Legal Developments

IRS Revised Its Qualified Plans Correction Program to Address the Determination Letter Program Changes

This column discusses the major changes made to the Employee Plans Compliance Resolution System (EPCRS) by Revenue Procedure 2016-51 to address the determination letter program changes.

By Elizabeth Thomas Dold

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Every few years the Internal Revenue Service (IRS) looks at new ways to improve its Employee Plans Compliance Resolution System (EPCRS). Recently, the IRS issued the latest rendition of the program in Revenue Procedure 2016-51, effective January 1, 2017. This replaces and updates Revenue Procedure 2013-12, along with incorporating the changes set forth in Revenue Procedure 2015-27, which focused on correction of overpayments and changes to the various voluntary correction program (VCP) fees, and Revenue Procedure 2015-28, which focused on new safe harbor correction methods for auto-enrollment/auto-accelerator failures. The intent behind the majority of the changes to the EPCRS program that we highlight below is to conform the correction program with the changes being made to the determination letter program, and to help plan sponsors manage the risks that the loss of the determination letter cycle program has on audit.

The Changes

The top five changes are summarized below.

1. Determination Letter Requirement for Self Correction Eliminated

Old Rule: Under long-standard guidance, in order to be able to self-correct a significant operational failure (*i.e.*, a failure to follow the terms of the plan), the plan sponsor must have had a current favorable determination letter for an individually designed plan (or opinion or advisory letter, for a pre-approved plan). There were special rules for 403(b) plans that could not get a determination letter. Whether the failure was significant or insignificant was a facts and circumstances analysis.

New Rule: As of January 1, 2017, the plan sponsor of an individually designed plan is no longer required to have a current favorable determination letter in order to self-correct a significant operational failure. This makes sense as plan sponsors are no longer able to routinely file for determination letters. No changes were made for pre-approved plans as the cycle program still remains for those plans.

2. Requirement (or Ability) to Apply for a Determination Letter as Part of EPCRS Eliminated

Old Rule: Under the previous rules, depending on the type of correction and other factors, there was a requirement (or an option) to file for a determination letter as part of the correction.

New Rule: For submissions made on or after January 1, 2017, there is no requirement or ability to make a determination letter submission as part of the correction. The purpose of the determination letter was to ensure that the plan document still complied with the plan qualification requirements under the Internal Revenue Code (Code), so that the determination letter process would include a review of any plan amendment made as part of the correction. But now that a requirement (or option, in some cases) does not apply, and unfortunately the IRS clarified that a compliance statement that blesses a correction *via* a plan amendment only covers the correction of the error and is not evidence that the amendment or plan meets the qualification requirements, there is no longer a path to obtain that level of protection. Plan sponsors will need to make their own determination, with the assistance of their tax advisor, regarding the impact on the plan. For example, it is not uncommon for a plan sponsor to have to represent as part of a correction with a retroactive amendment that the amendment complies with coverage, nondiscrimination, pension funding restrictions, and anti-cutback provisions under Code Sections 410, 401(a)(4), 436, and 411(d)(6).

3. IRS VCP Fees and Schedules Moved

Old Rule: The various IRS VCP fees have historically been set forth in the EPCRS Revenue Procedure. This included a special rule for refund of 50 percent of the fee for an anonymous VCP application in the rare instance that the IRS and the plan sponsor could not agree to a correction.

New Rule: The various IRS VCP fees will now be contained in the annual revenue procedure issued on employee plans—currently Revenue Procedure 2017-4. Please remember that a number of VCP fees were reduced when Revenue Procedure 2016-8 was issued (*e.g.*, for large plans the VCP fee dropped from $25,000 to $15,000). But unfortunately, all the special rules regarding fees were not set forth in Revenue Procedure 2016-8, which for 2016 resulted in applicants having to review a number of various Revenue Procedures to ascertain the appropriate user fee. This was all changed beginning in 2017, as nearly all the special fee provisions were removed from Revenue Procedure 2016-51 and now appear in Revenue Procedure 2017-4 (and its successor). In the past, the IRS user fee Form 8951 (*https://www.irs.gov/pub/irs-pdf/f8951.pdf*) could be used to help with this determination, but unfortunately the new form no longer makes this an easy task. Moreover, the 50 percent refund for the anonymous applications was eliminated (so if you cannot agree, you can walk away but you forfeit your submission fee). Lastly, all the streamlined schedules were deleted as they are now separate forms. Forms 14568-A through Forms 14568-I are available with other forms on the IRS Web site. [*See https://apps.irs.gov/app/picklist/list/formsPublications.html?value=14568&criteria=formNumber&submitSearch=Find.*]

4. IRS Audit Cap Sanctions Revamped to Address the Lack of a Recent Determination Letter

Old Rule: In the event that an error is discovered during an employee plans audit, the IRS agent generally mandates that the error be corrected (and there is no statute of limitation that runs on plan qualification issues), and the IRS will impose a nondeductible sanction on the plan sponsor. The amount of that sanction is largely at the discretion of the IRS auditor (and his/her manager). As a technical matter, the sanction was a negotiated percentage of the "maximum payment amount," which is the maximum tax that the IRS could collect if the plan were disqualified for all open tax years and includes:

- The tax on the previously tax-exempt trust, including interest and penalties that would be due on the trust return (Form 1041);
- The tax due resulting from the loss of the employer's deduction for contributions made to the trust, including interest and penalties that would be due on the employer's tax return (*e.g.*, Form 1120);
- The tax due resulting from income inclusion of participants' account balances, including the tax that would be due on plan distributions previously rolled to an eligible retirement plan, along with interest and penalties that would be due on the participants' individual tax returns (*e.g.*, Form 1040); and
- Any other tax that would occur if the plan were disqualified (*e.g.*, employment taxes).

