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I. INTRODUCTION AND UPDATE FROM PRIOR GUIDANCE

A. Why Is There an EPCRS?

To the casual observer, a retirement or profit-sharing plan should be able to become qualified under the Internal Revenue Code (the Code) upon its adoption and remain qualified during its existence until it is ultimately terminated. However, due to the Code's complexity and continuous legislative changes, establishing and maintaining a qualified plan has become a definite challenge for plan sponsors and plan administrators. To assist them, the Internal Revenue Service (''the Service'' or IRS) has developed a corrections program to assure continued and ongoing qualification for plans. This program is called the Employee Plans Compliance Resolution System (EPCRS), which is administered by the Service through its revenue procedures. There are three separate correction programs: Self Correction Program (SCP), Voluntary Correction Program (VCP), and Audit Closing Agreement Program (Audit CAP).

Until recently, practitioners have relied upon Rev. Proc. 2008-501 for guidance as to the three correction programs provided under EPCRS. However, the Service issued new guidance on December 31, 2012, in Rev. Proc. 2013-12,2 with appendices, along with a chart of the significant changes, a topical index, and new IRS forms to be now used for submissions under the Voluntary Correction Program (VCP). This article is intended for those practitioners unfamiliar with EPCRS, and thus, it summarizes not only the recent changes but the cumulative effect of the changes made to EPCRS as well. Practitioners should also be aware that the IRS’s corrections program is independent of the Department of Labor’s (DOL) Voluntary Fiduciary Correction Program (VFCP) and DOL’s Delinquent Filer Voluntary Compliance (DFVC) Program.3

Although compliance under the DOL program does

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1 2008-35 I.R.B. 464. All section references herein are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, unless otherwise indicated.


3 The finalized version of the DOL’s Voluntary Fiduciary Correction Program is available at http://www.dol.gov/whd/vfc/index.html, effective May 19, 2006. The DOL’s DFVC Program is summarized by the DOL at http://
not necessarily result in compliance with the IRS’s programs, the recent revenue procedures permit reliance on certain features of the DOL program for purposes of EPCRS.

B. Update from Rev. Proc. 2008-50

Rev. Proc. 2013-12 retains the basic structure of the program under the previous guidance, but provides the following welcomed enhancements to the program:

- For §403(b) plans, EPCRS is now available to correct plan document failures, beginning for tax years after January 1, 2009, and the corrections for operational failures are now more in alignment with those available for §401(k) plans.

- For excluded eligible employees under elective defined contribution plans, further clarification was provided for determining the “missed deferral” in connection with missed safe harbor elective, §403(b) elective, after-tax, catch-up, and Roth contributions.

- For defined benefit plans, actuarial equivalence factors (not the plan’s rate, which included §417(e)(3) factors) must be used to determine a corrective distribution (e.g., minimum distribution amount); however, §417(e)(3) factors may be used if the corrective distribution covers missed payments in a form that is subject to §417(e)(3).

- Model corrections for failure to satisfy the new benefit restriction rules of §436 have been provided.

C. Relevant 2006 PPA Changes and ACT Recommendations

In §1101 of the Pension Protection Act of 2006 (2006 PPA), Congress ratified the Secretary of Treasury’s authority and power to establish and implement the EPCRS program, as well as any other employee plans correction program. It extended to the Secretary the power to waive income, excise or other taxes under such program to guarantee that the penalty not be excessive in light of the extent and severity of the failure. This was expected to expand the types of defects that could be corrected under EPCRS. Congress also directed the Secretary to continue to update and improve EPCRS, with particular attention to the following areas:

- education of small employers as to the availability and practicality of the program, but taking into account the special issues facing small employers in compliance and correction;


4 P.L. 109–280 (8/17/06).
5 See id. at §1101(a).
• expansion of the SCP for significant compliance failures;
• expansion of the SCP to correct insignificant compliance failures discovered during audit; and
• consideration that the tax, penalty or sanction imposed by noncompliance be balanced with the reasonable relationship of the type, extent and severity of the failure.6

This legislation expanded the Treasury’s ability to permit and process corrections for plan qualification failures, with the recognition that such failures may be more acute in the small employer arena. However, with the wave of legislative requirements imposed on qualified plans in recent years, there has been a significant shift in small and medium-size employers to prototype or volume submitter plans, as opposed to individually-drafted plans. This certainly leads to less formal plan document failures, but it will not reduce the operational failures, especially if an employee of the plan sponsor is responsible for the plan’s administration. Such an employee may wear multiple hats (e.g., office manager, human resource specialist, plan administrator), making it difficult to have the time to assure that the plan’s qualification requirements are in compliance.

In the 2008 revenue procedure governing EPCRS, the IRS made mention of this legislation and reacted to it through the expansion of the appendices to add additional failures that commonly occur in plans maintained by small employers.7 It also expanded eligibility under SCP for employers that discovered failures and had begun the correction process prior to being under examination.8 Unfortunately, the expansion of the SCP did not lengthen the current two-year window for correction of significant failures to a three- or four-year window as hoped. The 2013 revenue procedure did not make reference to the 2006 PPA, but the IRS continues to invite comments, especially on corrections for failure to implement a §401(k) plan’s automatic enrollment provision where no amounts were withheld from an employee eligible for enrollment who did not so elect,9 as well as failure to implement a participant’s election to have a designated Roth contribution made on his or her behalf.10

The IRS Advisory Committee on Tax-Exempt and Government Entities (ACT) held its seventh annual public meeting on June 11, 2008, and made the following recommendations regarding EPCRS:11

With respect to SCP, ACT made the following recommendations:12
• Expand the duration of the self-correction period for significant operational failures from the last day of the second plan year following the occurrence of the failure to the last day of the third plan year.
• Expand the self-correction amendment options to include retroactive correction by amendment for scrivener errors.

With respect to VCP, ACT made the following recommendations:13
• Adopt a new program allowing plan sponsors to submit a notice to the IRS that a VCP submission is forthcoming, so that in the event of an interim amendment, the plan sponsor will be treated as though a VCP submission had been filed.
• Adopt a standardized application form for VCP to assist and expedite in the initial screening and review process to classify submissions as routine or complex.
• Reform the VCP fee structure to make it fairer and encourage greater participation.
• Amend the VCP rules to permit plan sponsors to file a qualified separate line of business (QSLOB) correction in the event the plan sponsor fails to timely file the proper notice.
• Amend the VCP procedures to clearly permit the use of the DOL Online Calculator to calculate earnings adjustments.
• Amend the VCP procedures to permit correction of limited exclusive benefit failures (e.g., inadvertent receipt and retention by a plan sponsor of demutualization proceeds).
• Amend the VCP procedures to permit a plan sponsor that is not otherwise entitled to use the DOL’s delinquent filer program to correct IRS Form 5500 filing failures.

6 Id. at §1101(b)(1)–(5). The effective date of this provision is the date of the law’s enactment, Aug. 17, 2006.
8 Id. at §2.02(4)(b).
9 Rev. Proc. 2013-12, §2.05(2).
10 Id. at §2.05(3).
11 The principal activity of ACT is to engage in year-long projects of specific topics, including the Employee Plans area, in the hope of improving the administration of the tax law and the relationship of the IRS to its constituencies. The text of the 2008 ACT Report is available at http://www.irs.gov/pub/irs-tege/tege_act_rpt7.pdf.
12 Id.
13 Id.
With respect to the Audit CAP program, ACT made the following recommendations:14

- Make information public regarding the administration of Audit CAP to facilitate better understanding of the resolution process.
- Permit a plan sponsor to request an internal high-level reconsideration of proposed Audit CAP sanctions to improve consistency and fairness.

With respect to EPCRS in general, ACT made the following recommendations:15

- Improve education and outreach by reminding plan sponsors of compliance issues and by reaching out to non-traditional stakeholders (e.g., registered investment advisors) to enlist their assistance in compliance for small employers.
- Develop a revenue procedure to assist payors in reporting corrective distributions.
- Expand EPCRS to include §457(b) programs.
- Expand EPCRS to permit correction of §403(b) plan document failures.

The two most recent revenue procedures adopt many of the ACT recommendations and, as such, the ACT’s recommendations will undoubtedly serve as a roadmap for future possible enhancements. The author understands that ACT is undertaking another review of EPCRS and will have follow-up recommendations to make during its 12th public meeting in June 2013.

II. OVERVIEW OF EPCRS

The Service’s corrections program is best understood as part of a twofold comprehensive system designed to keep retirement and profit-sharing plans qualified. The determination letter process (with extensions provided through the remedial amendment provisions)16 assures plan document compliance. The corrections program assures plan operational compliance and permits nonamenders17 to make certain retroactive plan amendments to attain plan document compliance.18 Generally, those plan sponsors that have utilized the Service’s determination letter process in a timely fashion will be concerned only with ongoing operational failures, whereas plan sponsors that have not taken advantage of the Service’s determination letter program will be concerned with both plan document and operational failures.

As a professor, I am always trying to analogize the law of employee benefits to the everyday experiences of my students. Reflecting on the Service’s determination letter and corrections programs, it occurred to me that the purchase and maintenance of a new car and the establishment and maintenance of a qualified plan may have a lot in common. When I purchase a new car, I certainly expect that it will work in accordance with the owner’s manual. The manual is designed to explain to me how to maintain and care for the car so that mechanical difficulties will be minimized; no one believes that difficulties won’t ever occur. If I secured a manufacturer’s warranty on the car, it promises to cover the costs of unexpected mechanical failures, either at no charge or for a modest fee. Certain ongoing maintenance items may not be covered by the warranty: oil changes, tire rotations, windshield wipers, etc. Nevertheless, it is in my best interest to perform these routine maintenance items, even at my own expense, in order to avoid later and more expensive charges that may or may not be covered under the manufacturer’s warranty. As significant problems unfold (e.g., transmission leakage), it may still be more effective for me to correct the defect, whether or not covered under the warranty. The alternative of waiting too long may result in the car’s self-destruction after years of non-maintenance.

Court for a declaratory judgment, provided all administrative remedies have been pursued.

17 Plan sponsors that do not make necessary corrective retroactive plan amendments to the applicable remedial amendment period (or cycle) are referred to as “nonamenders.” In the context of nonamender failures, Rev. Proc 2008-50 added a sentence in §14.04 stating that a greater sanction would be assessed if the failure was discovered upon exam. Thus, §14.04 of Rev. Proc. 2008-50 provided a lower fee schedule for nonamender failures discovered during the determination letter process (which continues under the new revenue procedure), as the plan sponsor voluntarily subjected itself to that process. If the nonamender failure is discovered upon examination, the higher fee is justified in order to maintain the integrity of VCP.

18 Retroactive plan amendments may be used to correct plan document failures that would otherwise cause the plan to lose its qualified status, provided such amendments are made within the remedial amendment period as described in §401(b) andRegs. §1.401(b)-1. The remedial amendment period refers to the applicable time period during which the plan amendment must be made and retroactively effective such that the plan attains or retains qualified status.
Likewise, every qualified plan needs an instruction manual, known as its plan document. Certainly, many small and medium-size employers utilize a standardized master or prototype plan or a volume submitter plan, which has a plan document pre-approved by the Service. Other employers desiring an individually-designed plan generally draft the plan and then have the Service later affirm its qualified status through the determination letter process. As long as the plan document terms are followed, the Service’s determination letter generally assures the plan sponsor that the plan document is qualified. Similarly, as legislative and regulatory changes require plan amendments, resubmission of a determination letter assures the sponsor that the plan will continue to be qualified as long as the plan amendments are made retroactively in accordance with the applicable remedial amendment period. The Service has discretion under the Code’s remedial amendment period to extend the time frame for retroactive plan amendments, which it does for those sponsors seeking a determination letter.19 Thus, the determination letter program is designed to review and perfect the plan document within an appropriate time frame so that most, but not all, plan document qualification failures may be avoided.

Because operational errors can occur with the administration of the plan and since certain plan features are not covered by the Service’s determination letter, the Service has initiated a second program — referred to as EPCRS — by which plan sponsors and plan administrators may correct disqualifying defects so as to avoid plan disqualification. In my analogy, it makes sense to correct defects as they occur, as the future cost of noncompliance is too expensive relative to current costs. EPCRS’s SCP is similar to correcting under warranty — there is no additional charge if defects are caught on a timely basis or are insignificant. Even if defects are caught outside the SCP period (i.e., outside of the warranty period), the use of EPCRS results in a less expensive correction method than waiting for the plan defects to be detected under examination. Now it makes no sense to ignore qualification issues involving a plan and subject the plan to potential disqualification. EPCRS is designed for use by plans qualified under §§401(a) and 403(b), and for SEPs and SIMPLE IRAs. Section 457(b) plans sponsored by government entities as described by §457(e)(1)(A)) may also apply to the IRS for corrective closing agreements under standards that are similar to EPCRS.20

A. The Service’s Overall System to Assure Qualification

To understand the Service’s correction program, it is important to step back and review the Service’s overall structure to assure qualification for existing plans. To ensure that the terms of the plan document are valid, the Service’s determination letter program is available on a voluntary basis for §401(a) plans.21 As the plan administrator is required to administer the plan as written,22 it makes no sense to start out with a defective plan document, especially when the Service has a voluntary program to review the plan’s terms. Unfortunately, the Service does not review the terms of most plan documents in advance of the plan’s actual establishment and ongoing administration. For most plans, a determination letter is sought within the initial year of the plan’s establishment. For subsequent plan amendments required because of legislative or regulatory changes, plan sponsors may need to request subsequent determination letters. Also, when a plan terminates, it may request a determination letter to assure that the distributions are qualified plan distributions and eligible for rollover treatment.

Due to the flurry of legislative activity in the late 1990s, the Service temporarily closed its determination letter program in order to provide guidance under the new rules.23 It utilized its discretion under the Code’s §401(b) remedial amendment provisions and postponed the adoption of the retroactive GUST plan amendments for all plans.24 This afforded practitioners sufficient time to amend plan documents so that

19 See Regs. §1.401(b)-1(e).
20 See Rev. Proc. 2013-12, §4.09. The Service will not extend similar EPCRS standards to §457(b) plans that were established as unfunded defined contribution plans for “top hat” employees, unless such plans were “erroneously established” to benefit the employer’s nonhighly compensated employees and has been operated as such. Id.
22 See Regs. §1.401-1(a)(2).
24 See Rev. Proc. 2000-27, 2000-1 C.B. 1272 (extending the remedial amendment period for disqualifying provisions for nongovernmental plans until the later of (1) the last day of the first plan year beginning on or after Jan. 1, 2001, or (2) the last day of the first plan year beginning after the 2000 legislative date. Announcement 2001-12, 2001-6 I.R.B. 526, provided a different extension for certain employers that utilize master and prototype plans or volume submitter plans. GUST is an acronym for the Uruguay Round Agreements Act (GATT), P.L. 103-465; the Uniformed Services Employment and Reemployment Rights Act of
they retroactively reflected the Code’s new requirements. While this additional time allowed the plan document to become “picture perfect” as of the appropriate date, the plan sponsor and plan administrator were still required to operate the plan in compliance with the applicable law beginning on and after the effective date of the changes.## Such disconnect between the timing of the plan amendments and the effective dates of the legislative changes exposed the plan sponsor and plan administrator to the potential for operational failures. EPCRS was designed to permit corrections to be made for those errors.

Over the past 10 years, the IRS has been revising and simplifying this correction program and its determination letter program. **By now, the EPCRS program is so simplified and streamlined that practitioners should educate and advise plan sponsors and administrators that use of such correction procedures is simply “best practices” for the ongoing maintenance of a qualified plan.** The costs of implementing proper practices and procedures to take advantage of this program must no longer be dismissed as unnecessary costs. Just as we have taken for granted the submission of a determination letter for approval of the plan document’s compliance, even though there is a related user fee, now use of the IRS correction program simply makes economic sense for keeping the plan in compliance during operation. The days of playing the audit roulette wheel are over — such costs now far surpass the costs of ongoing compliance.## The potential fees to correct the plan under Audit CAP have been designed to be considerably higher than he fees available through VCP.

Even if a plan sponsor secures a favorable determination letter, not all aspects of the plan documents are protected under the Service’s determination letter.## Certain terms of the plan document are operational in nature (e.g., the minimum participation and coverage rules under §§410(b) and 401(a)(26) and the nondiscrimination rules under §401(a)(4)),## and thus, the Service cannot always preapprove their application. Failures to satisfy these requirements on an ongoing basis are referred to as demographic failures, as such failures are the result of a shift in the demographics of the sponsor’s workforce.## Obviously, such failures can only be cured through the EPCRS program. Such corrections can be differentiated from other types of operational failures, as these may require corrective plan amendments to provide for greater benefits in order to assure compliance. Other types of operational failures (e.g., failures under the $401(k)$ or $(m)$ nondiscrimination rules) may simply necessitate the use of a correction method, but not require a retroactive plan amendment.

