



Pension Analyst

Important information

Plan administration and operation

December 2008

IRS updates correction programs

Who's affected

These programs are available to sponsors of qualified pension, profit sharing and stock bonus plans to correct errors in plan operation, demographics, and documents that might otherwise disqualify a plan. They are also available to ERISA and non-ERISA 403(b) plans, simplified employee pension (SEP) plans and SIMPLE IRA plans. The programs available to correct a mistake depend upon the type of error being corrected and the timing of the correction.

Background and summary

Over the course of several years, the IRS created programs to encourage plan sponsors to identify and correct errors in both plan operations and plan documents. The IRS eventually consolidated these programs under the Employee Plans Compliance Resolution System (EPCRS).

The IRS recently issued the first updates to EPCRS since 2006. These revisions retain the structure of the three existing programs:

- Self-Correction Program (SCP);
- Voluntary Correction Program with IRS Approval (VCP); and
- Audit Closing Agreement Program (Audit CAP).

However, in an ongoing effort by the IRS to make the programs more useful for plan sponsors, the correction programs have been expanded to include correction methods on errors that had not previously been addressed in EPCRS, as well as revisions to other correction methods, the submission process, and certain fee structures.

This publication will provide a summary of the significant changes, as well as provide links to several useful tools for plan sponsors that have encountered errors.

Action and next steps

Plan sponsors and their legal counsel should decide whether to review plan administration to determine if it meets IRS requirements. If errors have occurred, plan sponsors should discuss the EPCRS options described in this *Pension Analyst* and related documents with their legal counsel to determine if any are appropriate for their situation.

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Related documents

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Qualified plans and 403(b) plans must follow complex rules to maintain their tax-favored status. As a result, errors in plan operation may occur. The IRS first established programs to allow plan sponsors to correct errors in plan operation and avoid disqualification several years ago. These programs were expanded and updated over time to meet employers' needs. The IRS eventually consolidated these programs under EPCRS.

The EPCRS continues to offer three types of programs:

- *Self-Correction.* SCP allows many plan sponsors to correct operational errors without having to make a formal filing with the IRS or pay a correction fee.
- *Voluntary correction with IRS approval.* VCP allows plan sponsors to correct errors before audit, pay a limited fee, and receive IRS approval of the correction. VCP contains special procedures for anonymous submissions and group submissions.
- *Correction under audit.* Under Audit CAP, plan sponsors may avoid plan disqualification if the IRS discovers an operational, plan document, demographic or employer eligibility error upon audit.

The IRS periodically updates the EPCRS and provides additional guidance about the methods of correction it considers acceptable. Most recently, the IRS expanded the correction methods available under the program, and made additional revisions and clarifications that are intended to improve upon the existing structure of the program. These changes are generally effective January 1, 2009, but plan sponsors may choose to apply them anytime on or after September 2, 2008.

Summary of EPCRS programs, including recent changes

A brief summary of the EPCRS programs, including recent changes, is provided below. For more information about a particular program, refer to the document titled *IRS Employee Plans Compliance Resolution System (EPCRS) options*.

Self-Correction Program (SCP)

SCP allows plan sponsors to correct operational errors without making a formal submission to the IRS. As a result, the plan sponsor does not receive approval of its correction method from the IRS. The IRS has assured plan sponsors that it will not disqualify a plan due to an error that has been corrected under SCP.

Insignificant errors can be corrected under this program at any time without IRS review. Significant errors generally need to be corrected by the last day of the second plan year following the plan year in which the error occurred.

Certain errors (see details in document titled *Errors and acceptable correction methods*) can be corrected under SCP by adopting a retroactive plan amendment. For significant SCP corrections by plan amendments, the plan sponsor must request an IRS determination letter for the amendment before the end of the plan's applicable remedial amendment period.

The revised EPCRS program now provides a longer period for self-correcting certain significant errors and provides an extended correction period for self-correcting significant errors involving transferred assets.

Voluntary Correction with IRS Approval (VCP)

Plan sponsors may use VCP to correct operational errors, plan document errors, employer eligibility errors, or demographic errors. To use this program, the plan sponsor voluntarily discloses the error(s) to the IRS. The plan sponsor must also submit a proposed correction method and pay a correction fee. Once the IRS and plan sponsor agree on the appropriate correction, the IRS issues a Compliance Statement.

In an anonymous ("John Doe") submission, the VCP procedures apply, but the plan sponsor is not identified in the submission. After the correction method is agreed upon in writing, the plan and plan sponsor must be identified within 21 calendar days from the date of the letter of agreement.

The revised EPCRS program now contains [streamlined VCP application procedures](#) for several additional situations, including certain participant loan failures, failures to distribute minimum required distributions in a timely manner, failure to distribute excess deferrals, and the failure to adopt certain plan amendments in a timely manner.

