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Internal Revenue Service
Attention: Joyce Kahn SE:T:EP:RA:VC
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Washington, D.C. 20224

It is Advisable to Make the Same Relief Available to Administrators
of Retirement Plans Restricted to Owner-Employees When Those Administrators
Have Failed to Make Timely Annual Filings of Form 5500s
That is Available to Administrators of All Other Plans

Those small employers with retirement plans confined to (1) partners in a business and their spouses, or (2) individuals owning 100% of a business and their spouses, in which (3) the business is not a member of either businesses under common control or a controlled group of corporations (“Owner-Employee Plans”) should be provided by the Internal Revenue Service (the “Service”) with the same relief from excessive penalties under the Internal Revenue Code of 1986 (the “Code”) for failing to make timely filings of Form 5500s that is available to every other employer. Such relief may be best provided in concert with the Department of Labor with whom all Form 5500 filing are made, and which has a compliance program for non-filers, the Delinquent Filer Voluntary Compliance (“DFVC”) Program, that now excludes Owner-Employee Plans and only Owner-Employee Plans.

The Service provides sponsors of retirement plans who have not met the Code requirements applicable to tax-qualified plans with a comprehensive set of correction programs, the Employee Plans Compliance Resolution System (“EPCRS”). Rev. Proc. 2006-27, 2006-1 C.B. 945, Section 1.01. The EPCRS is designed to encourage these plans to be operated properly in accordance with these requirements. *Id.* 1.02 Section 1101 of the Pension Protection Act of

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2006 (“PPA”) directs the Service to “update and improve” the EPCRS giving special attention to small employers and assuring that any penalty that is imposed by reason of a compliance failure “is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure.”

The planned EPCRS update would be a good vehicle for the Service to announce that relief for late filers would be available to administrators of all plans, including Owner-Employee Plans, in the same manner the EPCRS program references determination letter requests and permits such requests to be made either separate from or in concert with an EPCRS filing. Permitting late filing penalty relief requests in concert with EPCRS filings recognizes that errors with respect to the filing of determination requests or annual filings often occur together with other compliance errors that the EPCRS addresses, such as failures to make contributions or distributions consistent with plan terms.

The Annual Code Filing Requirement for Retirement Plans

One of the most fundamental Code requirements applicable to tax-qualified retirement plans is the requirement that their administrators make timely annual filings with the Service. Otherwise, the Service may not be able to monitor whether the plan is operating in accordance with the applicable Code requirements and the plan administrator will not verify such compliance in the course of making such a filing. If the plan is not in compliance, the plan may not qualify for the favorable tax treatment available under the Code and the plan’s sponsor or administrator may be subject to excise taxes.

Code § 6058 generally requires tax-qualified retirement plans to make annual Form 5500 filings. If such filings are not made in a timely fashion, Code § 6652(e) authorizes the Service to assess \$ 25 daily penalties up to a total of \$15,000 for each year timely filings are not made. Penalties may be abated if it is shown that there was reasonable cause for the failure to make timely filings. Penalties are assessed against plan administrators, which for Owner-Employee Plans are almost always the owner-employees.

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Those Owner-Employee Plans which satisfy additional conditions to assure that they do not discriminate against non-highly compensated employees are called “One-Participant Plans” and may file a simplified Form 5500, known as a Form 5500-EZ. *See, e.g.*, pages 1 and 2 of the instructions for the 2007 Form 5500-EZ. The Form 5500-EZ is frequently used by the smallest of businesses, *i.e.*, sole proprietors with no employees other than spouses.

Owner-Employee Plans seem to have been first required to make annual filings starting in 1985 when they were permitted to file a Form 5500-R. Annual Form 5500-EZ filings have been permitted since the 1986 calendar year, when there appears to have been no minimum asset threshold exception to the annual filing requirement. In both 1986 and 1987, annual filings were usually not required if no contributions were made for the year and the plan assets did not exceed \$25,000. In 1988, annual filings were generally only required if the plan assets exceeded \$25,000. From 1989 until 1990, no annual filings were required if plan assets were less than \$100,000 at the end of the plan year for the year at issue (although all plans were aggregated for purposes of the test). From 1991 until 1994, the \$100,000 limit was retained but made inapplicable to the year of plan termination. From 1995 until 2006, the \$100,000 limit had to be satisfied at the end of the year in question, and in all prior years going back to and including 1994 (the multiple plan and year of termination provisos were retained).