Other operational failures can occur for a multitude of reasons — an inadvertent error is made; the terms of the plan are not followed; and as legislative changes were made, the plan’s administration was not in compliance even though the plan document was later properly retroactively amended. Most of the time, correction of an operational failure involves following the terms of the plan and restoring the participants and beneficiaries to the position they should have been in had the failure not occurred. However, correction of an operational failure may require a retroactive plan amendment so that the plan’s terms actually match the operation of the plan. For example, if hardship distributions or participant loans were made from the plan but not authorized by the terms of the plan, correction requires a retroactive plan amendment authorizing such distributions or loans. If such retroactive amendment is made during the remedial amendment period, EPCRS is not needed. If such amendment must be made after the expiration of the remedial amendment period, such defect must be cured under EPCRS. If participant loans were made

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## Thus, the correction methods under EPCRS are not needed to correct qualifying defects that are cured within the remedial amendment period.

26 According to the U.S. Government Accountability Office’s (GAO) findings “Pension Plans: IRS Programs for Resolving Deviations from Tax-Exemption Requirements,” plans eligible to use the Service’s voluntary program could have avoided sanctions that were approximately 30% higher than the audit cap fees. The GAO’s findings supported the IRS’s assertions that voluntary reporting and correction of plan qualification defects is far preferable to the plan sponsor than correcting such defects as a part of an IRS audit. For more information on the GAO report, see [http://benefitslink.com/articles/audits001102.shtml](http://benefitslink.com/articles/audits001102.shtml).

27 See Ludden v. Comr. , 68 T.C. 826 (1977), aff’d, 620 F.2d 700 (9th Cir. 1980).

28 Coverage under §410(b), the minimum participation requirements of §401(a)(26) for defined benefit plans, and the nondiscrimination rules of §401(a)(4) may require testing on an annual basis to assure compliance.

29 Note that as part of the determination letter process, a higher user fee may be paid in order for the Service to review the plan sponsor’s method of testing for participation and nondiscrimination rules. See Rev. Proc. 2013–8, 2013–1 I.R.B. 237, for the applicable user fee for Employee Plans determination letter requests.
from the plan (with or without the authorization under the plan), they may have violated the terms of the Code — otherwise resulting in a taxable distribution from the plan, along with a premature excise tax, and an operational failure. EPCRS provides a cure for such failure, along with relief from the excise tax.

Finally, the adoption of a certain type of qualified plan by an employer that is not eligible to establish that type of plan is also a qualification failure, referred to as an employer eligibility failure, and can only be corrected through EPCRS. For example, employer eligibility would occur if a tax-exempt employer established a §401(k) plan between 1987 and 1996, or an employer implemented a SARSEP but has more employees than permitted under the limits of §408(k). 30

In summary, the Service’s EPCRS program permits correction of the following qualification failures:

- **plan document failures** (a plan provision or absence of a plan provision that violates §401(a)) that cannot be corrected through the determination letter program either because the plan sponsor did not seek a determination letter (“nonamender”) or the required retroactive plan amendment was not made within the remedial amendment period (“late-amender”);

- **operational failures** that occur because the terms of the plan were not followed (here, correction may be accomplished either through a retroactive plan amendment or a certain type of correction method, depending on which is appropriate);

- **demographic failures** in which the coverage/participation rules of §§410(b) or 401(a)(26) or the nondiscrimination testing rules of §401(a)(4) are not satisfied; and

- **employer eligibility failures** caused by the employer’s inability to establish the type of qualified plan that was adopted. 31

### B. Historical Background of EPCRS

The history of the IRS’s corrections program began back in 1990 with the Service’s original Closing Agreement Program (CAP), utilized to avoid disqualifying a plan. 32 It was restrictive regarding the issues that could be corrected and resulted in a sanction equal to a negotiated percentage of the “maximum payment amount” (i.e., the amount that approximated the taxes owed by the plan sponsor if the plan were actually disqualified). By 1991, the Service began an administrative policy, known as APRS (Administrative Policy Regarding Sanctions) or the Nonenforcement Policy, throughout the key district offices, to correct minor operational defects without any sanctions. 33 The Voluntary Compliance Resolution Program (VCR) was announced in 1992, 34 and made permanent in 1994. 35 Employers utilizing VCR had to have a favorable determination letter, disclose the defect and make the correction, but paid a fixed fee to the IRS as a sanction.

For plans not eligible for VCR, the Service devised a Walk-In Closing Agreement Program (Walk-In CAP) in 1994. 36 That program did not require a favorable determination letter and provided relief for plans with plan documents and demographic failures. By 1998, the programs were then consolidated under EPCRS, with the Service stating that ongoing revenue procedures would be implemented to further perfect the program. 37 By 2000, the corrections program was extended to §403(b) plans. 38 In 2001, the Service made major revisions to its corrections program, consolidating it into three separate programs, which still exist today. 39 The Service made further refinements in Rev. Proc. 2002-47. 40

Rev. Proc. 2003-44 made comprehensive and widespread changes to EPCRS, including a fixed fee

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30 See Rev. Proc. 2013-12, §5.01(2)(d) (noting that the SCP and the group submissions under the VCP are not available to correct an employer eligibility failure).

31 The new guidance modifies the definitions for §403(b) plans to add a definition of plan document failure and to revise the definitions of operational failure, demographic failure, and employer eligibility failure to coordinate with the new definition of plan document failure. Id. at §2.03.


33 In a memorandum from John E. Burke, Assistant Commissioner (Employee Plans and Exempt Organizations) to Assistant Regional Commissioners (Examination) and District Directors: Brooklyn, Chicago and Cincinnati (“APRS Memo”), the Service’s Administrative Policy Regarding Sanctions (APRS) was established (Mar. 26, 1991). The APRS Memo was the transmittal and back-up administrative policy, known as APRS (Administrative Policy Regarding Sanctions) or the Nonenforcement Policy, throughout the key district offices, to correct the same defect in at least 20 plans and introduced the concept of group submissions for eligible organizations (i.e., sponsors of a master or prototype or volume submitter plans and organizations providing administrative services) to correct the same defect in at least 20 plans and introducing a special rule in determining the correction period in the case of an operational defect relating solely to transferred assets).
schedule and revising Audit CAP.\textsuperscript{41} It greatly simplified the submission of a plan for voluntary compliance and drastically reduced the fee for such submissions. At that time, the Service indicated its intent to make \textit{annual} changes to EPCRS. However, there was no guidance issued during 2004 or 2005, leaving practitioners wondering whether meaningful changes would really be made and how often future changes would be forthcoming. The long-awaited Rev. Proc. 2006-27\textsuperscript{12} was released on May 5, 2006, and was cumulative in nature. Although the 2006 changes were not as extensive as the prior ones, they nevertheless reflected the Service’s continued intention to make ongoing compliance of the Code’s qualification rules straightforward and without threat of an impending audit. With the passage of the 2006 PPA in August 2006, Congress affirmed the Secretary of the Treasury’s authority and power to establish and implement the EPCRS program, as well as any other employee plans correction program, including the power to waive income, excise and other taxes.\textsuperscript{43} Congress desired that small employers be educated as to the availability and practicality of the program, but taking into account the special issues facing small employers in compliance and correction, expansion of SCP, and the balance of sanctions against the extent of the failure.

With a two-year gap, the Service issued Rev. Proc. 2008-50,\textsuperscript{44} which, like its predecessor, was cumulative in nature. The appendices under the 2008 revenue procedure were expanded to include additional failures that commonly occur in plans maintained by small employers, thereby reducing the burden and cost to the employer of submitting under the VCP. It also took into account changes that the IRS had made to its determination letter program reflected in Rev. Proc. 2007-44.\textsuperscript{45} The most recent guidance was published in Rev. Proc. 2013-12.\textsuperscript{46} It, too, is cumulative in nature, and includes a chart of significant changes to EPCRS, a topical index, and two IRS forms to be used in subsequent VCP submissions.

EPCRS is administered by the Employee Plans segment of the Tax-Exempt and Government Entities (TE/GE) Division of the Service, through different Voluntary Compliance (VC) Group Managers and Area Coordinators, depending on whether VCP, SCP or Audit CAP is being utilized. (See Attachment 1 of this article, which sets forth the names, addresses and phone numbers of these individuals.) With the improvements under the recent revenue procedures and electronic changes in processing cases, the handling of cases should be expedited.

To appreciate the relevance of the EPCRS program, it is important to understand the Service’s position on disqualifying plan document and operational failures. Beginning in 1989, the Service became vocal in its position that \textit{any} disqualifying defect, no matter how insignificant, could disqualify the plan\textsuperscript{47} — an insurmountable hurdle for any plan! The Tax Court affirmed the Service’s literal position, regardless of either the significance of the defect, the innocence of the violation, or the unreasonableness of disqualification in light of the violation committed.\textsuperscript{48} The Service’s position is further exacerbated by its position that once a disqualifying defect occurs, the plan remains disqualified until correction, thereby subverting the statute of limitations.\textsuperscript{49}

Given the Service’s rigid position, plan sponsors have been grateful that audits of qualified plans have been relatively limited both in number and scope.\textsuperscript{50} But, the IRS’s literal focus on disqualification and the potential cost to the plan sponsor in sanctions if disqualification is pursued should heighten plan sponsors’ concerns to address emerging plan disqualifying failures in a prompt fashion. The Service’s EPCRS program is a welcome response for plan sponsors and practitioners wishing to avoid disqualification.

\begin{footnotesize}
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\item\textsuperscript{41} 2003-1 C.B. 1051. See \url{http://www.irs.gov/retirement/article/0,,id=96907,00.html} for a summary of the changes, a topical index and a presentation highlighting the changes. Also, the link provides an order form for a free copy of the Retirement Plan Correction Program.
\item\textsuperscript{43} See note 4, above.
\item\textsuperscript{44} 2008-35 I.R.B. 464. For a summary of the significant changes made to EPCRS by this revenue procedure, see \url{http://www.irs.gov/pub/irs-tege/rp08_50_summary.pdf}. Highlights of that guidance were the subject of a Special Edition Newsletter, dated Aug. 14, 2008, issued by the IRS and available at \url{http://www.irs.gov/pub/irs-tege/rne_se_0808.pdf}.
\item\textsuperscript{45} 2007-28 I.R.B. 54.
\item\textsuperscript{46} 2013-4 I.R.B. 313.
\item\textsuperscript{48} Id.
\item\textsuperscript{49} Under a theory known as the “\textit{tainted asset theory},” if a plan becomes disqualified for more than five years and the money remains in the plan, the Service can perpetually disqualify the plan, and thus, the plan must be corrected even for years barred by the statute of limitations. See Rev. Rul. 73-79, 1973-1 C.B. 194. See also \textit{Martin Fireproofing Profit Sharing Plan and Trust v. Commr.}, 92 T.C. 1173, 1188 (1989).
\item\textsuperscript{50} According to the 2012 ACT Report, the Employee Plans Team Audit (EPTA) is a distinct audit program within EP exams which focuses on plans with at least 2,500 participants, and conducts about 100 EPTA audits annually. See the 2012 ACT Report, available at \url{http://www.irs.gov/pub/irs-tege/tege_act_rpt11.pdf}. Those 100 EPTA audits are in comparison with a total of 10,000 employee plans audits done annually, for the 1 million qualified plans under the IRS’s jurisdiction. \textit{Id}.
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plan administrators, particularly with the Service’s assurances that use of such programs will not heighten the threat of a plan audit. During informal discussions with the Service, the issue was raised whether a plan sponsor that was in the midst of self-correction or voluntary correction and discovered itself under audit could continue to resolve known defects under the voluntary programs. The Service indicated its willingness to allow plan sponsors to finalize corrections prior to resolution under the audit correction method, affirming its intent to promote EPCRS in lieu of audit.

During the GUST restatement period, the Service’s resources were diverted toward the determination letter and compliance programs, instead of the examinations. During recent years, the Service has expanded its examination program to include not only widespread audits of qualified plans, but also targeted audits on specific qualification requirements. The top five items that trigger an audit include:

- large number of separated participants with less than 100% vesting;
- large percentage of plan assets classified as “other assets”;
- large distributions on income statement;
- top-heavy §401(k) plans; and
- top-heavy plans covering self-employed individuals.\(^5\)

The Service has an enforcement unit, known as the Employee Plans Compliance Unit (EPCU), that does targeted compliance checks based on specific topics.\(^5\) It also is aggressively targeting Abusive Tax Avoidance Transactions (known as “ATATs”) that may involve a qualified plan or the plan sponsor.\(^5\) In the most recent EPCRS revenue procedure, the Service made it clear that EPCRS is not available to a plan or plan sponsor that has been a party to an ATAT where the plan failures noted in the VCP application are related to the ATAT. In such a case, a compliance statement will not be issued, and the case will be referred for examination. However, if the plan failures are unrelated to the ATAT (or an ATAT did not occur), the VCP submission can continue, and a compliance statement can be issued.\(^5\) The IRS also reserved the right to conclude that SCP and Audit CAP were not available if the plan failures relate to the ATAT.\(^5\)

### C. Goals and Structure of EPCRS

The Service has consistently listed the following items as goals for the EPCRS program:\(^5\)

- to encourage plan sponsors to establish administrative practices and procedures;
- to have plans satisfy the applicable plan document requirements of the Code;
- to have plan sponsors make voluntary and timely correction of plan failures;
- to impose fees and sanctions that are reasonable in light of the nature, extent and severity of the violation, and to graduate such fees and sanctions to encourage prompt correction;
- to administer the program in a consistent and uniform way; and
- to provide reliance to plan sponsors in taking correction actions.

These goals are certainly important considerations in applying the features of EPCRS — especially those that are dependent upon individual facts and circumstances.


\(^5\) EPCU conducted a recent §401(k) compliance Checklist Questionnaire Project, available at [http://www.irs.gov/RetirementPlans/Employee-Plans-Compliance-Unit-%28EPCU%29-%20401%28k%29-Compliance-Check-Questionnaire-Project](http://www.irs.gov/RetirementPlans/Employee-Plans-Compliance-Unit-%28EPCU%29-%20401%28k%29-Compliance-Check-Questionnaire-Project). Note that a plan sponsor contacted for an EPCU compliance check can still proceed with SCP or VCP corrections, as the compliance check is not an audit for purposes of EPCRS.

\(^5\) See Regs. §1.6011-4(b)(2) for listed transactions that are regarded as tax avoidance transactions. These include in the employee benefits context: §401(k) accelerated deductions; prohibited allocations of ESOP securities in an S corporation; collectively bargained welfare benefit funds for sham unions; certain trust arrangements seeking to qualify for exemption under §419; abusive Roth IRA transactions; S corporation ESOP abuses and §409 violations; deductions for excess life insurance in a §412(i) plan; and channeling S corporation pass-through income to government retirement plans.

\(^5\) See Rev. Proc. 2013-12, §4.13(1)(b). The prior revenue procedures were not clear as to who at the IRS makes a determination to refer the plan for examination and whether such determination can be challenged. The issue of an appeals process was not addressed in either the 2008 or 2013 revenue procedures.