Audit Closing Agreement Program (Audit CAP)

Under Audit CAP, if the IRS discovers operational, plan document, demographic, or employer eligibility errors while performing a plan audit, the plan sponsor may enter into a closing agreement rather than face plan disqualification. Since errors are not voluntarily disclosed, the penalty imposed is a negotiated percentage of the amount of tax the IRS would collect upon plan disqualification. The penalty may be reduced if correction is made before audit, even if that correction is made outside of the SCP or VCP. An additional factor considered when determining a penalty amount under Audit CAP is "whether the failure(s) were discovered during the determination letter process."

Other changes affecting the EPCRS

Under VCP, a plan may correct certain participant loan errors. The correction methods for these loan errors are described in detail in the document titled *Errors and acceptable correction methods*. If a plan sponsor wants relief from tax reporting a defaulted loan, or wants to tax report the defaulted loan in the year of the correction instead of the year of the failure, the plan sponsor must specifically request this relief. Additionally, the VCP submission fee for loan failures is reduced by 50% if the following conditions are met:

- The VCP submission involves participant loans that exceed the maximum permissible loan amounts or repayment period, or do not meet the level amortization requirement;
- No more than 25% of the participants are affected; and
- The loan failures are the only reason for the VCP submission.

The correction methods under the prior EPCRS guidance addressed situations where an employee was improperly excluded from making a deferral election. The new guidance expands the correction methods to address employees who were improperly excluded from making Roth contributions, and employees who were not provided the opportunity to make catch-up contributions. In addition, EPCRS now addresses situations where an employee made a deferral election, but that election was not implemented.

Another change requires plans to distribute earnings on late minimum required distributions from the date of the failure to the date of distribution.

In addition, the IRS may now waive the excise taxes for two additional situations, as part of a VCP submission:

- In overpayment situations, the IRS may waive the 6% excise tax on an excess contribution rolled to an IRA if the participant removes the overpayment from the IRA and returns the amount to the plan. The plan sponsor must request the relief and provide an explanation supporting the request; and
- In overpayment situations where an improper early distribution was made, the IRS may waive the 10% early distribution penalty if the participant removes the amount improperly distributed and rolled over to the IRA and returns the amount to the plan. The plan sponsor must request the relief and provide an explanation supporting the request. The IRS may also require the plan sponsor to pay an additional fee not to exceed the 10% income tax.

Sponsors of qualified plans are not required to submit a determination letter application under VCP and Audit CAP, unless a plan amendment is being adopted to correct a failure to amend the plan to correct a disqualifying provision and the year of the VCP or Audit CAP submission is an [on-cycle filing year](#), or the plan is terminating.

Specific errors and methods of correction under EPCRS

In the EPCRS guidelines, the IRS provides a list of general correction principles that apply to all corrections. These guidelines are described in the document titled *General correction principles under the EPCRS*. In addition, the IRS provides specific correction methods that may be used to correct certain errors under some of the programs.

The following errors can be corrected under SCP or VCP using the correction method(s) described in the EPCRS guidelines.

- Failure to properly provide the minimum top-heavy benefit to non-key employees.
- Failure to satisfy the ADP test, the ACP test, or the multiple use test (QNEC method or one-one method).
- Failure to distribute elective deferrals in excess of the section 402(g) limit.
- Exclusion of an eligible employee from all contributions or accruals under the plan for one or more plan years.
- Failure to timely pay the minimum required distribution (MRD) under section 401(a)(9).
- Failure to obtain participant and/or spousal consent for a distribution subject to the participant and spousal consent rules.
- Failure to satisfy the defined contribution annual additions limit under section 415(c).
- Vesting errors.
- Failure to satisfy the defined benefit annual benefit limit.
- All overpayment errors.
- Failure to apply the \$200,000 (as indexed) compensation limit.

EPCRS also allows the following errors to be corrected by a plan amendment under SCP or VCP.

- Failure to apply the \$200,000 (as indexed) compensation limit.
- Hardship distribution and plan loan errors.
- Inclusion of an employee who has not met the plan's minimum age and service requirements or who was included too soon due to an incorrect plan entry date.

EPCRS allows the following errors to be corrected only under VCP.

- Employer eligibility error.
- Loan amount exceeding the maximum permissible amount (\$50,000/50% Limit).
- Loan repayment period exceeds the maximum permissible repayment period.
- Loans that do not meet the level amortization requirement.
- Accidentally defaulted loans.

Descriptions of the correction methods allowed under the EPCRS programs for the above list of errors can be found in the document titled *Errors and acceptable correction methods*. Guidelines regarding the calculation of lost earnings for some of these correction methods can be found in the document titled *Earnings adjustments for corrective contributions*.

Plan sponsor next steps

Plan sponsors that discover operational, plan document, demographic, or employer eligibility errors either during the course of normal plan administration or as the result of a self-audit should review their EPCRS options with the plan's legal counsel.

Plan sponsors that are interested in reviewing the details of EPCRS may access Revenue Procedure 2008-50 and other related information through the IRS's web site at <http://www.irs.gov/retirement/topic>. The EPCRS information is under the topic titled 'Correcting Plan Errors'.

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