Section 1103(c) of the PPA increased the filing threshold for the 2007 plan year for One-Participant-Plans to \$250,000. Moreover, the threshold became applicable only at the end of the year. The multiple plan proviso and the exception for the year of plan termination continue.

The Annual ERISA Filing Requirement for Retirement Plans

Title I of the Employer Income Security Act of 1974, as amended (“ERISA”), generally requires retirement plans subject to its coverage to file annual reports with the Department of Labor. ERISA § 104. The DOL penalties for the failure to file timely annual reports are

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substantially larger than those imposed by the Code. Section 502(c)(2) of ERISA authorizes the DOL to assess daily penalties of \$1,100 a day with no limit, although the Department of Labor generally limits daily penalties against late filers to \$50 with a limit of \$30,000 for each year. 67 FR 15052 (March 28, 2002). These penalties, like those of the Code, may be abated if it is shown that there was reasonable cause for the failure to make timely filings. Penalties are assessed against plan administrators, which for Owner-Employee Plans are almost always the owner-employees.

ERISA only covers retirement plans which cover employees other than owner-employees and their spouses. ERISA § 3(2). Thus, ERISA does not cover Owner-Employee Plans. 29 C.F.R. § 2510.3-3(B). Nevertheless, the Service's Form 5500s satisfy both the Code and the ERISA annual filing requirements. Moreover, starting with the 1999 plan year all Form 5500 filings have been required to be made with the Department of Labor, even those of Owner-Employee Plans. Thus, Owner-Employee Plans, like all tax-qualified plans, must make their annual Code filings with the Department of Labor.

**The DOL Compliance Program Applicable to Retirement Plans
Other than Owner-Employee Plans**

The Department of Labor DFVC Program applies to administrators of employee benefit plans subject to ERISA coverage that have not fulfilled their annual filing requirements. 67 FR 15052 (March 28, 2002). For eligible administrators of plans with less than 100 participants, the daily penalty is reduced to a \$10 daily penalty, with a maximum annual penalty for a single plan is \$750. The maximum total penalty for all the untimely filings submitted on behalf of a single plan is \$1,500. Payments are made to and payable to the Department of Labor. The administrator is required to (1) file the outstanding annual reports at the same address that is used for current annual filings, but may use the current forms for any prior years; (2) check off the box on the front page of the Form 5500 showing that it is a DFVC filing; and (3) send copies of the

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late Form 5500s without schedules or attachments with the penalty payment to a different address. FAQs About the Delinquent Filing Voluntary Compliance Program http://www.dol.gov/ebsa/faqs/faq_dfvc.html (May 5, 2008). The administrator does not need to show or allege that there was reasonable cause for the failure to file timely, but by participating in the program waives the right to make a reasonable cause challenge to the penalty. *Id.*

Administrators of retirement plans covered by ERISA may use the DFVC Program if they have not been notified in writing by the DOL of a failure to file a timely annual report. *Id.* A disqualifying notice would appear to be one that applies to a year other than the one being corrected. The DFVC Program only addresses failure to file penalties imposed by Title I of ERISA, which do not include the Code's penalties for the failure to file annual reports. 67 FR 15052, 15053 (March 28, 2002). Thus, the DOL will not consider the failure by Owner-Employee Plans to file annual reports. *Id.*

The Service has announced it will not impose non-filing penalties on an administrator who is eligible for and satisfies the requirements of the DFVC Program with respect to an annual Form 5500 filing. IRS Notice 2002-23; 2002-1 C.B. 742. This appears to be the case even if the plan administrator has received a notice of non-filing from the Service, but not the DOL, before satisfying the DFVC Program. FAQs About the Delinquent Filing Voluntary Compliance Program http://www.dol.gov/ebsa/faqs/faq_dfvc.html (April 28, 2008). In fact, it appears that the initial notice of non-filing is often issued by the DOL, which may observe that it has not received an annual filing with respect to a plan whose administrator that has made prior filings with the DOL without giving any notice of a plan termination.