\(^5\) See id. at §1.02, stating the general principles underlying EPCRS. In an effort to update and improve the EPCRS program, the IRS encourages comments, which may be sent to Attn: SE:T:EP:RA:VC, 1111 Constitution Ave. NW, Washington, D.C. 20224. The Service has requested comments on how to correct a failure to implement a §401(k) plan’s automatic enrollment feature and a failure to implement a participant’s election to have a designated Roth contribution be made where a pre-tax elective deferral was made instead.
The easiest way to envision EPCRS is to view it as providing three “doors” of correction. Two of the doors are voluntary — the Self Correction Program (SCP) and the Voluntary Correction Program (VCP) — and are accessible only if the plan is not “under examination.” The third door for correction is actually a “trap door” which may be opened by the Service for unsuspecting plan sponsors upon audit. The audit fee structure obviously penalizes those plan sponsors who wait for an examination, whereas the voluntary programs encourage self-correction and offer lesser costs. Unfortunately, not all violations may be corrected through EPCRS. Failures relating to diversion or misuse of plan assets cannot be corrected through any of these three programs.58

Generally EPCRS is not available to resolve certain excise tax liabilities, income tax liabilities that are not directly related to plan disqualification, additions to tax (e.g., the §72(t) penalty), and employment tax liabilities.59 However, the revenue procedures provide a waiver from the excise penalties for the following: §4974 (for a minimum distribution failure), §4972 (an employer contribution that is not deductible), §4979 (failure to timely perform the ADP test under a §401(k) plan that leads to insufficient amounts of excess elective deferrals to be distributed to the highly paid), §4973 (relating to excess contributions made to a §403(b) plan or IRA in certain circumstances), and §72(t) (for distributions to employees that do not qualify as a distributable event).60

The 2006 revenue procedure expanded the use of VCP and Audit CAP to “orphan plans” (or, as the Department of Labor (DOL) refers to them, “abandoned plans”).61 Under EPCRS, an “eligible party” may demonstrate that the plan sponsor no longer exists, cannot be located, is unable to maintain the plan, or is deemed to have abandoned the plan per the DOL regulations.62 This inclusion permits orphan plans to make distributions and closure with respect to benefit payments. The Service may permit orphan plans to make less than full correction, and reserves the right to waive the usual VCP fee if a formal request is made.63 The 2008 revenue procedure expanded the use of VCP and Audit CAP to terminated plans, whether or not a trust was still in existence.64

The focus of the IRS corrections program is on the common defects that are routinely seen in the ongoing administration of qualified plans. In ascertaining how a given defect is going to be corrected, the revenue procedure envisions correction either through a retroactive plan amendment or through a correction method that will restore the plan to its qualified status. The Service’s 2003 revenue procedure endorsed only three situations in which a retroactive plan amendment could be automatically made; other situations required approval from the Service.65 The 2006 revenue procedure permitted a fourth retrospective plan amendment in the situation in which the plan was making plan loans without the necessary plan language.66 This was added to reduce the number of Form 1099s that would otherwise have to be distributed to participants for distributions in lieu of plan loans. The 2008 and 2013 revenue procedures did not expand upon the list of retroactive plan amendments.

In contrast, operational defects cured by a correction method are regarded as more prevalent, and thus, the revenue procedure affords multiple correction methods for a variety of operational failures. If the defect is one not contemplated by the revenue procedure, or if an alternative correction method is sought for a given defect, dialogue with the Service should commence to ascertain a correction method, consistent with the model correction principles.67 (See Attachment 2 of the article for a summary of the four plan. Id. at §6.09(6).

57 See id. at §4.02. The revenue procedure defines “under examination” as either an Employee Plans examination with respect to the Form 5500 series (or other Employee Plans examination) or under an Exempt Organizations examination (if the plan sponsor is an exempt organization) in which the plan sponsor or its representative has received verbal or written notice of an impending examination.” The third door for correction is actually a “trap door” which may be opened by the Service for unsuspecting plan sponsors upon audit. The audit fee structure obviously penalizes those plan sponsors who wait for an examination, whereas the voluntary programs encourage self-correction and offer lesser costs. Unfortunately, not all violations may be corrected through EPCRS. Failures relating to diversion or misuse of plan assets cannot be corrected through any of these three programs.

58 See Rev. Proc. 2006-27, §5.07(3). Once such period begins, it is not clear how long the plan remains under examination for purposes of EPCRS.

59 See Rev. Proc. 2013-12 at §4.12. Note that the DOL has a Voluntary Fiduciary Correction Program (the VFC Program) to allow the avoidance of civil actions initiated by the Department and the assessment of civil penalties under ERISA §502(l) for certain fiduciary violations. See 67 Fed. Reg. 15062 (5/28/02).

60 See Levine, Pustulka, and Davis, “A Guide to the Self-Correction and Audit Closing Agreement Programs,” 2003 IRS Employee Plans Continuing Professional Education Program, Coursebook, Catalog No. 89089V, Ch. 11, p. 45.


62 An “eligible party” includes a court-appointed representative; a person determined by the DOL as having responsibility to distribute and terminate the plan; or a surviving spouse of the plan owner, provided it was never covered under ERISA Title I because the owner was the sole participant. See Rev. Proc. 2013-12, §5.03(2).

63 See id. at §12.02(4).


67 To see the list of the IRS’s 10 top failures cured under VCP.
permissible retroactive plan amendments and the model correction methods for a variety of different operational failures.)

VCP allows the employer to obtain approval from the IRS for the correction, given a certain user fee, and results in a compliance statement from the IRS in advance of making the necessary corrections. Although the employer may make an anonymous VCP submission, this does not protect a plan sponsor if the plan is subsequently examined prior to the completion of the actual VCP. In contrast, Audit CAP requires full correction to be made before the compliance statement will be issued. Audit CAP results because the IRS discovers a qualifying failure upon exam or sometime during the determination letter application review, and then, the IRS offers resolution by a closing agreement. The sanction levied during Audit CAP bears a reasonable relationship to the “nature, extent, and severity of the failure” but must be acceptable to the IRS and the plan sponsor. Nonamender failures caught on exam must be resolved under Audit CAP, as they are not eligible for SCP. Although Audit CAP is available while the plan is under exam, it is not available on appeal, as the appeals sanction is different from the Audit CAP sanction.

1. Model Correction Principles

Under all three correction programs, there are underlying principles that the Service utilizes in designing its model correction methods/retroactive plan amendments and in accepting alternative proposals. Many times the model correction method may not be the most cost-efficient correction method for the employer. Practitioners must be aware of these principles in order to fashion correction methods/amendments that best suit the plan sponsor’s needs. The practitioner must work with the Service to fashion a correction method that satisfies the qualification rules, consistent with the plan sponsor’s desire to minimize costs and administration concerns. The Service’s general correction principles are as follows:

- The correction method should make full correction to all affected participants (former and active) and authorized beneficiaries for all tax years, not simply those open under the statute of limitations.
- The correction method should be restitutionary in nature, restoring the participants/beneficiaries to the position they would have been in had the failure not occurred.
- In correcting operational failures, the correction method must take into account the terms of the plan at the time of the failure and must adjust for earnings (or losses) and forfeitures that would have applied.
- The correction method should be “reasonable and appropriate” for the failure. The 2008 revenue procedure expanded the scope of this principle by considering correction methods that are permitted by other governmental agencies for similar failures.
- The corrections noted under Appendices A and B of the revenue procedure are automatically deemed to be reasonable and appropriate for correcting the related qualification failure.
- The correction method, if feasible, should resemble one otherwise provided under the Code, the regulations or other authoritative guidance.
- The correction method should be applied consistently in correcting failures of the same type in the same plan year.
- Discriminatory defects must be resolved in favor of the non-highly compensated employees (NHCEs) (e.g., failure relating to the discrimination requirements applicable to benefits allocated

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68 See Rev. Proc. 2013-12, §6 (describing the applicable correction principles).
69 See Rev. Proc. 2013-12, §6.02. However, if correction is made for a closed tax year, the Service will not redetermine the tax liability because of the correction.
to the NHCEs should be corrected by contributing more to the NHCEs rather than distributions of excess to the highly compensated employees (HCEs)).

- The correction method must keep assets in the plan unless the Code or official guidance permits correction through distribution of assets (e.g., distribution of excess allocations).

- The correction method should not violate another applicable provision of §§401(a), 403(b), 408(k) or 408(p), but it may take into account a correction method recognized by the DOL.

- The correction method must include a procedure to locate former participants/beneficiaries.

- If the plan is subject to ERISA but the failure results from either the employer having ceased to exist, no longer maintaining the plan or similar reason, the permitted correction will be to terminate the plan and distribute assets to participants/beneficiaries in accordance with the DOL standards and procedures. Similarly, in the case of fiduciary violations under Title I of ERISA, correction under the DOL’s VFCP will be deemed correction for a similar failure under the Code.

2. Exceptions to Model Correction Principles

There are several noted exceptions to these model correction principles which may serve as a welcome relief for plan sponsors:

- Reasonable estimates may be used in making a correction if it is impossible to make precise calculations or if the administrative costs of exact calculations outweigh the difference between the proposed correction method and the precise corrective amount (e.g., DOL’s VFCP Online Calculator is deemed to be a reasonable interest rate).

- Correction of small distributions of $75 or less do not have to be made if the administrative costs associated with the payment of the benefit would exceed the amount of the distribution.

- Correction of small excess amounts ($100 or less/participant) are not required to be distributed or forfeited.

- Recovery of small overpayments ($100 or less) do not have to be sought if the plan sponsor so decides.

- Corrective distributions to former participants/beneficiaries whose location is unknown do not have to be made.

- In the context of an orphan plan, the Service retains the discretion under VCP and/or CAP whether to require full correction.

D. Common Failures in SCP and AUDIT CAP

In remarks made by Michael J. Sanders, Mid-Atlantic Area Manager, and Kathleen Schaffer, Mid-Atlantic Area Coordinator, the following is a list of what appear to be the most common failures under the various programs:

- Most common violations found in SCP and Audit CAP cases include: nonamenders for GUST, EG-

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77 See id. at §6.02(2)(c).
78 See id. at §6.02(2)(b) (noting an exception provided for under the Code, regulations or other IRS guidance for correction by participants/beneficiaries or return of plan assets to the plan sponsor).
79 See id. at §6.02(2)(d).
80 See id. at §6.02(5)(d). Reasonable action includes mailing to the individual’s last known address by certified mail, and if unsuccessful, then using a search method such as a commercial locator service. The IRS Forwarding Letter program will no longer be available for requests received on or after Aug. 31, 2012. See Rev. Proc. 2012-35, 2012-37 I.R.B. 341.
81 See Rev. Proc. 2013-12 at §6.02(2)(e)(i). The correction must satisfy four conditions: (1) it must fully comply with the DOL’s regulations relating to abandoned plans; (2) the qualified termination administrator must have reasonably determined whether and to what extent the Code’s survivor annuity requirements apply and taken reasonable steps to comply with such requirements; (3) each participant and beneficiary must be fully vested in his/her accrued benefits as of the date of deemed termination; and (4) participants and beneficiaries must be notified of their rights under §402(f).
82 See id. at §6.02(2)(e)(ii). Correction under the DOL’s VFCP for correction of a defaulted participant loans that provides for repayment in accordance with §72(p)(2) requires only submission of the correction under VCP and inclusion of the VCP compliance statement (with proof of any required corrective payment).
83 See id. at §6.02(5)(a). Although the Service generally requires full correction, it acknowledges this need not occur if it is unreasonable or not feasible; however, the mere fact that the correction is inconvenient or burdensome alone is not sufficient. The VFCP Online Calculator can be located at http://www.dol.gov/ebria/calculator.
84 See id. at §6.02(5)(b). According to the Service, this exception for small distributions applies to a single failure of $75, not multiple failures of $75 each. This correction refers to small corrective distributions that may not have to be made; it does not authorize the forfeiture of very small account balances. This exception also does not apply to corrective contributions, which are required to be made. Id.
85 See id. at §6.02(5)(e). If the excess amount exceeds a statutory limit, the participant/beneficiary must be notified that the excess amounts plus earnings is not eligible for favorable tax. The employer is still required to contribute to the plan to make it whole for the overpayment.
86 See id. at §6.02(5)(c).
87 See id. at §6.02(5)(d).
88 See id. at §6.02(5)(f).
89 See the transcript of the phone forum hosted by the IRS on Nov. 30, 2011, featuring Michael J. Sanders and Kathleen Schaffer, “Self Correction Program (SCP) and Closing Agreement Pro-
TRRA and §401(a)(9) changes; misapplication of the plan’s definition of compensation; exclusion of otherwise eligible employees; failure to follow plan loan features; and failure to make minimum required distributions.

- Most common violations in §401(k) examinations of such plans include: failure to make required matching contributions; average deferral percentage (ADP) and average contribution percentage (ACP) testing failures that are not timely corrected; elective deferrals in excess of the §402(g) limits; late deposits by the plan sponsor of elective deferrals; misapplication of the plan’s definition of compensation; exclusion of eligible employees; and misclassification of highly compensated employees (HCEs) and nonhighly compensated employees (NHCEs).

- Common issues in §403(b) SCP and Audit CAP cases include: excessive elective deferrals due to incorrect use of the 15-years-of-service catch-up rules; failure to make eligibility universally available; MAP failures (i.e., employees not eligible to participate because a participant agreement was not signed).

III. OUTLINE OF THE REVENUE PROCEDURE

The current revenue procedure is outlined as follows:

- Part I introduces the various correction programs and their effects on other programs, and requests public comments for future enhancements.
- Part II explains the effect of the compliance statement and the eligibility requirements for the various programs.
- Part III defines terms used in the revenue procedure and sets forth the general correction principles. This section is important when fashioning an alternative correction method not otherwise set forth in the revenue procedure.
- Part IV explains SCP and its use for insignificant versus significant operational failures.
- Part V explains VCP, including its eligibility requirements, submission procedures, and user fees.
- Part VI explains correction under Audit CAP, with its requirements, the effect of a closing agreement, and applicable sanctions.
- Part VII provides effective dates and various effects on other documents.

- Appendix A sets forth nine very common operational failures and deemed reasonable correction methods which plan sponsors may rely upon for SCP and VCP correction.
- Appendix B provides various correction methods (with examples) for other operational failures (e.g., ADP/ACP failures, exclusion of eligible employees, vesting failures, §§401(a)(17) and 415 failures, overpayment failures, and retroactive plan amendments) and an explanation of the earnings adjustment that is required under the correction.
- Appendix C now provides instructions for a Model VCP Submission Compliance Statement and various schedules to be completed if the failure refers to one of the nine operational failures noted under Appendix A. Obviously, using the existing schedules will streamline the submission process.
- Appendix D is the Acknowledgement Letter that the IRS returns to the plan sponsor, confirming that it received the VCP submission.

IV. SCP

This EPCRS program provides a “revolving door” for the plan sponsor because it can simply self-correct as operational failures unfold with no IRS involvement.\(^9^0\) Hence, there are no IRS compliance fees assessed.\(^9^1\) The cost of correction is simply the cost of applying the corrective method to the affected participants/beneficiaries. Obviously, the sooner the defect is caught, the cheaper it is to correct the defect. SCP is not available to cure plan document failures for nonamenders\(^9^2\) or to correct egregious operational failures.\(^9^3\) The determination of an egregious failure is a facts-and-circumstances determination, with examples provided in the revenue procedure.\(^9^4\)

\(^9^0\) Rev. Proc. 2013-12, §7 (SIMPLE IRA plans may only utilize SCP for insignificant operational failures). SCP is also available if the plan is under examination — for failures that are either insignificant and/or correctable under SCP.

\(^9^1\) See id. at §1.03.

\(^9^2\) See id. at §4.05(2).

\(^9^3\) See id. at §4.11. Examples of egregious failures could include improper coverage of only HCEs, use of phony union contracts to exclude hourly employees, and allocations to HCEs far in excess of the maximum limitation allowed under §415.

\(^9^4\) See id. at §4.11 (citing the following as examples of egregious failures: the plan has consistently and improperly covered only highly compensated employees; the plan provides more favorable benefits for an owner of the employer based on a purported collective bargaining agreement where there has in fact been no good faith bargaining between bona fide employee repre-
A. Prerequisites to SCP

Although SCP is voluntary on the part of the plan sponsor, there are several prerequisites to utilizing this program:

• Generally, any operational failure may be corrected under SCP. However, operational failures that require retroactive plan amendments to conform the terms of the plan to the prior operations are permitted only with respect to the failures noted in §2.07 of Appendix B of the revenue procedure.95

• Significant operational failures96 must be cured within a two-year window period under SCP, whereas insignificant operational failures may be cured at any time, even if the plan or plan spon-

sentatives and the employer (see Notice 2003-24, 2003-1 C.B. 853); or there are contributions to a defined contribution plan for a highly compensated employee several times greater than the maximum dollar limitations set forth in §415).

95 See id. at §4.05(2) and App. B §2.07 (providing three situations in which retroactive plan amendments are provided as the corrective method: (1) amending the plan to permit hardship distributions and/or plan loans if the plan has been providing such distributions and/or loans, (2) amending the plan to reflect that the plan has admitted employees at an earlier date than specified in the plan document (providing the only employee affected by the amendment are predominately NHCEs), and (3) for §401(a)(17) failures, amending the plan to increase the allocations for employees below the §401(a)(17) limit so that the allocation becomes the same percentage of compensation as contributed for the employee having the §401(a)(17) failure). The Service will consider other corrections through retroactive amendments under VCP even though they do not fit within one of the three model amendments. In the latest revenue procedures, the IRS noted that a plan that corrects through an appropriate correction method under Appendices A or B may voluntarily amend the plan to correct any failure that was discovered upon exam by the agent; lack of discrimination testing for multiple years, or if tests were made, failures were never corrected; the amounts of the vested accrued benefits for terminated participants were routinely in error, or if the amount of the distributions did not match the documented distribution amount; exclusion of a group of eligible employees, especially in the context of a recent acquisition. Generally, errors that continue to occur over multiple years are regarded as significant, and errors that affect multiple employees (especially a specific group of employees, e.g., part-time employees or employees of a certain employer within the controlled group) are regarded as significant. Correction of significant operational failures that have been completed or 65% completed can continue to be completed under SCP even if the plan or sponsor comes under exam. See id. at §§4.02 and 9.04.

