IF IT AIN'T BROKE, DON'T FIX IT; BUT IF IT IS, USE VCP

Charles M. Lax, Esq.

Employee Plans Compliance Resolution System ("EPCRS")

- IRS program designed to save the tax qualified status of retirement plans
- Comprised of 3 component programs
  - Self-correction programs ("SCP")
  - Voluntary Correction Program ("VCP")
  - Audit Closing Agreement Program ("CAP")

General Correction Principles Under EPCRS

- Full correction is required for all participants for all years (whether closed or not)
- Participants should be restored to the position they would have been if a failure did not occur
- Plan assets should remain in the plan if possible

General Correction Principles Under EPCRS

- The correction should not violate another provision of the Code
- Where possible correction should be made by providing additional benefits to non-highly compensated employees

Eligibility for SCP

- Generally limited to operational issues and not the failure to timely amend plans
- Correction must be made either:
  - Within two years after the end of the plan year in which the failure occurred
  - At any time for "insignificant" failures

Eligibility for SCP

- Factors considered in determining whether failures were insignificant
  - Percentage of plan's assets involved
  - The number of years the failure occurred
  - The percentage of participants affected by the failure

Eligibility for SCP

- The reason for the failure (i.e. minor arithmetic error)
- If multiple errors occurred the significance of all error in the aggregate

- Correction must be made before the plan is under audit
  - Available even during a general income tax audit or DOL audit

Key Elements of VCP

- Only available before the plan or sponsor is under IRS audit
- Plan sponsor files an application with the IRS
  - Describes all failures for all years and all participants
  - Describes administrative changes to assure the failure will not occur in the future
  - Describes the proposed correction method

Key Elements of VCP

- Plan must pay a compliance fee
  - Starts at $750 for plans under 20 participants
  - Increases to $25,000 for plans with over 10,000 participants
  - Reduced fees are available for plan amendment failures, missed RMDs and plan loan failures

How VCP Has Evolved Over the Years

- More plans covered including:
  - SEPs
  - SIMPLEs
  - 403(b) Plans

How VCP Has Evolved Over the Years

- Process "Streamlined" for More Failures
  - Expanded the situations where the streamlined procedures are available
  - Now includes certain participant loans, RMD failures and the failure to distribute excess deferrals timely

How VCP Has Evolved Over the Years

- Reduced Fees
  - $250 for SEPS or SIMPLE IRAs
  - $375 for the failure to timely adopt a required interim amendment
  - Plan loan failures start at $300 for plans with 13 or fewer participants

How VCP Has Evolved Over the Years

- For plans where there are RMD failures, the fee starts at $500 if there are 150 less affected participants

Correction Examples

- Defaulted Plan Loan

  Joe borrows $50,000 from his plan in January of 2015 to be repaid in 60 monthly installments. Joe becomes disabled in May of 2015, goes out on a leave and payments stop. The plan accountant in February 2016 in his year end work, identifies the default

Correction Examples

- General rule is that a 1099 must be issued to Joe for 2015 for the balance owing
- VCP (but not SCP) allows for correction by either:
  - Joe making a lump sum payment bringing the balance current

Correction Examples

- Joe re-amortizing the balance including accrued interest over remaining loan term (February of 2016 through January of 2020).

Correction Examples

- Elective Deferral Failures

Because of a failure of internal procedures, the Acme, Inc. 401k Plan fails to notify Harry that he is eligible to begin elective deferrals on January 1, 2015. Later in the year its determined that a mistake was made. What is required for correction:

Correction Examples

- The correction is determined under one of the following:
  - If correction occurs within 3 months of when Harry was first eligible – no correction is necessary

Correction Examples

- If correction occurs before the end of the second plan year following the year of the failure (December 31, 2017), the employer must make a corrective contribution equal to 25% of the lost opportunity plus 100% of the lost match and lost earnings

Correction Examples

- If correction occurs after December 31, 2017 the corrective contribution increases to 50%
- The missed opportunity would be calculated based on the average deferral percentage for that class of employee (HCE or NHCE)

Correction Examples

- Failed ADP Test

  ABC, Inc. maintains a calendar year 401k plan. For the year 2015 it fails to pass the ADP test. However, due to internal problems it fails to transmit data to its TPA. Sometime after December 31, 2016, information is provided to its TPA and they determine that the plan failed ADP for 2015. Because correction of the ADP failure will occur, more than 12 months after the end of the plan year, a plan "failure" occurred. How can it be corrected?

Correction Examples

- It may be corrected with SCP if the correction occurred no later than December 31, 2018 (the two year rule) or the failure was insignificant. Thereafter, it must be corrected under VCP
- One option the plan has to collect is to make a Qualified Non-Elective contribution for NHCEs at a level sufficient to pass the ADP test.

Correction Examples

- A second option that the plan may utilize is for deferrals to be returned to the HCEs in sufficient amounts to pass ADP; provided, however, the employer must make a contribution to the plan equal to the amount returned and allocate it among the NHCEs.