The Service has also announced that it will continue to impose non-filing penalties against administrators of Owner-Employee Plans unless there is reasonable cause for the lack of the filing. IRS Notice 2002-23; 2002-1 C.B. 742. The IRS has no compliance program for administrators of Owner-Employee Plans that have failed to make timely annual filings. *Id.* It is irrelevant whether the plan administrator uses a Form 5500-EZ or a Form 5500. In fact, it

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appears that the Service often automatically imposes the maximum permissible penalties on administrators of Owner-Employee Plans, whether the administrator has made a filing voluntarily without any prompting from the IRS or only after having received a notice of non-filing from the IRS or the DOL.

The Service Should Provide a Means for Owner-Employee Plans to Qualify for Relief From IRS Penalties for Late Annual Filings Under Similar Conditions As Other Tax-Qualified Retirement Plans

The Service's current policy of denying relief from the late filing penalties only to Owner-Employee Plans is inequitable and discourages tax compliance from the very owner-employees who wish to comply with the Code's requirements.

The Service is generally less disadvantaged by the lack of timely filings by administrators of Owner-Employee Plans than by those of other plans. Thus equity requires that Owner-Employee Plans be treated more leniently rather than more severely. Many Owner-Employee Plans, such as simple sole proprietorships, are permitted to file Form 5500-EZs rather than the more detailed Form 5500s. Thus, in many cases the Service is being deprived of less information than when it grants relief of the penalties. Moreover, the compliance issues that pertain to Owner-Employee Plans often do not involve third party employees. Thus, the issues are simpler to address by the owner-employees and the Service.

Owner-Employee Plans need more not less encouragement than other plans to correct their compliance deficiencies. Their small sponsors often lack the resources to assure compliance that larger plan sponsors take for granted. Owner-employees often rely on (1) financial institutions to provide timely plan documents that are rarely reviewed by professional counsel and often treated by the owner-employees as boilerplate which may be discarded, and (2) individual income tax software to compute their annual tax contributions, often the maximum permissible under certain presumed plan terms. Such owner-employees often make no annual

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filings. Without those filings, such owner-employees may not have sufficient encouragement to verify that (1) the plan contributions and distributions are consistent with the plan terms; (2) the owner-employees did not engage in prohibited transactions with the plan, such as borrowing from the plan; and (3) tax qualification plan amendments were timely adopted.

Furthermore, the current relief policies make any prudent administrator of an Owner-Employee Plan, which has not made all its annual filings in a timely fashion, reluctant to use the VCP part of the EPCRS because such filings require inclusion of the plan's latest annual filing. Section 11.03(1) Rev. Proc. 2006-27; 2006-1 C.B. 945. If some annual filings are still due, a VCP filing could expose the administrator to very substantial personal liability for the \$15,000 of penalties that may be imposed for each year that timely filings may not have been made. No such disincentive applies to administrators of other tax-qualified plans who face at most a total penalty of \$1,500 for all years for which filings were not made. Thus, the Owner-Employee Plan would not use the VCP part of the EPCRS (*Id.* Part V) to obtain a retroactive determination letter, avoid the excise taxes applicable to excessive contributions (Code § 4972) or to the failure to make timely minimum distributions (Code § 4982).

Proposed Procedure for Providing Relief to Administrators of Owner-Employee Plans from the Penalties for the Failure to Make Timely Annual Filings

The DOL DFVC Program may be easily revised to address non-timely filings by administrators of Owner-Employee Plans. The filing part of the DOL DFVC program may be modified as described below, and the confirmation of the filing and penalty payment could be made to either the DOL or the IRS. In either case, the confirmation could be coordinated with an EPCRS filing as is now permitted with a determination letter filing. It is quite common for administrators who discover they have failed to make timely annual filings, to also discover

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operating or form defects that require a VCP filing.