• The plan sponsor must have received a favorable determination letter in order to correct significant operational failures under SCP.98

• The plan sponsor must have in place “practices and procedures” designed to promote and facilitate overall compliance with the Code.99

The requirement for a determination letter has been altered in the context of §403(b) plans. According to

97 Id. at §4.02. There are other extensions of the correction period. Correction of failures relating only to “transferred assets” or plans assumed in connection with a corporate merger or acquisition may be extended to the last day of the first plan year that begins after the merger or acquisition. See id. at §9.02(2). For violations of the actual deferral percentage (ADP) and actual contribution percentage (ACP) applicable to §401(k) plans, such plans have up to three years to correct the failure because Regs. §1.401(k)-1(f) extends the correction for another 12 months after the plan year in which the failure occurred. Id. at §9.02(1). In written materials prepared by Aavanesh Bhagat, a VCP program coordinator, for the 2007 Great Lakes Benefits Conference co-sponsored by the IRS TE/GE and ASPPA, the following examples were provided, illustrating the difference between insignificant and significant operational failures. For a plan with a total of 250 participants and total annual contributions of $3,500,000, three participants (out of a potential pool of 50 affected participants) received allocations in excess of §415(c) of $4,550. That represents an insignificant operational failure. However, if the number of participants who received excess allocations was 18 (instead of three) and the excess allocations totaled $150,000, that would represent a significant operational failure.

98 Rev. Proc. 2013-12, §4.03. Note that in the context of a prototype plan, an advisory letter from the plan sponsor certifying that the plan as adopted is identical to the plan approved under the determination letter is sufficient to qualify for VCP submission.

99 See id. at §4.04 (noting that the plan sponsor or administrator must have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with applicable Code requirements). Although the Service does not elaborate on the types of practices and procedures that would suffice, it does note that the plan document alone is insufficient. The reason for this is that operational failures should be the result of oversight or mistakes in applying existing practices and procedures. The practice and procedures do not have to be formal, but need to be in place before the failure occurred. Examples to the agent that a plan has such “practice and procedures” include: employee census data is tested against the source document; participant statements are accurate; records indicate that deferrals were timely remitted. During an agent’s exam of a plan, his/her initial interview is assessing the “internal controls” in place to assure adequate compliance of the terms of the plan. Under the 2013 guidance, plans with elective and nonelective employer contributions that experience recurring excess annual additions under §415(c) are permitted to self-correct if timely actions (within 2½ months after the plan’s limitation year) are taken to return elective deferrals to affected employees. See id. at §4.04. This raises the issue that corrections after 2½ months may demonstrate that the sponsor does not have “practices and procedures” in place to correct such failures.
the IRS, a plan document is not required for such plans prior to 2009. Thus, if the plan sponsor failed to adopt a plan document by December 31, 2009, the latest guidance permits a compliance statement to be obtained through VCP and Audit CAP correcting this failure. However, there is still not a determination letter program for §403(b) plans. Thus, the guidance confirms that having a timely adopted plan document or a VCP compliance statement addressing the plan document failure will satisfy the “determination letter” requirement for SCP purposes.102

B. Limitations of SCP

Because SCP is “self-corrective” on the part of the plan sponsor, the Service is reluctant to provide a blanket permission for retroactive plan amendments to cure operational failures due to its concern that such amendments could result in a cutback of benefits in violation of §411(d)(6). Thus, self-correction of an operational failure by means of a retroactive plan amendment is available only if the operational failure relates to the types of failures noted in §2.07 of Appendix B of the revenue procedure: §401(a)(17) failures, hardship distribution failures, inclusion of ineligible employees failures, and lack of plan loan language.103 The Service also requires that such plan amendments be submitted to the Service for the determination letter review during the plan’s next on-cycle year, or if earlier, in connection with the plan’s termination.104 Retroactive plan amendments to cure other types of operational failures must be corrected under VCP.105

For correction of other operational defects, use of any of the model correction methods described in Appendices A or B of the revenue procedure is deemed to be appropriate and reasonable. However, the Service acknowledges that there may be more than one reasonable and appropriate correction for a given failure. Hence, if the plan sponsor wants assurance that the use of an alternative correction method is reasonable and appropriate, VCP, not SCP, must be utilized. Although such alternative involves a fee under VCP, the alternative correction method approved by the Service may be less expensive for the plan sponsor than the model correction method.107

The revenue procedure clarifies that SCP can be used to cure insignificant operational failures even if the plan or plan sponsor is “under examination” and even if the insignificant operational failures are discovered by an agent on examination.108

C. Significant Versus Insignificant Failures

SCP makes a distinction between significant and insignificant operational defects, as the former must be cured within the two-year window. The revenue procedure provides the following list of factors to be used in determining “significance” (but no one factor is outcome determinative, nor is the list exhaustive):

- whether the failure occurred during the period of examination;
- percentage of assets/contributions involved;

102 See id. at §6.05(2). Note that the plan sponsor is not required to use one of the EPCRS correction methods, nor is it prevented from correcting a failure for which the EPCRS presently does not have a correction method. However, if the plan is audited, the plan sponsor may wish to concur with the plan’s auditor in advance to assure that a viable audit will be issued.

103 The Service has indicated its willingness to dialogue with plan sponsors as to the viability of alternative corrections methods, even under SCP. Note that if the plan is subject to ERA’s auditing requirements, any correction for an error that EPCRS does not have a prescribed correction method or for an error where an alternative correction method is being used may need the auditor’s approval in order to secure a favorable audit. Alternatively, if the plan is not subject to an audit, the plan sponsor must believe the correction method being utilized is sufficiently appropriate to pass the scrutiny of an IRS agent.

104 See id. at §9.02(1). “Under examination” is defined in §5.09 of the revenue procedure as including the plan being notified that it is under an Employee Plans exam, the plan sponsor that is under an Exempt Organizations exam is notified, or the plan is under investigation by the Criminal Investigation Division of the Service. Note that the revenue procedure permits a plan sponsor under examination to continue to correct any significant failures within the two-year window as long as it had substantially completed such correction (meaning it completed about 65% of the correction and will correct the remainder in a diligent manner). See id. at §9.04.
• number of years involved in the failure;
• percentage of participants who were affected and could be affected;
• whether correction occurred within a reasonable period; and
• the reason for the failure.\textsuperscript{110}

In applying these factors, the Service has indicated that all failures during an applicable correction period must be aggregated before applying these factors.\textsuperscript{111} Thus, plans with multiple defects will have a more difficult time justifying that the cumulative failures amount to an insignificant failure.

\section*{D. Two-Year Window for Significant Failures}

The two-year window available for SCP begins on the date of the operational failure (not the date the plan sponsor discovers the error) and ends on the last day of the second plan year following the plan year in which the failure occurred.\textsuperscript{112} For example, a plan sponsor with a calendar plan year discovers that certain eligible employees were excluded from participation as of the plan’s entry date of July 1, 2010. The date of the operational failure is the applicable entry date of July 1, 2010, as the employees were excluded from participation, and the two-year ending date is December 31, 2012 (the second plan year following the date of the initial plan failure). A few exceptions exist:

• If the plan becomes under examination, the correction period ends on the date notice of examination is provided (however, §9.04 of the revenue procedure recognizes that if correction has been substantially completed before that time, the plan sponsor will be permitted to complete correction).\textsuperscript{113}

• If the operational failure is due to failing the special discrimination tests of §401(k)(3) or (m)(9), the correction period is extended by the additional period of time permitted under those applicable Code sections.\textsuperscript{114}

• For §403(b) plans that do not have a plan year, the calendar year will be presumed to be used.\textsuperscript{115}

• Special rules and an extended period exist for transferred assets.\textsuperscript{116}

\section*{E. Administrative Practices and Procedures}

To utilize SCP, the Service requires that the plan sponsor or administrator have in place administrative practices and procedures designed to ensure compliance with the Code’s qualification rules. Thus, the operational failure must have occurred as a result of an oversight or mistake in application or because of the inadequacy of the procedures.\textsuperscript{117} Although the Service does not offer much guidance as to what has to be in place to satisfy this practices and procedures requirement, it notes that the plan document alone is not suf-
ficient. Specifically what type of operations manual has to be in place to spot disqualifying failures is not clear from the revenue procedure. Also, it is not clear whether a plan sponsor can formulate these procedures on an ongoing basis, as errors are uncovered and methods are adopted to correct such errors.

This requirement of pre-existing practices and procedures to facilitate ongoing compliance is consistent with the Service’s distinction in treatment between significant and insignificant operational defects. Such ongoing practices and procedures assume that routine and insignificant defects will be uncovered and corrected on an ongoing basis (i.e., within a two-year window). To the extent a significant operational failure occurs but is not corrected within this two-year window, SCP is unavailable, and hence, the plan sponsor must pursue VCP, which necessitates the Service’s involvement and fees in order to bring the plan back into compliance. Such approach is certainly consistent with the philosophy that the plan’s “best practices” should have ongoing practices and procedures to identify any defects as they occur, with assumed methods of correction (from the IRS revenue procedures), which keeps the plan in compliance and the Service at bay.

Because SCP is self-corrective on the part of the plan sponsor, certain verification information should be recorded by the plan sponsor in the event that the plan later finds itself under examination. Thus, the plan sponsor may wish to “mock up” the VCP form and schedules to record the failures and correction, not for submission purposes, but to document how it proceeded. Such records would be extremely helpful to an IRS agent upon a subsequent plan audit. In reviewing verification of an SCP correction, the Service says it will look for the following documentation:

- that corrective contributions/distributions were adjusted for earnings;
- that significant operational failures were corrected within the applicable two-year window;
- if the correction method used was not one of the ones specifically described in the appendices of

the revenue procedure, the correction method nevertheless complied with the Service’s correction principles, especially those outlined in §6.02(2) of the revenue procedure regarding reasonableness and appropriateness; and

V. VCP

VCP has evolved the most over the past 10 years. This door of opportunity must be opened by the plan sponsor and does involve the Service. The variety of programs offered under Rev. Proc. 2002-47 — VCO, VCS, VCT — has now been consolidated into a single VCP program to simplify the submission process. For plan sponsors with very minor defects, the prior VCO provided a flat $350 fee, which was preferable to the new VCP fee schedule. In all other respects, the simplification and reduced fee schedule make the new VCP a more-welcomed program.

Prior to the latest guidance, VCP submissions were sent to the IRS national office for initial review and then sent out to an IRS agent, under the supervision of one of five group managers. The latest guidance now calls for the VCP submissions to be sent to the Covington, Kentucky office (the same office that plan sponsors use for a determination letter filing). The intent is to smooth out the processing time and allow the group managers more control over the allocation of cases among agents.

A. Types of Failures

VCP is available to cure a wide variety of qualifying defects, including:

- plan document failures because the plan was not timely amended within the remedial amendment period afforded to plans requesting determination letters (e.g., nonamenders or late-amenders) or because the plan was not administered in accordance with its terms but operated in accordance with the qualification rules;
- operational failures that are or are not egregious in nature;
- demographic and employer eligibility failures; and

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118 APRS, the predecessor to SCP, required established practices and procedures regarding the area in which the violation occurred. Therefore, some concern exists if the plan sponsor’s general checklist or procedural guidelines do not cover a specific qualification failure. Whether broad categories of qualification covered by the checklist or procedure are sufficient is not yet known. See Rev. Proc. 92-89.

119 If a plan sponsor retains an external or third-party record-keeper, such recordkeeper’s procedures should suffice for purposes of satisfying the administrative practices and procedures requirement; but as is the case in any fiduciary delegation, the plan sponsor must exercise due diligence in selecting and maintaining a given recordkeeper.

120 See Levine, et al., note 59 above, at Ch. 11, p. 13.

121 See Rev. Proc. 2002-47, §1.03 (for the definition of VCO, VCS and VCT).

122 See id. at §12.02.


B. Applicable Fee Schedule

Under the current revenue procedure, for a given fee, the Service is willing to affirm acceptable correction methods in order for plans to rely on continued qualification, without the risk of audit. Interestingly, plan document failures were relatively rare during the past decade of compliance submission. During the past few years, the Service has indicated that plan document failures amount to a significant percentage of VCP requests. The fee schedule revised by the 2003 revenue procedure ranged from $750 for plans with fewer than 20 participants to $25,000 for plans with more than 10,000 participants, a decrease of at least 50% for the appropriate brackets under the prior fee schedule. This fee schedule remains intact under the 2013 revenue procedure and is as follows:

<table>
<thead>
<tr>
<th># of Participants under the Plan</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 or fewer</td>
<td>$750</td>
</tr>
<tr>
<td>21 – 50</td>
<td>$1,000</td>
</tr>
<tr>
<td>51 – 100</td>
<td>$2,500</td>
</tr>
<tr>
<td>101 – 500</td>
<td>$5,000</td>
</tr>
<tr>
<td>501 – 1,000</td>
<td>$8,000</td>
</tr>
</tbody>
</table>

The revenue procedure provides reduced fees in certain circumstances:

- $500 if the submission relates solely to the minimum distribution requirements of §401(a)(9) and the violation affected 50 or fewer participants;
- a 50% reduction in the applicable fee if the submission relates solely to the failure of the participant loans to comply with the requirements of §72(p)(2) and the failure did not affect more than 25% of the sponsor’s participants in any of the years in which the failure occurred;
- the Service reserves the right to waive the fee for terminating orphan plans;
- a 50% reduction in the applicable fee if the submission relates solely to the failure by a §403(b) plan sponsor that failed to timely adopt a written plan document and is filed on or before December 31, 2013;
- a 50% reduction in the applicable fee if the submission relates solely to a nonamender failure provided it is submitted within one year following the expiration of the plan’s remedial amendment period for complying with such changes;
- $250 if the submission relates to a SEP or SIMPLE IRA plan; and
to the extent the VCP submission includes multiple failures, each with a reduced fee, the fee is

125 See id. at §4.01(2). If under VCP, the Service determines that the plan or the plan sponsor was, or may have been, a party to an ATAT, the matter will be referred to the IRS Employee Plans Tax Shelter Coordinator. If the failure in the VCP submission is related to the ATAT, the case will be referred to Employee Plans Examination. See id. at §4.13(1)(b). According to the IRS website, the 10 most common VCP corrections include plan document failures; failure to follow the plan’s definition on compensation; failure to include eligible employees or exclude ineligible employees; failure to satisfy the plan loan rules; impermissible in-service withdrawals; failures to satisfy the minimum distribution rules; employer eligibility failures; failure to pass the ADP/ACT discrimination tests; failure to provide the top-heavy minimums; and failure to satisfy the limits of §415.

126 See Rev. Proc. 2003-44, §12.02. Although the reduction in fees under the 2003 revenue procedure provided relief to employers, it still provided perverse incentives at the break-points. For example, a plan sponsor with 50 participants pays a fee of $1,000, while a plan sponsor with 51 participants pays an additional $1,500 in fees. It is suggested that the Service should consider making the schedule incrementally graduated, similar to the income tax table.

127 See Rev. Proc. 2013-12, §12.02. Note that the number of participants used in the fee schedule is determined from the most recently filed Form 5500 (not the number in the year of failure). Id. at §12.08. Rev. Proc. 2008-50, §§11.03–11.04, eliminated the need to submit actual pages from the plan’s Form 5500 return.


129 See id. at §12.02(3). The Service may waive the excise penalty in this situation. Id. at §6.09(6).

130 Id. at §12.02(4). In such case, the submission needs to include a request for such waiver.

131 Id. at §12.02(5).

132 Id. at §12.03(1). Nonamenders refers to plans that were not timely amended within the remedial amendment period to comply with the changes to the qualification rules as a result of legislative or regulatory changes. See id. at §6.05(2)(ii). However, there is a special flat $375 fee if the only failure is the failure to timely adopt EGTRRA good faith amendments, interim amendments or amendments required to implement optional law changes. See id. at §12.03(2). Also added to the revenue procedure was a special flat $500 fee if the only failure is the failure to adopt an amendment (upon which a favorable determination letter is conditioned) within the applicable remedial amendment period, provided it is adopted within three months of the expiration of such period. See id. at §12.03(3).

