in these situations? Would it make a difference if both operational failures existed at the same time?

# PLAN LOAN ERRORS

## Plan Loan Errors – Default

- ✦ Failure to withhold loan repayments
- ✦ Issues:
  - > Operational failure;
  - > Potential fiduciary breach; and
  - > Triggers deemed distribution

## Plan Loan Errors – Default

- ★ 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

## Plan Loan Errors – Default

- ★ 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 over the remaining period of the loan or by the end of the maximum period under IRC section 72(p)(2)(B);
  - > By making a single corrective “catch-up” payment; or
  - > A combination of these correction methods

## Plan Loan Errors – Default

- ★ If the default is not corrected in this manner, it is corrected by treating it as a deemed distribution
- ★ Under the new rules, the deemed distribution may be reported and recognized in the participant's current tax year rather than the year of the original default
- ★ Under the old rules, the deemed distribution would have been required to be recognized in the year of the original default unless the plan sponsor filed under VCP and made a specific request for current recognition of the deemed distribution

## Plan Loan Errors – Default Correction

- ★ ER contributes/pays the interest which continued to accrue because of failure to withhold:
  - > Greater of plan loan rate or plan earnings rate
- ★ Participant still must repay principal and interest under note by either:
  - > Making lump sum repayment = missed payments;
  - > Reamortizing loan over remainder of original term; or
  - > A combination of the above

## Loan Example

- ★ Participant with a \$50,000 account balance commences a \$20,000 loan, effective January 1, 2019. The loan terms provide for repayment through level amortization payments over a five year period (the maximum period under IRC section 72(p)(2)(B))
- ★ Plan sponsor mistakenly does not set-up payroll withholding to commence loan repayments. The error is discovered on July 1, 2019
- ★ Loan went into default on April 1, 2019

## Loan Example

- ★ Once discovered, the Plan sponsor informs the participant, and the participant consents to reamortizing the loan over the remainder of the five year repayment period (the maximum period under IRC section 72(p)(2)(B))
- ★ Plan sponsor pays the additional interest that accrued from January 1, 2019 until withholding actually commenced

## Loan Example

- ★ Old Rule: Self-correction of the failure to repay the loan in accordance with the plan's terms (i.e., defaulted loans) was permissible, but absent obtaining a compliance statement under VCP, the defaulted loan became a deemed distribution
- ★ New Rule: No VCP application is required to avoid treating a properly reamortized loan as a deemed distribution

## DOL on Plan Loan Errors – Default

- ✦ Note, the DOL takes the position that the failure of a “Plan Official” to properly withhold “a number of loan repayments” based on administrative or systems processing errors is a breach of fiduciary responsibilities. See section 7.3(b) of the Voluntary Fiduciary Correction Program (VFCP)
- ✦ The DOL will not issue a no-action letter unless an IRS VCP filing is made, and a compliance statement is received
- ✦ For this reason, plan sponsors may still want to consider a VCP filing and then a subsequent VFCP filing depending on the circumstances and the implications for a fiduciary breach

## Plan Loan Errors – Spousal Consent

- ★ Under the new procedure, it is now possible to self-correct the failure to obtain spousal consent to a participant loan
- ★ This defect can be corrected by notifying the spouse, **to whom participant was married at time of the loan**, and obtaining his or her retroactive consent
- ★ If the spouse will not consent, then the correction must be effected through negotiation with the IRS in the context of a VCP filing (or an IRS audit)

## Plan Loan Errors – Excessive Number

- ★ A final change is with regard to 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

## Plan Loan Errors – Excessive Number

- ★ In such a case, SCP will permit a retroactive conforming amendment to increase the number of loans allowed as long as the amendment:
  - > doesn't violate the qualification requirements of IRC section 401(a);
  - > the requirements of IRC section 72(p); and
  - > that plan loans (including plan loans in excess of the number permitted under the terms of the plan) were available to either all participants, or solely to one or more participants who were classified as "non-highly compensated employees"

# PLAN DOCUMENT FAILURES

## 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
- ★ This type of defect can be corrected when discovered in the context of an IRS audit or a determination letter application review, but only if a monetary sanction is paid. **The new procedure does not change this.**

## Plan Document Failures

- ★ The new procedure will now permit self-correction of a qualified plan document failure by retroactively adopting the required amendment
  - > This self-correction approach **is only available if:**
    - **With respect to an individually designed plan, the plan has a favorable determination letter; or**
    - **With respect to a pre-approved plan, the plan has a favorable opinion or advisory letter for the most recently 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

## Plan Document Failures – Pre-Approved Plan Example

- ✦ Pre-approved defined contribution plans will begin the updating process for the 3<sup>rd</sup> pre-approved plan during a 2-year window which is expected to open in the summer of 2020 and run until the summer of 2022. The 3<sup>rd</sup> cycle will formally end on January 31, 2023
- ✦ **Example** – Acme Paint Company timely adopted a pre-approved 401(k) plan effective January 1, 2014. The plan was timely amended by April 30, 2016 for the 2<sup>nd</sup> 6-year cycle and is due to be updated for the 3<sup>rd</sup> cycle during the 2-year restatement window. Acme missed the deadline for the 3<sup>rd</sup> cycle restatement, which is discovered in February of 2023

## **Plan Document Failures – Pre-Approved Plan Example**

- ★ In March of 2023, while doing the plan compliance testing for the 2022 plan year, it is discovered that Acme failed to update the plan during the 3<sup>rd</sup> remedial amendment cycle by the deadline for doing so in the summer of 2022
- ★ Can Acme self-correct this plan document failure?

## Plan Document Failures – Pre-Approved Plan Example

- ✦ Unfortunately, the answer is no
  - > In order to self correct a plan document failure, a pre-approved plan must have a favorable opinion or advisory letter “... issued with respect to the most recently expired six-year remedial amendment cycle”
  - > As of February 1, 2023, the Acme plan will no longer have a favorable opinion or advisory letter with respect to the most recently expired cycle
  - > The deadline to self-correct this document failure would be January 31, 2023. After that date, a VCP filing must be made to correct the defect

## EPCRS – What's Next

- ★ Revenue Procedure 2019-19 indicates the IRS is will continue to update and improve EPCRS, and invites further comment from interested parties
- ★ Trucker Huss attorneys will be participating in this process through their committee work with the ABA and ASPPA
- ★ The Revenue Procedure specifically notes as an area for further change the rules dealing with self-correction of overpayments (as well as their potential recoupment by the plan)

## EPCRS – What's Next

- ★ 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 costs and burdens of doing so
- ★ The modifications that were made are a direct result of the partnership and dialogue that exists between the private sector and the IRS

## Trucker Huss Webinars – What's Next

- ★ Our next webcast is “401(k) Hot Topics” scheduled for June 20, 2019, at 11:00 AM PDT/2:00 PM EDT
- ★ Topics include:
  - > Proposed IRS hardship regulations and transitional options;
  - > “Matching” contributions for student loan repayments – How does it work and what are the pitfalls; and
  - > “Backdoor” Roth contributions – Popular in the press, but do they make sense?
- ★ Register today at [www.truckerhuss.com](http://www.truckerhuss.com)

# Questions ?



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