The same box to show a DFVC that was added to the top of the first page of all Form 5500s on or after 2002 may be added to each future Form 5500-EZ. Administrators of all plans would be instructed to make such late filings with the same DOL Employee Benefit Security Administration offices as is now the case for their timely filings. In order to encourage enforcement as soon as possible, administrators of Owner-Employee Plans could be encouraged to mark “DFVC Program” in red on the 2007 Form 5500-EZ in the same manner that they did in the initial DFVC filings before the Form 5500s were modified. EBSA Fact Sheet DFVC Program, 2003 ERISA LEXIS 6 (May 14, 2003). Thus, simplified annual filings using the Form 5500-EZs would be permitted in 2008 as well as in those future years when the new Form 5500-EZs would be generated in the normal course of operations.

Eligibility conditions may need to differ slightly from that for other retirement plans. A plan administrator of an Owner-Employee Plan would be disqualified if he or she received a notice of lack of timely filing from the Service or the DOL. Owner-Employee Plans, unlike other plans, may never receive such a notice from the DOL, particularly if they have made filings using Form 5500-EZs or no annual filings. Consideration may be given to whether the administrator of any plan should be permitted to participate in the DFVC Program if the plan administrator has received a notice of a lack of timely filing from the Service before making its DFVC filing of annual reports. This may not be a substantive change because it appears that the DOL issues notices of the lack of a timely annual report for employers subject to Title I of ERISA prior to the IRS notice. In any case, it would be useful to clarify whether a notice from the DOL and/or the Service disqualifies any DFVC filing or only one applicable to the year that the notice is applicable to.

Administrators of Owner-Employee Plans would be instructed to compute penalties in the same manner as other small plans. The \$10 daily penalties and maximum penalties would be the same. For a single plan for a year the maximum would be \$750, and for multiple years would

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be \$1,500.

Decisions are needed about where to send the confirmation of the annual filings, the penalty payment and whether the amount is payable to the U.S. Treasury rather the U.S. Department of Labor. All administrators could be instructed to make the check payable to the DOL and sent to the DOL, and thus avoid any confusion about the mailing. This places the burden on the DOL to determine which payments to forward to the Service. Alternatively, checks for only Owner-Employee Plans could be payable to US Treasury and could be mailed with filing confirmations to an IRS address. This places the burden on the plan administrator to determine whether to forward payments to the Service. Clear instructions on both the IRS and DOL web sites could minimize but not eliminate the number of cases in which plan administrators would make payments to the wrong government agency because most plan administrators may be expected to know whether they are administering Owner-Employee Plans or other plans.

CONCLUSION

In conclusion, the Service would achieve the Congressional goal set forth in the PPA of encouraging more small employers to comply with the Code's complex and extensive rules by providing relief from late filing penalties to administrators of Owner-Employee Plans similar to those it makes available to administrators of larger plans. In particular, the administrators willing to step forward would be treated leniently and encouraged to use the EPCRS to correct any other compliance failures. The universal availability of such relief would encourage owner-employees to keep their retirement plan documents up-to-date, maintain plan terms consistent with their contribution policies, make the requisite minimum distributions, require spousal consents to distributions other than qualified and joint and survivor annuities when those requirements are applicable, and avoid loans to owner-employees or other prohibited transactions. All those items would be addressed by administrators of Owner-Employee Plans who carefully prepare timely annual filings, but may not be considered if they are not making such filings, whether because of

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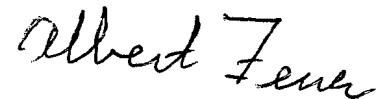
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ignorance or the fear of the imposition of substantial late filing penalties.

Sincerely,

A handwritten signature in black ink that reads "Albert Feuer". The signature is fluid and cursive, with "Albert" on the top line and "Feuer" on the bottom line.

Albert Feuer