133 Id. at §12.06.
the lesser of the sum of the reduced fees or the normal fee under the schedule in §12.02(1).134

The revenue procedure also provides possible relief from the excise tax penalties under §§4974 (for failures to satisfy the minimum required distribution rules); 4972 (for employer contributions that are nondeductible due to the limits of §404); 4979 (due to excessive elective deferrals or matching contributions made to the highly compensated employees resulting from testing failures); 4973 (for excess contributions made to a §403(b) plan or IRA, provided the participant/beneficiary removes the overpayment with earnings, returns such amounts to the plan, and reports the amount as a taxable distribution for the year in which the overpayment was removed); and 72(t) (for distributions from an employee’s vested account balance that was distributed but not pursuant to a distributable event, provided the amount with earnings is returned to the plan).135

The 2006 revenue procedure added a separate fee schedule for nonamenders discovered during the determination letter process (e.g., plans that were not amended for the GUST changes but applied for a determination letter).136 This is not a VCP submission which explains why there is a separate fee schedule; such schedule applies only if failure is a nonamender failure. This was a welcome addition to EPCRS, as it encouraged sponsors to seek a determination letter even if defects are later discovered during the application process. However, small employers may view such fees as too high. The 2013 revenue procedure expanded the fee schedule to include nonamenders for the first and second remedial amendment cycles that now exist under Rev. Proc. 2007-44. Like the VCP fee schedule, the fee schedule is based on the number of plan participants; however, it is also based on the earliest statute for which the plan was not amended:137

<table>
<thead>
<tr>
<th>Number of Participants</th>
<th>Employer’s 2nd RAC*</th>
<th>Employer’s 1st RAC*</th>
<th>GUST/401(a)(9) Regulations</th>
<th>UCA/OBRA ’93</th>
<th>TRA ’86</th>
<th>T/D/R**</th>
<th>ERISA</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 or fewer</td>
<td>$2,500</td>
<td>$3,000</td>
<td>$3,500</td>
<td>$4,000</td>
<td>$4,500</td>
<td>$5,000</td>
<td>$5,500</td>
</tr>
<tr>
<td>21–50</td>
<td>$5,000</td>
<td>$6,000</td>
<td>$7,000</td>
<td>$8,000</td>
<td>$9,000</td>
<td>$10,000</td>
<td>$11,000</td>
</tr>
<tr>
<td>51–100</td>
<td>$7,500</td>
<td>$9,000</td>
<td>$10,500</td>
<td>$12,000</td>
<td>$13,500</td>
<td>$15,000</td>
<td>$16,500</td>
</tr>
<tr>
<td>101–500</td>
<td>$12,500</td>
<td>$15,000</td>
<td>$17,500</td>
<td>$20,000</td>
<td>$22,500</td>
<td>$25,000</td>
<td>$27,500</td>
</tr>
<tr>
<td>501–1,000</td>
<td>$17,500</td>
<td>$21,000</td>
<td>$24,500</td>
<td>$28,000</td>
<td>$31,500</td>
<td>$35,000</td>
<td>$38,500</td>
</tr>
<tr>
<td>1,001–5,000</td>
<td>$25,000</td>
<td>$30,000</td>
<td>$35,000</td>
<td>$40,000</td>
<td>$45,000</td>
<td>$50,000</td>
<td>$55,000</td>
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<tr>
<td>5,001–10,000</td>
<td>$32,500</td>
<td>$39,000</td>
<td>$45,500</td>
<td>$52,000</td>
<td>$58,500</td>
<td>$65,000</td>
<td>$71,500</td>
</tr>
<tr>
<td>Over 10,000</td>
<td>$40,000</td>
<td>$48,000</td>
<td>$56,000</td>
<td>$64,000</td>
<td>$72,000</td>
<td>$80,000</td>
<td>$88,000</td>
</tr>
</tbody>
</table>

*Remedial Amendment Cycle
**TEFRA ’82, DEFRA ’84, REA ’84

Note: The fees for nonamender failures discovered during an IRS audit are even higher than those noted above.138

C. Correction Methods and Retroactive Plan Amendments

Although the two voluntary doors (SCP and VCP) permit different correction methods, SCP assumes that defects listed in Appendix A of the revenue procedure will be corrected according to the model correction methods provided in the Appendices, even though alternative methods are permitted. If a retroactive plan amendment is necessary, Appendix B of the revenue procedure contemplates four different scenarios. Use of the VCP permits alternate correction methods and alternate plan amendments, provided they meet with the Service’s approval. The Service has indicated its willingness to engage in dialogue with the plan sponsor’s representative regarding possible correction methods, realizing that one correction method may not fit all fact situations. Although EPCRS is primarily focused on operational plan defects, the Service realizes that not all plan sponsors have taken advantage of the determination letter process and the various ex-

134 See id. at §12.04.
135 See id. at §6.09(2)–(6).
137 See Rev. Proc. 2013-12, §14.04. Note that if the sole failure consists of failure to adopt EGTRRA good faith amendments, interim amendments, or amendments to implement optional law changes by their applicable deadlines, but such adoption is before the expiration of the extended remedial amendment period, then the fee is 40% of the applicable fee under “Employer’s 2nd Remedial Amendment Cycle” on the chart, and the fee is a flat $1,000 if the required amendment was adopted within three months of the expiration of the remedial amendment period. Such reduced fees clearly incent plan sponsors to timely adopt such amendments. Id. at §§14.04(3)–(4).
138 See id. at §14.02. The rationale for imposing a higher fee if the nonamender failure is discovered upon examination is to maintain the integrity of VCP.
tended remedial amendment periods and, thus, permits plan document failures to be corrected.

D. Application Process and Compliance Statement

VCP begins with the submission by the plan sponsor or its representative of a given or proposed correction method for a disclosed failure. Under the current guidance, the IRS will acknowledge receipt of a submission if the identifying information is submitted on the Acknowledgement Letter (now contained in Appendix D of the new revenue procedure). The 2013 revenue procedure provided two new IRS forms (Forms 8950 and 8951) that must be used with submissions beginning on or after April 1, 2013. The purpose of the new forms is to streamline the information to be submitted and to expedite the process. Such submissions will now be directed to the IRS Service Center in Covington, Kentucky. According to the new rules, a VCP submission includes:

- Form 8951, with a signed check for the compliance fee (along with a photocopy of the check) attached to the front of the form;
- signed Form 8950;
- Power of Attorney (Form 2848) or Tax Information Authorization (Form 8821) attached to Form 8950 (if applicable);
- any other items relevant to the submission; and
- if the VCP submission includes the new Model Compliance Statement or any Schedules (as now provided in Appendix C, not Appendix D), any required information and enclosures relating to those statements;
- Appendix D, the Acknowledgement Letter (formerly in Appendix E);
- copy of opinion, advisory or determination letter (if applicable);
- relevant plan document language or plan document (if applicable); if the submission includes a determination letter application, a second copy of the relevant plan document or plan amendment may be necessary;
- any other items relevant to the submission; and
- if appropriate, a new determination letter application with all its required documentation.

The last few revenue procedures have been streamlining the application process, by using various schedules if the failure relates to one of those listed in Appendix A of the procedure or retroactive plan amend-

139 The plan sponsor prepares its own Acknowledgement Letter using the sample in App. D. in Rev. Proc. 2013-12. The IRS will then stamp the date of receipt of the letter, assign a control number, and return it to the plan sponsor or representative. This should expedite the processing time.

140 Id. at §11.14.

141 Id. at §11.12, using the address: Internal Revenue Service, P.O. Box 12192, Covington, KY 41012-0192 (for first-class mail).

142 Id. at §12.01(1). The revenue procedure provides notice that the compliance fee checks may be converted into an electronic fund transfer. The Service notes that if the appropriate fee was not included, the submission will be returned. Id. at §12.01(2). The final version of the form was released on Jan. 22, 2013, and is available at http://www.irs.gov/pub/irs-pdf/f8951.pdf;

143 The final version of the form was released on Jan. 22, 2013, and is available at http://www.irs.gov/pub/irs-pdf/f8950.pdf. Instructions to the form are available at http://www.irs.gov/pub/irs-pdf/f8950.pdf. This includes information about name and contact information about the plan sponsor; name and contact information about a person to contact if a power of attorney is attached; type of VCP submission; name and type of plan being submitted; whether schedules from Appendix C are included; whether the correction involves a retroactive plan amendment and, if so, whether there is an accompanying determination letter application; whether the plan or sponsor have been party to an ATAF; whether the submission relates to the diversion or misuse of plan assets; whether the plan or sponsor is under examination; whether the plan is being currently considered in an unrelated determination letter application; if the submission includes a nonamender failure other than a late interim amendment, a copy of the plan document prior to any of the amendments used to correct the failure, as well as boxes that must be checked off indicating that the

144 Rev. Proc. 2013-12, §11.14(2), noting that this should also be the ordering used in the submission.
The 2013 revenue procedure creates a new Appendix C (based on the former Appendices D and F) which now has two parts: a Model VCP Submission Compliance Statement and various schedules (formerly Appendix F schedules) that have standardized failure descriptions and correction methods. Using the new Compliance Statement and applicable schedules will obviously expedite the processing time for the IRS.

Appendix C’s supporting schedules deal with particular failures and particular plan types:

Schedule 1: for failure to adopt timely interim amendments or certain discretionary nonamender failures;

Schedule 2: for nonamender failures (other than those which Schedule 1 applies) and for failure to timely adopt a §403(b) plan;

Schedule 3: for a SEP or SARSEP with one or more failures shown below:
- employer eligibility failure (SARSEPs only);
- failure to satisfy the deferral percentage test (SARSEPs only);
- failure to make required employer contributions to the plan;
- failure to provide eligible employees with the opportunity to make elective deferrals (SARSEPs only); or
- excess amounts contributed to the plan.

Schedule 4: for a SIMPLE IRA with one or more failures shown below:
- employer eligibility failure;
- failure to make required employer contributions to the plan;
- failure to provide eligible employees with the opportunity to make elective deferrals; or
- excess amounts contributed to the plan.

Schedule 5: for failure to administer plan loans under a qualified plan or §403(b) plan in accordance with §72(p)(2);

Schedule 6: for failure satisfy the criteria for an employer to sponsor either a §403(b) or §401(k);

Schedule 7: for failure to distribute elective deferrals made in excess of the §402(g) limit;

Schedule 8: for failure to make required minimum distributions pursuant to §401(a)(9); and

Schedule 9: for one or more of the following failures:
- §401(a)(17) failure;
- hardship distribution failure;
- loans permitted in operation, but not permitted under the terms of the plan document; or
- early inclusion of other eligible employees.

One concern for practitioners is whether additional qualification defects may be added to the VCP after the initial submission has been made. Although the revenue procedure notes that the Service retains discretion in allowing or rejecting new failures, the Service has indicated informally that it wishes to be extremely flexible in this regard, as its goal is to resolve all known qualification failures.

VCP should end with a compliance statement issued by the Service (§VII in Appendix C, Part I), assuring the plan sponsor that the Service will not seek to disqualify the plan based on the information submitted in the VCP. In the latest guidance, the Service reserves the right to require the plan sponsor to sign the compliance statement. In the unlikely event that the parties are unable to agree upon resolutions, the plan sponsor may withdraw its submission. In actuality, the Service has indicated that this rarely ever happens.

The latest guidance clarifies that, with respect to failures to timely amend for EGTRRA good faith amendments, interim amendments or operational law changes, the issuance of a compliance statement will result in the corrective amendments being treated as if they had been adopted during the applicable remedial amendment period in accordance with Rev. Proc. 2007-44. However, such statement does not constitute a determination letter with respect to such amendments.

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147 Because ATATs cannot be corrected through EPCRS, any compliance statement issued by the Service through VCP may not be relied on for purposes of concluding that the plan or the plan sponsor was not a party to an ATAT. See id. at §4.13(1)(b).

148 See id. at §10.07(8). Normally, if agreement has been reached and fees have been paid, the Service will send a signed compliance statement specifying the correction required. It reserves the right to require the plan sponsor to sign the compliance statement. In that case, the plan sponsor has 30 calendar days to sign and return the compliance statement, with fees. Then the Service will issue a signed copy of the compliance statement to the plan sponsor.

149 See id. at §10.08(2).
E. John Doe Submissions

EPCRS began offering anonymous or “John Doe” submissions to VCP in 2001. Originally, such submissions could only address compliance failures not otherwise addressed in the appendices of the applicable revenue procedure. Today, any type of failure permitted under EPCRS may be submitted under a “John Doe” basis. A “John Doe” submission contains the same information that is required to be submitted under the VCP, except that identifying information is redacted. Once an agreement is reached between the Service and the plan sponsor’s representative, there is a 21-day window in which the plan sponsor must be identified in order to move forward under VCP.

As practitioners continue to receive assurances from the Service that “EPCRS” is not “EPCRS with referral for examination,” there is actually no reason for the plan sponsor to pursue a “John Doe” submission under VCP. If the plan sponsor cannot reach an agreement under VCP with the Service, experience has proven that a plan audit is not imminent, let alone automatic. Given that this is the case, pursuing “John Doe” submission simply forestalls the VCP process and subjects the plan to a greater time period in which it could be selected for audit.

F. Group Submissions

Group submissions under EPCRS were introduced in 2001 by adding a separate submission process for “eligible organizations” (i.e., sponsors or administrators of eligible master or prototype plans) to correct plan document and operational failures. According to the Service, very few eligible organizations have taken advantage of this program. A VC Group submission may be made only for failures “resulting from a systematic error involved the Eligible Organization that affects at least 20 plans.” The eligible organization makes the submission, as opposed to the plan sponsors (which do not have to be identified until the compliance stage). Once agreement is reached between the eligible organization and the Service, the revenue procedure provides a 120-day window period in which the plan sponsor’s identifying information must be revealed and a 240-day window period to make the agreed-upon corrections. The fee schedule for VC Group submissions was changed in 2008 to a flat $10,000, with a fee of $250 for each additional plan, with an overall maximum of $50,000. The revenue procedure makes it clear that the group VCP submission protects all the adopting employers’ plans against examination, but only with respect to the failures identified in the submission.

G. Specific Correction Methods Under the Revenue Procedure

There are specified correction methods in Appendix A of the revenue procedure used to correct certain operational failures. Appendix B expands the model correction methods for these and other operational failures and provides model retroactive plan amendments that may be used to correct the plan document. Corrective allocations and distributions prescribed under a given model correction must reflect investment earnings and actuarial adjustments, if necessary. An explanation of the model correction methods is provided in Attachment 2 of this article. Practitioners can decide which examples from the appendices to use for correction. The following is a summary of the most common failures and model corrections set forth in Appendices A and B of the most recent guidance:

1. Excess Amounts

The 2008 revenue procedure changed the definition of the term “excess amounts” to include a qualification failure due to a contribution, allocation or credit

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152 See Rev. Proc. 2001-17, §10.14(2) (defining an “eligible organization” as: (1) a sponsor of a master or prototype plan that receives an opinion letter that considers the provisions of GUST, or has received an opinion letter that considers the Tax Reform Act of 1986, and has been submitted for a GUST opinion letter by Dec. 31, 2000; (2) an insurance company or other entity that has issued annuity contracts or provided services with respect to assets for §403(b) plans; or (3) an entity that provides its clients with administrative services with respect to qualified plans or §403(b) plans).
153 See Rev. Proc. 2013-12, §10.11(2). The guidance clarifies that the number of plans is determined with respect to the number of basic plan documents, not adoption agreements. Id. at §10.11(1).
154 The 2008 revenue procedure clarified that if a plan sponsor that is eligible to be included in the group submission and has not elected to be excluded from such submission is later notified of an impending examination, the plan sponsor’s plan is deemed to be included in the group submission. See Rev. Proc. 2008-50, §10.11(3)(d), and Rev. Proc. 2013-12, §10.11(3)(d).
155 See Rev. Proc. 2013-12, §10.11(3)(c). Note that the required power of attorney for each affected plan sponsor is not required. The sponsor of the master or prototype plan, the insurance company or the third-party administrator must notify all affected plan sponsors of the group submission.
156 See id. at §12.05.
157 Id. The 2013 revenue procedure made it clear that, with respect to preapproved plans, the compliance fee is based on the number of basic plan documents and the number of employers that have adopted each basic plan by using an adoption agreement for such plan.
158 See id. at App. A (providing the original seven operational errors and correction methods approved under the original SVP program that was part of VCR).
Excess allocation failures are handled according to a method referred to as the “reduction of account balance” correction method, and generally depend on whether the failure is caused by employer monies or employee deferrals or after-tax contributions.161 If the failure is attributable to the employer monies, the employee’s account balance is reduced by the excess (plus earnings).162 If the excess would have been allocated to the other employees in the year of failure, the excess is adjusted for earnings and reallocated according to the plan terms.163 Otherwise, the excess (plus earnings) is placed in a suspense account.164

To the extent the excess is attributable to an employee’s elective deferrals or after-tax contributions, the excess plus earnings are to be distributed to the participant.165 Such distribution is not eligible for rollover or other favorable tax treatment.166 The distribution must then be reported on Form 1099-R for the year of distribution, and the taxpayer must be informed that the distribution is an excess amount and does not qualify for favorable tax treatment, specifically, not eligible for rollover.167

2. Overpayments

The term “overpayment” refers to a qualification failure resulting from a payment made to a participant or beneficiary that exceeds the amount to be paid under the plan terms or exceeds a statutory limit (Code or regulations), including those amounts distributed too soon or in excess.168 It includes overpayments from defined benefit and defined contribution plans.169 For defined benefit overpayments, the correction method requires the employer to take “reasonable steps” to have the overpayment, plus earnings, returned to the plan or offset against future payments, using the same method applied for overpayments relating to a §415(b) failure, which is described in Appendix 2.170 Otherwise, the employer (or another person) must contribute the difference to the plan.171

For defined contribution plan (including §403(b) plan) overpayments, the correction method requires the employer to take “reasonable steps” to have the overpayment, plus earnings, returned to the plan.172 If less than the amount of the overpayment is returned, such amounts are to be disregarded for purposes of §§402(g) and 415 and the ADP and ACP tests of §401(k).166 Id. at §6.06(1). The rollover of such amounts into an IRA would not be a valid rollover contribution and may result in an excess IRA contribution, subject to a 6% penalty.167 Id. The employer uses Code E on the Form 1099-R.168 Id. at §5.01(3)(c).

Id. Examples of overpayments from a qualified plan include distributions for benefits in excess of the §415 limits; amounts in excess of the plan’s formula; and amounts that were not vested benefits. Additional examples for defined benefit plans could include making an in-service distribution before the participant attains age 62 or paying a lump sum benefit when the plan was subject to the benefit restrictions of §436(d). Additional examples for defined contribution plans could include providing a matching contribution when the participant failed the allocation condition; making a hardship distribution when the participant was not eligible for one; or distributing an amount that should have been forfeited as an ACP failure.169 Id. at §6.06(3) and App. B, §2.04(1).

Id. at §6.06(3). If the overpayment is not repaid or if less than the full overpayment is returned to the plan, the employer must notify the taxpayer that the overpayment does not qualify for favorable tax treatment, specifically, not eligible for rollover. Id. §6.06(1).

Id. at §6.06(4)(a). To the extent the overpayment was due to a premature distribution, it will be allocated to the participant’s or beneficiary’s account balance. Id. at §6.06(4)(d). Otherwise, it will be treated as an excess allocation returned to the plan and placed in a suspense account or reallocated to other employees if the plan

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159 Rev. Proc. 2008-50, §5.01(3), and Rev. Proc. 2013-12, §5.01(3). It includes: (1) elective deferrals or after-tax employee contributions in excess of the maximum contribution under the plan (e.g., 10% of compensation as the maximum limit); (2) elective deferrals or after-tax employee contributions made in excess of the limit in §415; (3) elective deferrals in excess of $402(g); (4) excess contributions or excess aggregate contributions under §401(k) or (m); (5) elective deferrals or after-tax employee contributions made in excess of the limitation of §401(a)(17); (6) any other employer contribution that exceeds a limitation under §401(a)(17), (m) (but only with respect to the forfeiture of nonvesting matching contributions that are excess aggregate contributions), 411(a)(53)(G) or 415. Excess amounts do not include contributions, allocations or credits made to correct a different qualification failure. They are limited to contributions, allocations or annual additions under a defined contribution plan, after-tax employee contributions under a defined benefit plan, and contributions and allocations that are made to a separate account (with earnings) under a defined benefit plan. In the context of §403(b) plans, excess amounts refer to amounts returned to guarantee that the plan satisfies the requirements of §§§402(g) and 415, and any distributions to guarantee that the plan complies with the requirements of §403(b). See Rev. Proc. 2013-12, §5.02(3).

160 Id. at §5.02(3)(b).

161 Id. at §6.06(2).

162 Id.

163 Id.

164 Id. Although such amounts remain in the suspense account, the employer is not permitted to make contributions to the plan other than elective deferrals.
the employer (or another person) must contribute the difference, as a “make whole” contribution.173

3. Excluded Eligible Employees

For defined benefit plans, when an employee is excluded from eligibility, the plan sponsor corrects by contributing the benefit accruals for such employees.174 For defined contribution plans with nonelective employer contributions, the plan sponsor corrects by contributing on the same basis that the allocation amounts were determined for other eligible employees.175 However, there is an alternate reallocation correction method for profit-sharing plans described in Attachment 2.176

The more complicated question concerns defined contribution plans with employee elective and after-tax employee contributions and defined benefit plans with after-tax employee contributions. If an employee otherwise is eligible but was excluded, the ‘Service had to make some assumption as to the participant’s presumed elective or after-tax contribution, as there was no actual election to implement. This was referred to as the “missed deferral” or “missed after-tax contribution.” Obviously, such discussion becomes more complicated depending on whether the employer relied on the traditional nondiscrimination tests of §401(k) or whether the employer used the safe harbor rules of §401(k)(12) (either the safe harbor nonelective rules or the safe harbor match rules).177

Under the earlier guidance, the Service’s correction for a traditional §401(k) plan required the employer to make a QNEC that had to equal 100% of the ADP percentage rate relating to the excluded employee’s group (NHCE or HCE) applied to the excluded participant’s compensation.178 Beginning with the 2006 revenue procedure, EPCRS provided a correction of 50% of the presumed missed deferral (i.e., the ADP percentage rate related to the excluded employee’s group (NHCE or HCE) applied to the excluded participant’s compensation), referring to this as “missed deferral opportunity.”179 Practitioners viewed the correction as resulting in a windfall to the employee. Thus, there has been continued pressure on the Service to apply a lesser percentage to the missed deferral in determining the “missed deferral opportunity.”180

Under the current guidance, for “missed deferral” under a traditional §401(k) plan, the “missed deferral” continues to be the ADP percentage related to the employee’s group (NHCE or HCE) multiplied by compensation, and the necessary contribution will be a QNEC equal to 50% of the “missed deferrals” (still referred to as the “missed deferral opportunity”).181 However, any employer matching contributions must be corrected with the necessary matching percentage applied to the entire “missed deferral.”182 The most recent guidance does not require such corrective matching contribution to be a QNEC. (See Attachment 2 for the determinations of the “missed deferrals” to be used for safe harbor §401(k) plans, §403(b) plans, SIMPLE IRAs, “catch-up” contributions, after-tax employee contributions, and designated Roth contributions, as the amount of corrective employer contributions.)

4. Failure to Obtain Required Spousal Consent

The guidance sets forth an additional correction method in the context of failing to obtain the required spousal consent under §§401(a)(11), 411(a)(11) and 1% and up to 6% of compensation. Similar to the prior safe harbor, the employer may make QNECs equal to at least 3% of compensation for every NHCE.

177 In a traditional §401(k) plan, the employer matches the actual elective deferrals and must satisfy both the actual deferral percentage (ADP) test of §401(k)(3) (which is applied to the elective deferrals) and the average contribution percentage (ACP) test of §401(m) (which is applied to employer matching or employee after-tax contributions other than designated Roth §401(k) contributions). To avoid these tests, there are safe harbor designs that can be used, including the use of an alternative automatic enrollment option, effective beginning in 2008. Under the safe harbor nonelective plan, the employer makes a QNEC equal to 3% of the employee’s compensation, whereas under the safe harbor match plan, the employer’s match must be 100% on all salary deferrals up to 3% of the employee’s compensation, plus a 50% match on deferrals between 3% and 5% of the employee’s compensation. A 2006 PPA statutory safe harbor permits eligible employees who have not elected to defer to have automatic deferrals of 3% of compensation (first year), 4% (second year), 5% (third year), and 6% (fourth year). The employer match must be at least 100% on deferrals up to 1% of compensation, plus 50% on deferrals over

179 In order to mitigate damages, some plan sponsors are altering the salary reduction agreement form to state that if a disparity exists between what was elected and what was actually deferred or not deferred, the employee has an affirmative duty to alert the plan administrator in a timely fashion, and failure to do so reduces the deferral election to zero.
180 Note that there is a brief exclusion rule exception to the improper exclusion failure whereby if a participant that was excluded for less than three months has the opportunity to contribute the annual limit for at least nine months during the plan year, the plan does not have to require corrective contributions for the missed deferrals or missed after-tax deferrals. See Rev. Proc. 2013-12, App. B, §2.01(a)(ii)(F).
181 Id. at App. A, §.05(2)(c).
If a distribution was made without the necessary spousal consent, EPCRS recognized that consent may be given retroactively. However, as it is unlikely that the spouse will provide such consent, the plan is still required to provide the survivor portion of the QJSA after the participant’s death. Under the 2003 revenue procedure, the plan could commence payment of the QJSA upon the participant’s death (with the participant’s portion of the QJSA offset by payments already made). The 2006 revenue procedure provided the plan with the alternative of providing the spouse with a lump sum equivalent to the actuarial value of the survivor benefit. This avoids the problem of waiting and seeing whether the spouse later claims a spousal benefit. It also eliminates the plan’s liability for the survivor annuity benefit. Such lump sum payment is treated in the same manner as a distribution under §402(c)(9) for purposes of rolling over the amount to an IRA or other eligible retirement plan.

5. Retroactive Plan Amendments for Plan Loans

The 2006 revenue procedure allowed a retroactive plan amendment to be made if plan loans were actually being made but not authorized under the terms of the plan. Such loans nevertheless had to comply with the Code requirements in order to retain the plan’s qualification status. For example, a plan loan is made for $10,000 over a six-year repayment schedule and the defect is discovered in year two. The loan may be reamortized and repaid over the next three-year period (consistent with the §72(p)(2)(B) five-year required repayment schedule) and comply with the qualification rules. The 2013 revenue procedure clarifies that these correction principles would also apply to Audit CAP. The 2008 revenue procedure extended corrections to situations in which the plan loan did not satisfy the requirements of §72(p)(2).

6. Correction of Failures of the ADP, ACP and/or Multiple Use Tests

The 2003 revenue procedure provided two correction methods for §401(k) plans for failing the

\[\text{§401(k)(3) (ADP test, §401(m)(2) (ACP test or §401(m)(9) (multiple use test) (those required for passing the special nondiscrimination rules applicable under §401(k) and (m)).} \]

Under the 2003 revenue procedure and the later guidance, both methods permitted QNEC contributions to be made on behalf of NHCEs, allocated either on a pro rata (based on compensation) or per capita (equal amount for each eligible NHCE). In December 2004, the §401(k) final regulations eliminated the use of disproportionate QNECs to correct ADP failures or ACP failures. Hence, the 2006 revenue procedure and later guidance eliminated the per capita method of allocation under both of these correction methods. The 2013 revenue procedure made it clear that QNECs needed to correct these failures may not be funded from the plan’s forfeiture accounts (See Attachment 2 for a description of an alternate one-to-one correction method that may be used.)

7. Benefit Restrictions

The 2013 guidance addresses correction methods for defined benefit plans with benefit restrictions failures under §436. Generally, failures to satisfy §436(b) (payment of unpredictable contingent event benefits when the AFTAP is below 60%), §436(c) (adoption of a plan amendment increasing liabilities when the AFTAP is below 80%), or §436(e) (not freezing benefit accruals when the AFTAP is below 60%) may be corrected with an employer contribution (plus earnings) such that the restriction no longer applies. This could be a fairly large contribution depending on the level of benefits in question. The plan sponsor may also correct any such failures by treating any actual distributions as an overpayment.

If the plan is subject to a restriction under §436 at the time of correction, the plan sponsor is required to make a contribution to the plan as follows: (1) if distributions were made in a single lump sum or other
prohibited payments at the time the plan was subject to the restriction of §436(d), the contribution equals the amount of the corrective distribution (but only 50% if the plan was simply subject to the restriction of §436(d)(3)); and (2) if the correction is accomplished through a plan amendment at the time the plan was subject to the restriction of §436(c), the contribution equals the amount necessary to increase the funding target attributable to the corrective amendment.\textsuperscript{198}  

\section*{8. §403(b) Operational and “Late-Adopter” Plan Document Failures}

Prior to 2009, the IRS did not require §403(b) plans to have a plan document. The 2007 IRS regulations added this requirement, generally effective for the 2009 plan year.\textsuperscript{199} Announcements 2009-34 and 2009-89 provided guidance on the plan document requirement, including a retroactive remedial amendment period for years after 2009, allowing employers to retroactively amend for plan document failures.\textsuperscript{200} The latest EPCRS guidance adds new correction principles applicable to §403(b) plans, including the failure to timely adopt a written plan document, which begins the integration of these plans into the same correction system applicable to qualified plans. The guidance states that most of the corrections for operational failures under §403(b) are expected to be the same correction as used under a §401(k) plan, except that pre-2009 plan document failures are not correctable, as there was no requirement for a pre-2009 document.\textsuperscript{201}  

The newest guidance clarifies the four types of failures in the context of §403(b) plans:

\begin{itemize}
  \item plan document failures, which now includes the failure of a §403(b) plan to be adopted in written form or amended to reflect a new requirement within the plan’s applicable remedial amendment period;
  \item operational failures, which for §403(b) plans includes failure to follow the terms of the plan beginning January 1, 2009;
  \item demographic failures, which for §403(b) plans is failure to satisfy the nondiscrimination requirements of §§403(b)(12)(A)(i) and (ii); and
  \item Employer eligibility failures, which could include correction by having the contributions being treated as if contributed to an annuity contract under §403(c).\textsuperscript{202}
\end{itemize}

The special correction principles applicable to §403(b) plans now include correction under VCP and Audit CAP for failure to adopt a written plan during 2009. Issuance of a compliance statement or closing agreement for such failure will result in the plan being treated as having a timely adoption within the applicable remedial amendment period.\textsuperscript{203} To motivate such plan sponsors, the correction fee under VCP is reduced by 50% if this is the only failure in the submission and application is made by December 31, 2013.\textsuperscript{204} Special correction principles exist for failures to provide for full vesting (including failure to maintain a separate account) and information-sharing failures (which involve transfer of assets to a vendor which is not part of the plan).\textsuperscript{205}

\section*{H. Scrivener’s Errors}

To date, the IRS will generally not permit scrivener’s or drafting errors to be corrected through a retroactive plan amendment. The Service’s position is that these types of errors are operational failures to be corrected under VCP. As such, correction would be to implement the terms of the plan as drafted and make any necessary contributions and earnings to reflect the terms of the plan. These types of errors commonly occur with prototype documents where a plan sponsor checks off a box that it had not intended. However, to the extent there is “overwhelming evidence” showing what the sponsor intended and the employees’ expectations as to the plan’s operation, the Service may permit a retroactive plan amendment be made to reform the document to reflect the intent of the parties.\textsuperscript{206} The alternatives are to go to court (which is expensive—

\textsuperscript{198} Id. at §6.04(e)(ii).

\textsuperscript{199} Regs. §1.403(b)-3(b)(3)(i), requiring a plan document be adopted by Dec. 31, 2008. The Service granted an extension until Dec. 31, 2009, provided the plan was adopted during 2009, effective Jan. 1, 2009; the plan was operated in accordance with a reasonable interpretation of §403(b) and its regulations; and before the end of 2009, the sponsor made best efforts to retroactively correct any operational failures to conform to the written terms of the plan. \textit{See} Notice 2009-3, 2009-2 I.R.B. 250.


\textsuperscript{201} Rev. Proc. 2013-12, §6.10(3).

\textsuperscript{202} Id. at §2.03.

\textsuperscript{203} Id. at §6.10(3). However, as noted by Robert Toth in his Business of Benefits blog, available at http://www.businessofbenefits.com/Robert-toth.html, the revenue procedure requires representation from the plan sponsor that it “has contacted all other entities involved with the plan and has been assured of cooperation to the extent necessary to implement the applicable correction.” \textit{See} Item 25 on the Procedural Requirement Checklist on Form 8950. According to Mr. Toth, this raises the issue as to which contracts are under the plan and which are not.

\textsuperscript{204} Rev. Proc. 2013-12, §12.02(5).

\textsuperscript{205} Id. at §6.10(2).

\textsuperscript{206} In such instances, the Service will want extrinsic evidence of the parties’ intention and a showing that the reformation will not result in a cut-back in participants’ benefits. If the reformation involves a plan amendment, it will have to be cured through VCP, as SCP does not generally allow operational failures to be cor-
sive) or to live with the mistake (which also could be expensive). In any event, the plan sponsor should amend the document prospectively to eliminate the error.

I. Failure to Give Safe Harbor Notice

The safe harbor notice is a requirement for reliance on a safe harbor §401(k) plan. On recent audits, the Service has been requesting evidence of proof that such safe harbor notices were in fact made. For correction purposes, the issue becomes how to correct such defect if the notice was never made or made late. Although the latest guidance does not address this issue, the IRS in its outreach through newsletters and presentations has been setting forth a possible correction method depending on whether or not the participant knew about his or her eligibility to make deferrals under the plan. If the participant knew about his or her eligibility to defer, the correction appears to be to provide the late notice and modify the plan administrator’s procedures to avoid such future failures. However, if the participant was unaware of his or her eligibility to defer, the correction appears to treat such participant as if he or she were an improperly excluded employee. Thus, the “missed deferral” would depend on whether the plan was a safe harbor matching plan or a safe harbor nonelective plan, and the plan sponsor would contribute 50% of the specified “missed deferral.” If there were required matching contributions, the correction would be to contribute the matching formula to the entire missed deferral (not 50% of the missed deferral).

J. Determination Letter Submissions

The latest guidance is intended to reduce the necessity of having a companion determination letter application, along with the VCP submission. Generally, nonamender failures submitted under VCP or Audit CAP will require a companion determination letter submission, regardless of whether the plan is in an on-cycle or off-cycle year. However, in the context of failure to adopt the EGTRRA good faith amendments, interim amendments, and optional plan amendments, determination letter submission is neither required nor should be submitted with a VCP submission or Audit CAP. The compliance statement will treat the plan amendment as if it were a timely adopted amendment. Plan amendments needed to correct an operational failure require a determination letter submission but only if the VCP submission or Audit CAP is made during the plan’s on-cycle year. If a determination letter application is required, the latest guidance now requires both submissions be filed together in the same package, with two separate checks.

VI. AUDIT CAP

The third door by which a plan sponsor may correct disqualifying defects is actually a “trap door” in which the plan sponsor finds itself, once the plan is “under examination.” The Service provides a closing agreement program (Audit CAP) for plans “under examination” to correct uncovered failures or risk plan disqualification. Most types of qualification failures may be corrected under this program — plan document failures, operational failures, demographic failures; and employer eligibility failures. However, defects relating to the misuse or diversion of plan assets and ATATs may not be corrected through this program. Unfortunately, plan sponsors that refuse to accept correction under Audit CAP are faced with the penalties of plan disqualification.

Under Audit CAP, as the plan sponsor did not take advantage of VCP, the fixed fee schedule of VCP is no longer available. Instead, the Service negotiates a sanction as a percentage of the maximum payment amount (MPA) that could be assessed if the plan were disqualified. The IRS considers the cost of correction, the financial condition of the employer, and overall practices and procedures that were in place by the plan sponsor in making this determination. The MPA equals the tax the Service would collect upon disqualification due to the following:

- sum of the tax on realized trust earnings for all open years;

210 Rev. Proc. 2013-12 §6.05(2).

211 Id. at §6.05(3).

212 Id. at §6.05(3)(c)

213 Id. at §6.05(2).

214 Id. at §10.05.

215 Although the corrections noted in Appendices A and B of the revenue procedure are safe harbor corrections for SCP and VCP, Michael J. Sanders and Kathleen Schaffer noted that use of such corrections under audit CAP requires Area Counsel’s approval. See note 89, above.


217 Additional factors considered in deciding upon the sanction include the size of the employer and the number and type of participants affected (e.g., NHCEs). Id. at §14.02. The 2012 ACT Report indicated that an assessment of the plan’s “internal controls” is made during the initial interview by the revenue agent in a plan audit.
• income tax on the employer’s disallowed deductions for the non-vested allocation of employer contributions; and
• income tax on the vested allocations to participants’ accounts under the plan.218

In fashioning the actual sanction, the percentage applied to this MPA is dependent upon a variety of different factors:
• whether the plan sponsor has steps in place to ensure that the plan had no failures;
• whether the plan sponsor’s steps identified failures that may have occurred;
• the extent to which correction had progress prior to the audit;
• the number and type of employees affected by the failure;
• the number of NHCEs that would be affected if the plan were disqualified;
• whether the failure is of the type under §§401(a)(4), 410(a)(26) or 410(b) (or §403(b)(12) for §403(b) plans);
• whether the failure is solely an employer eligibility failure;
• the period of time over which the failure occurred; and
• the reason for the failure.219

Under Rev. Proc. 2001-17, the sanction fee was to bear a reasonable relationship to the nature, extent and severity of the qualification defect.220 This requirement was eliminated under the 2008 guidance, signaling a shift toward a sanction more in line with the VCP correction fee amount. Practitioners negotiating for a given correction method during Audit CAP should be cognizant of negotiating a less restrictive fee for their client. Depending on the types of failures uncovered during an audit, the plan sponsor may be required to obtain a favorable determination letter and/or establish administrative practices and procedures.221

Audit CAP should result in a closing agreement after full correction and the payment of the sanction has been made.222 Such agreement binds both the plan sponsor and the Service regarding the tax matters identified in the agreement.223

VII. EFFECTIVE DATE

The effective date of Rev. Proc. 2013-12 is April 1, 2013. However, plan sponsors are permitted, at their option, to apply the new rules on or after December 31, 2012.224 In such cases, the sponsor must include Forms 8950 and 8951 with their VCP submission and use the new Covington, Kentucky, mailing address. For §403(b) plans, the definitions under Rev. Proc. 2008-50 apply to failures that occurred in taxable years beginning before January 1, 2009.225

Although the changes to the 2013 revenue procedure are not as robust as expected, the continued makeover of EPCRS is a welcome breath of fresh air for qualified plans and now for correction of §403(b) plan document failures. It was also refreshing to see several of the ACT recommendations implemented in the latest revenue procedure. As mentioned before, practitioners should encourage plan sponsors and plan administrators to conduct internal plan audits, not only to self-correct on an ongoing basis, but also to eliminate the potential for future failures. The 2012 ACT report makes it clear that IRS auditors are focusing on the plan’s internal controls as a measure of its ability to keep a plan in compliance with its own terms.226 Plan sponsors and plan administrators are now on notice that such controls will be keenly scrutinized by IRS auditors in plan examinations.

218 See Rev. Proc. 2013-12, §14.01. In the context of failures attributable to transferred assets identified within the correction period, the MPA is determined solely upon the taxes that would have resulted had the portion of the plan with the transferred assets had been disqualified. See id. at §14.03. MPA is approximately equal to the additional tax the IRS could have collected due to plan disqualification only for open tax years, including the tax on the trust, tax resulting from the loss of the employer deduction for plan contributions, and tax resulting for participants’ income inclusion, including distributions rolled over into other eligible retirement plans.
219 See id. at §14.02.
221 Rev. Proc. 2013-12, §13.03.
222 See id.
223 See id. at §13.05.
224 See id. at §16.
225 Id.
Attachment 1: Contact Information

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<table>
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Voluntary Compliance Group Managers

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Area Closing Agreement Coordinators

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The author would like to thank Jess Hinton, one of the Voluntary Compliance Group Managers, for his assistance in the preparation of this contact information.
Attachment 2: Correction Failures and Correction Methods

Appendix A covers the most common correction defects, prescribing model correction methods for such defects. Appendix B expands the list of defects and correction methods. Such failures and correction methods are described as follows:

1. Failure of a §403(b) plan to satisfy the universal availability requirement: The plan sponsor may wish to propose calculating the missed deferral for the excluded employees using the average deferral rate for all employees in the plan, in lieu of the model correction method. However, such correction method would fall outside the methods deemed reasonable in Appendix A and, thus, would need to satisfy the rules of §6.02 of the revenue procedure.228

2. Failure to make the minimum top-heavy allocation/benefit: The plan sponsor must contribute and allocate the make-up top-heavy contribution (for defined contribution plans) or the make-up top-heavy benefit (for defined benefit plans) for non-key employees (and any other employees required under the plan) to receive the top-heavy allocation.229

3. Failure to pass the §401(k)(3) (ADP test), the §401(m)(2) (ACP test),230 or the §401(m)(9) (multiple use test)231 required for passing the special nondiscrimination rules applicable under §401(k) and (m) and to correct within the prescribed 12-month correction period:
   a. QNEC correction method: Under the correction method specified in Appendix A, the employer must contribute QNECs for all eligible NHCEs (in accordance with §415) to raise the ADP or ACP of the NHCEs so as to satisfy the tests.232 This allocation is not done in accordance with the terms of the plan but, instead, in conformity with the terms of the revenue procedure. QNECs must be given to all eligible NHCEs and must now be a fixed percentage of compensation amount for eligible NHCEs. The 2003 revenue procedure permitted QNECs to be determined as a flat dollar amount (i.e., per capita allocation) for NHCEs (usually cheaper than a flat percentage of compensation allocation).233 The QNEC is considered an annual addition for §415 purposes in the year it was contributed, not the year the test was failed. Such QNECs need not be matched, but the plan must pass the ACP test. Example: ADP test is failed. Based on the applicable percentages used in the testing, $25,000 in QNECs must be contributed and allocated to NHCEs in order to pass the ADP test. [Note: Correction of the ADP test could also be made by distribution of the excess contributions (e.g., $10,000) to the HCEs within 12 months after the close of the plan year of failure.234]
   b. One-to-one correction method: Under the alternative correction method specified in Appendix B, the Service permits a one-to-one correction method to satisfy this failure. Such method may be cheaper for the employer and, thus, worth considering. Under this method, the excess ADP amounts and vested excess ACP amounts for each HCE are distributed (including earnings), and the plan forfeits any nonvested excess ACP amounts and related match contributions (which are allocated per the plan’s forfeiture provisions for the failed year).235 The employer then contributes as a QNEC (including

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229 See id. at App. A, §.02.
230 Regs. §1.401(k)-1(f)(6)(ii) allows the plan sponsor to contribute QNECs by the end of the 12-month period after the plan year in which the test is failed. Oftentimes, this additional 12-month period is not sufficient to correct the failed test(s) because of the amount of data needed to do the correction.
232 See Rev. Proc. 2013-12, App. A, §03. The 2013 revenue procedure makes it clear that the QNEC used to fund such amount must satisfy the requirements of Regs. §1.401(k)-6 and, thus, cannot be funded from forfeitures.
234 See Regs. §1.401(k)-1(f)(4)(ii).
earnings) in the same amount (excluding the amount of the forfeited match) to a smaller group of eligible NHCEs on a pro rata basis. So, in the above example, if $10,000 in corrective distributions is made to HCEs, QNECs in the amount of $10,000 may be made under the one-to-one correction method. The 2006 revenue procedure eliminated the option of a per capita allocation of contributions, which is consistent with the final §401(k) regulations, which stated that disproportionate contributions could not be taken into account for purposes of satisfying the ADP test or the ACP test.

4. Failure to distribute timely elective deferrals in excess of the §402(g) limit (i.e., the $17,500 annual limit for 2013 applicable to elective §§401(k), 403(b) and 457 deferrals): In accordance with the rules under the Code, if the plan sponsor distributes the excess amount (plus earnings) before the April 15 following the calendar year of the failure, the excess will be taxable in the year of deferral whereas the earnings would be taxable in the year of distribution. If the excess and earnings are distributed after the April 15 date, both are taxable in the year of distribution (even though the excess deferral already was taxable in the year of contribution). Thus, EPCRS does not provide relief for the employees for the double taxation rule.

5. Exclusion of an eligible employee from plan participation under the plan’s eligibility requirements:
   a. For noncontributory defined benefit plans, when an employee is excluded from eligibility, the plan sponsor corrects by contributing the benefit accruals for such employees. For defined contribution plans with nonelective employer contributions, the plan sponsor can correct by contributing on the same basis as the allocation amounts used to determine other eligible employees. Appendix B provides a “rereallocation correction method” as an alternative. This method assumes that the employer intended on making a given contribution to be allocated among all eligible employees; the original allocation was incorrect because all eligible employees had not been considered. Hence, the proper amount may be redetermined for each eligible employee’s account, realizing that this will increase the accounts of the excludible employees and decrease the accounts of the includible employees. The model correction requires that the make-up contribution be based on the allocations provided to all other employees under the plan formula, taking into account all relevant facts for the excluded employees, but the accounts of the other employees are not adjusted.

Example: The employer contributes $250,000, which resulted in an allocation of 10% for eligible employees. It was discovered that certain employees had been inadvertently excluded from participation. Once the $250,000 is reallocated according to all eligible employees, 9.75% is allocated to each participant’s account. Those employees that had 10% allocated will now reflect a 9.75% allocation; those excluded employees will now receive a 9.75% allocation.

b. In the case of a defined contribution plan with an employee deferral, the plan sponsor must contribute a QNEC based on a percentage of the revenue procedure affirms that this correction method can be used to correct a failure to satisfy the multiple use test for applicable years. Id. at App. B, §2.01(1)(b)(i).

Id. The plan sponsor has the option of limiting the eligible group to those employed on the correction date or to those who were NHCEs in the correction year. Id. at App. B, §2.01(1)(b)(iv)(B)(1).

See Regs. §§401(k)-2(a)(6)(iv) and 401(m)-2(a)(6)(v).

§402(g)(2).


236 Id. at App. B, §2.01(1)(b)(i).

237 See Regs. §§401(k)-2(a)(6)(iv) and 401(m)-2(a)(6)(v).

238 §402(g)(2).


240 See id. at App. B, §2.02(2)(a)(i).

241 Id. Thus, the plan sponsor uses the plan’s allocation formula (e.g., the same ratio of allocation to compensation) and uses all of the employee’s relevant factors (e.g., compensation) under the formula for that year. Of course, the employer contribution must be adjusted for earnings. The accounts of the other employees are not otherwise adjusted.

242 See id. at App. B, §2.02(2)(a)(iii).
missed deferral, as well as any required matching contribution on the full amount of the missed deferral.\textsuperscript{243} A similar correction method applies to the exclusion of an eligible employee from making catch-up contributions, Roth §401(k) contributions, or after-tax employee contributions.\textsuperscript{244}

- For traditional §401(k) plans, the missed deferral equals the ADP percentage of the group to which the employee belongs (NHCE or HCE) multiplied by the employee’s compensation for the year of exclusion, and the plan sponsor must contribute a QNEC equal to 50% of the missed deferral.\textsuperscript{245}

- For a safe harbor nonelective plan, the missed deferral equals 3% of compensation, and thus, the plan sponsor must contribute a QNEC equal to 50% of the missed deferral.\textsuperscript{246}

- For a safe harbor match plan, the missed deferral is equal to the greater of 3% of compensation or the maximum deferral percentage with at least a 100% match, and the plan sponsor must contribute a QNEC equal to 50% of the missed deferral.\textsuperscript{247}

- For a safe harbor qualified automatic contribution arrangement (QACA) plan, the missed deferral for the first year is 3% of compensation, but each year thereafter the missed deferral is the automatic contribution percentage designated under the plan. The plan sponsor must contribute a QNEC equal to 50% of the missed deferral.\textsuperscript{248}

- For a §403(b) plan, the missed deferral is equal to the greater of 3% of compensation or the maximum deferral percentage with at least a 100% match, and the employer must contribute a QNEC equal to 50% of the missed deferral.\textsuperscript{249}

- For a SIMPLE IRA, the missed deferral is equal to 3% of compensation, and the plan sponsor must contribute a QNEC equal to 50% of the missed deferral.\textsuperscript{250}

- For a defined contribution with an employer match on any employee deferrals, the plan sponsor must contribute a corrective contribution equal to the matching contribution that would have been made on the amount of the full missed deferral.\textsuperscript{251} Under the 2013 guidance, this contribution need not be a QNEC and, thus, can be subject to the plan’s vesting schedule.\textsuperscript{252}

- For a §401(k) plan that provides for the optional treatment of elective deferrals as designated Roth contribution, the correction is the same as described in App. A, §.05(2), and the same corrective employer contribution required to replace the missed deferral opportunity must be made.\textsuperscript{253} However, none of the corrective contributions may be

\textsuperscript{243} See id. at App. A, §.05.

\textsuperscript{244} See id. at App. A, §§.05(3)–(4), and App. B, §2.02(b), Ex. 11.

\textsuperscript{245} See id. at App. A, §.05(2)(b). The 2013 guidance continues the exception if an employee was improperly excluded for three months or less during the plan year but was provided the opportunity during the remaining months of the plan year to defer the maximum amount. In such case, a QNEC need not be made for the excluded months, but the employer must make up any matching amounts. See id. at App. B, §2.02(1)(a)(ii)(F).

\textsuperscript{246} Id. at App. A, §.05(2)(d)(i).

\textsuperscript{247} Id.

\textsuperscript{248} Id. at App. A, §.05(2)(d)(ii). Note that such correction method may be a deterrent for plan sponsors adding auto-enrollment to their plans, which is counter-intuitive, as participation in QACA plans is superior to that under traditional §401(k) plans with no auto-enrollment.

\textsuperscript{249} Id. at App. A, §.05(6).

\textsuperscript{250} Id. at App. A, §.05(7).

\textsuperscript{251} Id. at App. A, §.05(2)(c) (for traditional §401(k) plans); §.05(2)(d)(i) (for safe harbor §401(k) plans); §.05(2)(d)(ii) (for safe harbor §401(k) plans with QACA); §.05(6) (for §403(b) plans).

\textsuperscript{252} Id.

\textsuperscript{253} Id. at App. A, §.05(3).
treated as Roth contributions, nor allocated to a Roth Account.254

- For a §§401(k) or 403(b) plans that provide catch-up contributions, the missed deferral is equal to 50% of the applicable catch-up limit for the year in which the employee was improperly excluded, and the plan sponsor must contribute a QNEC equal to 50% of the missed deferral.255

- For a defined contribution plan with employee after-tax contributions, the missed after-tax contribution is equal to the actual contribution percentage (ACP) for the employee’s group (NHCE or HCE) multiplied by compensation, and the plan sponsor must contribute a QNEC equal to 40% of the missed after-tax contribution.256

- All of the above employer corrective contributions are subject to any and all plan limits (and statutory limits) and must be adjusted for earnings to the date the corrective contributions are made on behalf of the employee.

c. For failure to implement an employee’s actual deferral election, catch-up deferral election or after-tax employee contribution election:

- For the employee’s deferral election, the missed deferral is the employee’s actual elective deferral percentage multiplied by the employee’s compensation for the year of exclusion, and the plan sponsor must contribute a QNEC equal to 50% of the missed deferral.257 Such amount may be reduced by the amount actually deferred or matched by the employee. In the case of a partial year exclusion, the employer may use prorated compensation (as opposed to actual compensa-

6. Failure to make timely required minimum distribution under §401(a)(9): The employer is required to distribute the required minimum distribution amounts for all prior years.261

7. Failure to obtain participant and spousal consent as required under §§401(a)(11), 411(a)(11) and 417:262 If a non-QJSA distribution was made without the necessary spousal consent, EPCRS recognizes that

254 Id.
255 Id. at App. A, §.05(4).
256 Id. at App. A, §.05(2)(e).
257 Id. at App. A, §.05(5)(a)
258 Id. at App. B, §2.02(1)(a)(ii)(B).
259 Id. at App. A, §.05(5)(b).
260 Id. at App. A, §.05(5)(c).
261 Id. at App. A, §.06. For a defined contribution plan, the permitted correction method is to distribute the required minimum distribution with earnings from the date of the failure to the date of distribution. For a defined benefit plan, the permitted correction method is to distribute the required minimum distribution plus an interest payment based on the plan’s actuarial equivalence factors in effect on the date the distribution should have been made. In the event the correction is made at a time when the plan is restricted on single-sum payments pursuant to §436(d), the plan sponsor must contribute to the plan the applicable under §6.02(4)(e)(ii)(A) as part of the correction. The earnings adjustment for defined benefit plan is a changed from the prior guidance, which allowed use of the “plan’s rate,” including §417(e)(3) factors.
262 See id. at App. A, §.07.
consent may be given retroactively. However, that is unlikely, as the spouse has no incentive to provide such consent if the plan is required, in absence of the consent, to provide the survivor portion of the QJSA after the participant’s death. Under the 2003 revenue procedure, the plan could commence payment of the QJSA (with the participant’s portion of the QJSA offset by payments already made). If the spouse did not consent to the QJSA, the spousal portion would become payable to the spouse when he/she became entitled to the benefit. The 2006 revenue procedure and later guidance provided the plan with the alternative of providing the spouse with a lump sum equivalent to the actuarial value of the survivor benefit. This avoids the problem of waiting and seeing whether the spouse later claims a spousal benefit.

8. Failure to limit the annual additions allocated under a defined contribution plan in compliance with §415: In accordance with the Preamble of the regulations under §415, the IRS has decided that all corrections should occur under EPCRS, and therefore, it removed the methods to correct §415 failures from the regulations. In an effort to unify the correction approach for excess amounts, the 2008 revenue procedure defined “excess amount” as a qualification failure due to a contribution, allocation or similar credit that is made on behalf of a participant/beneficiary in excess of the maximum permitted amount according to the terms of the plan, the Code or the regulations. This continues under the 2013 guidance.

For limitation years beginning on or after January 1, 2009, the “reduction of account balance” is the presumed correction method. Under this method, the account balance of an employee receiving an excess allocation must be reduced by the excess (plus earnings). If such excess was reallocated to other employees under the terms of the plan, it must be reallocated. If it would not have been reallocated, then it is to be placed in a separate account to be used to reduce future employer contributions. While in the account, the employer is prohibited from making additional contributions to the plan other than elective deferrals. Any excess allocations attributable to elective deferrals or after-tax employee contributions must be distributed to the participant.

Regarding the ordering of the reduction if the excess allocation is attributable to both employer contributions and elective deferrals or after-tax employee contributions, the correction is completed by first distributing the unmatched employee’s after-tax contributions (plus earnings), then the unmatched employee’s elective deferrals (plus earnings). If any excess remains, it is apportioned first to the after-tax employee contributions with the associated matching employer contributions, and then to elective deferrals with associated matching employer contributions. Any matching or nonelective employer contributions that are excess amounts are forfeited and held in an account to be used to reduce future employer contributions.

a. Appendix B provides two alternative correction methods, applicable in different fact situations. If a §415 excess amount attributable to matching or nonelective contributions has been returned to the employee, Appendix B provides a “return of overpayment” method. This method requires the employer to take reasonable steps to have the participant/beneficiary return the amount of the overpayment (plus earnings), and if such amount is not returned, the employer must contribute the difference. The overpayment is to be placed in an unallocated account, to be used for reduce future employer contributions (or if the amount would have been allocated to other eligible employees, then reallocated according to the

\[263\text{ See id.}\]
\[265\text{ See T.D. 9319, 72 Fed. Reg. 16878, 16888 (4/5/07) (Preamble), noting that the final regulations do not include the correction methods for excess annual additions as such corrections should take into account the methods under VCP and Audit Cap under EPCRS.}\]
\[266\text{ See Rev. Proc. 2008-50, §5.01(3).}\]
\[267\text{ See Rev. Proc. 2013-12, §5.01(3).}\]
\[268\text{ See id. at §6.06(2).}\]
\[269\text{ Id.}\]
\[270\text{ See id. at App. B, §2.04(2)(a)(iii).}\]
plan’s allocation formula). The employer is required to notify the employees of the applicable tax treatment of the overpayment amount.

b. If a §415 failure occurs with respect to certain NHCEs who have terminated employment, Appendix B provides an alternate “forfeiture” correction method. If the NHCE has a §415 excess and made elective deferrals and received a match or nonelective contributions (but was 0% vested in the latter), the §415 excess may be considered to consist solely of the matching and nonelective contributions. The excess adjusted for earnings is forfeited and used to reduce future employer contributions or reallocated according to the terms of the plan.

9. Failure to satisfy §415 for defined benefit plans: Appendix B provides two correction methods that may be used to correct an excess benefit payment.

a. The “return of overpayment” correction method directs the plan sponsor to have the employee return the overpayment (i.e., the portion in excess of §415(b) limit), adjusted for earnings at the plan’s earnings rate. If the employee returns less than is required, the plan sponsor or “another person” must make up the difference. Also, the employee must be notified that the overpayment was not eligible for favorable tax treatment (e.g., tax-free rollover). This method must be used if the employee has no remaining plan benefits which could be used to offset the excess amount.

b. Alternatively, there is an “adjustment to future payments” method that may be used if benefits are being distributed as periodic payments. This method permits future payments to be reduced over the remaining payment period by the actuarial equivalence of the overpayment plus earnings. Such adjustment may not result in the reduction of any surviving spouse’s joint and survivor benefits; thus, it must be returned over the employee’s lifetime benefit.

10. Orphan plans: When an orphan plan has one or more failures and the plan sponsor has ceased to exist, the revenue procedure permits the plan to be terminated and plan assets distributed to participants and beneficiaries. However, there are four conditions that must be satisfied: (1) the correction must comply with the DOL regulations relating to abandoned plans, (2) the qualified termination administrator must reasonably determine whether the survivor annuity requirements of §§401(a)(11) and 417 apply to any benefits and take reasonable steps to comply with those requirements, (3) each participant and beneficiary must have been provided a vested right to his/her accrued benefits as of the date of the deemed termination, and (4) such participants and beneficiaries must be notified of their rights under §402(f).

11. Vesting failures: If an employee is not credited with the sufficient vesting percentage, the employer is permitted to use either the “contribution correction” method or the “reallocation correction” method. The contribution correction method requires the employer to contribute the improperly forfeited amount, but no adjustment is made to the other participants sharing in the original improper forfeiture. The reallocation correction method adjusts a variety of accounts — increasing the accounts of those who suffered an improper forfeiture (plus earnings) and decreasing the accounts of other participants to the amount they would have received had the error not occurred.

12. Section 401(a)(17) failures: A defined contribution plan that allocated contributions among participants may be required to reallocate the unallocated forfeitures among participants. IRS officials have previously indicated on an informal basis that if the allocation of unallocated forfeitures is to be reallocated among participants, the IRS does not require a retroactive reallocation if the plan administrator can demonstrate that the plan is subject to a low turnover rate. The IRS recognizes that it may be impractical to require retroactive reallocation when the turnover rate is low.
tions or forfeitures on the basis of compensation that was in excess of the annual dollar limit under §401(a)(17) must be corrected under a “reduction of account balance” correction method as described in §6.06(2) of the revenue procedure.\textsuperscript{281}

13. Correction by plan amendment: Appendix B provides retroactive plan amendments as correction methods for four specific failures: failures for allocation in violation of §401(a)(17); hardship distributions made without authorizing plan document language; inclusion of ineligible employees; and, most recently, plan loans being made without authorizing plan document language.

a. Section 401(a)(17) failures: Although the revenue procedure already envisions a “reduction of account balance” as a valid correction method, Appendix B provides an additional correction in which the plan sponsor may contribute an additional amount for all other participants. Such correction requires a retroactive plan amendment which is permitted under the revenue procedure.\textsuperscript{282}

b. Hardship distribution failures: If hardship distributions have been made under a plan even though the plan document never envisioned such distributions, Appendix B permits a retroactive plan amendment to permit such hardship withdrawals.\textsuperscript{283}

c. Inclusion of ineligible employee failures: If the plan administrators disregarded the plan’s eligibility requirements and allowed premature eligibility for employees (e.g., plan uses quarterly entry dates, but employees were allowed to enter the plan prior to the appropriate entry date), Appendix B permits a retroactive plan amendment to change the eligibility or entry date provisions to reflect the plan’s actual operations.\textsuperscript{284} It is possible for this amendment to extend only to those ineligible employees (provided this group is predominantly NHCEs), but it may affect coverage testing for the plan year.

d. Plan loan failures: If plan loans to participants have been made under a plan even though the plan document never envisioned such loans, Appendix B permits a retroactive plan amendment to permit such plan loans in certain situations.\textsuperscript{285} The following are examples of corrections for plan loan failures:

- \textit{Example 1}: Participant borrows $60,000 and the violation is discovered two years later. Correction requires the participant to repay the $10,000 excess; the remaining loan balance is reamortized over the remaining life of the original loan; and the prior loan payments attributable to the $10,000 excess can be applied to interest on the excess if the participant pays only the $10,000 or can be applied to the remaining loan balance if the $10,000 excess plus interest is repaid.

- \textit{Example 2}: Participant borrows $10,000 over six years instead of the required five-year period and the violation is discovered two years later. Correction requires the loan to be reamortized over the remaining three-year period of the loan. Note: this correction is not available if the statutory term of the loan has expired (e.g., violation is discovered in year six).

- \textit{Example 3}: Participant borrows $10,000 over a five-year period but loan repayments never began and the violation is discovered two years later. The correction provides three options: (1) the participant can make a lump sum payment (including interest) to bring the loan current and continue payments under the old payment schedule;

\textsuperscript{282} See id. at App. B, §2.07(1).
\textsuperscript{283} See id. at App. B, §2.07(2)(a).
\textsuperscript{284} See id. at App. B, §2.07(3)(a).
\textsuperscript{285} See id. at App. B, §2.07(2).
(2) the loan may be reamortized over the remaining life of the original loan term; or (3) any combination of option 1 or option 2.

14. Earnings and forfeiture adjustments: As several of the above correction methods require adjustments for earnings and forfeitures, Appendix B affords approval of various earnings adjustment methods (but not forfeiture methods).  

a. Correction of an operational failure that includes a corrective contribution or allocation to increase an employee’s account balance must include an adjustment for earnings and forfeitures. Such requirement does not apply to corrective distributions or corrective reductions in account balances. Reasonable estimates may be used in determining earnings if the difference between an approximate versus exact determination is insignificant and the administrative cost of an exact determination significantly exceeds the approximate determination.

b. The earnings rate is generally based on the investment results that would have applied to the corrective contribution or allocation had the failure not occurred. If multiple investment funds are offered to participants, the earnings rate should be based on the participant’s choices for the period of failure. For administrative convenience, if most of the employees for whom the corrective contribution or allocation are NHCEs, the rate of return of the fund with the highest earnings rates for the period of failure may be used to determine the earnings rate for all corrective contributions or allocations. In the event the participant had not made any applicable investment choices, the earnings rate may be based on a weighted average of the earnings rate under the plan as a whole.

c. The “period of failure” runs from the date of the failure through the date of the correction.

d. The current guidance provides four alternative allocation methods, specifically designed to facilitate the crediting of earnings where corrective contributions are made to dates between the plan’s valuation dates:

(1) Plan allocation method: The earnings amount is allocated to the account balances in accordance with the plan’s method for allocating earnings as if the failure had not occurred.

(2) Specific employee allocation method: The earnings amount is allocated solely to the account of the employee on whose behalf the corrective contribution is made even if the plan’s allocation method would have produced an alternate result. Under this method, either the entire earnings amounts for the period of failure can be allocated to the affected participant or can be treated as having been made as of the last day of the prior plan year.

(3) Bifurcated allocation method: This method is a hybrid of the plan allocation and specific employee allocation method. For valuation periods prior to the date of correction, the specific employee allocation method is

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286 See id. at App. B, §3.01.
287 See id. at App. B, §3.01(1).
288 See id. at App. B, §3.01(1)(d).
289 See id. at App. B, §3.01(1)(c).
290 See id. at App. B, §3.01(3)(a). The revenue procedure clarified that earnings could include losses. Id. at §5.04.
291 See id. at App. B, §3.01(3)(b).
292 See id. at App. B, §3.01(4)(b). In Ex. 28, the plan’s method for allocating earnings is determined by valuing the plan assets annually on the last day of the plan year and then allocating earnings in proportion to account balances as of the last day of the prior plan year (after reduction for distributions during the current year but without regard to contributions received during the current plan year). Had the failure not occurred, the prior account balances would have been different and the earnings allocated to those account balances would have been different. Hence, correction under this allocation method requires adjustments to the account balances to all participants in the plan for each year of correction. Accordingly, the Service has provided alternative allocation methods to address this issue.
used to allocate earnings attributable to those periods; for valuation periods during which the correction occurs, the plan allocation method is used.  

(4) Current period allocation method: This method is also a hybrid of the plan allocation and specific employee allocation method. For the first valuation period for which the correction is made, earnings are allocated under the plan method, and for all subsequent earnings, the allocation is made solely to the employees.

297 See id. at App. B, §3.01(4)(d).