This may well result in a large "maximum payment amount" that can translate to a potentially large Audit CAP sanction as well.

However, there was a special rule for nonamender failures that were discovered as part of the determination letter program. Specifically, the audit cap sanction was generally determined based on the applicable law that was missed and the size of the plan, set forth in the chart below.

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

New Rule: As of January 1, 2017, the sanction will simply be a negotiated amount based on the relevant facts and circumstances, and the "maximum payment amount" will only be one such factor to consider. The factors include:

- The steps taken by the plan sponsor to ensure that the plan had no failures;
- The steps taken by the plan sponsor to identify failures that may have occurred;
- The extent to which correction had progressed before the examination was initiated, including full correction;
- The number and type of employees affected by the failure;
- The number of non-HCEs who could be adversely affected if the plan were disqualified;
- Whether the failure is a failure to satisfy nondiscrimination requirements;
- Whether the failure is solely an employer eligibility failure;
- The period over which the failure occurred (*e.g.,* for a plan document failure, the period since the end of the applicable remedial amendment period);
- The reason for the failure; and
- The maximum payment amount (which is the same calculation as noted above).

The fee chart for nonamender failures (generally, failure to timely adopt IRS required amendments) discovered as part of the determination letter program was eliminated, and replaced with a fee schedule based on a percentage of the VCP fees, which again is only relevant if a determination letter is available and sought (*e.g.*, on plan termination). In general, the sanction for nonamender failures is:

1. 150 percent of the applicable VCP user fee described in Section 6.08 of Revenue Procedure 2016-8 (as amended) if the nonamender failure arose in connection with an amendment that was required to be adopted *after* the end of the plan's last remedial amendment cycle to which Revenue Procedure 2007-44 applied (*for pre-approved plans, after* the end of the plan's second six-year remedial amendment cycle); and
2. 250 percent of the applicable VCP user fee described in Section 6.08 of Revenue Procedure 2016-8 (as amended) if the nonamender failure arose in connection with an amendment that was required to be adopted *before* the end of the plan's last remedial amendment cycle to which Revenue Procedure 2007-44 applied (*for pre-approved plans, before* the end of the plan's second six-year remedial amendment cycle).

Note that these special sanction amounts may be decreased if a plan amendment was timely adopted in order to maintain the plan's qualified status but is found to be lacking by the IRS (but generally not below the VCP user fee). And if the nonamender failure is egregious (taking into account all the facts and circumstances, including the number of plan amendments that were not timely adopted, the number of years that have elapsed from the end of the remedial amendment period until amendments were adopted (if at all), and the extent to which the plan lacked internal controls to facilitate the timely adoption of amendments), the sanction can be increased.

A special rule applies for failure to timely adopt an amendment required as part of receipt of a favorable determination letter. The sanction is $750 (it was $1,000) regardless of the number of plan participants, provided that the amendment is adopted within three months of the end of the remedial amendment period.

Lastly, the IRS added five additional factors to consider in determining the sanction amount for nonamender failures that are discovered outside the determination letter program, including:

- Whether the plan is subject to a favorable determination/opinion/advisory letter;
- The internal controls implemented by the plan sponsor to ensure the timely adoption of required amendments;
- The extent to which the plan sponsor has adopted a timely plan amendment that is later found not to satisfy the qualification requirements of the Code;
- The extent to which the plan sponsor has otherwise adopted applicable amendments identified on the Required Amendment List described in Section 9 of Revenue Procedure 2016-37 and published annually in the Internal Revenue Bulletin (which has not yet been issued); and
- The extent to which the plan sponsor had reasonably determined that a provision on the Required Amendments List described in Section 9 of Revenue Procedure 2016-37 was not applicable to the plan sponsor's plan.

5. Plan Amendment and Plan Document Failures Clarified

Old Rule: A plan document failure was defined to include late good faith and interim amendments that no longer apply to individually designed plans. Moreover, the IRS had been rather flexible as to when a plan amendment was required to be adopted (*e.g.*, before or after the VCP submission), likely because the plan amendment would generally be reviewed as part of the determination letter program.

New Rule: The new guidance revises the definition of plan document failure, and includes a reference to the new Required Amendments List, and clarifies that the failure to timely adopt a discretionary amendment does not result in a plan document failure (likely because it is viewed as an operational failure). It also clarifies that for a correction of interim amendments and nonamender failures, the failure must be corrected by adopting the required amendment *before* a VCP application is submitted to the IRS. This is in line with the fact that the VCP compliance statement is not going to make a determination that the contents of the amendment are accurate. However, if an amendment is required as part of the correction, it generally should not be signed until IRS approval is received, and the plan sponsor has 150 days after the date of the compliance statement to adopt the amendment.

These changes are welcomed in light of the uncertainties facing plan sponsors and the benefits community as to the future impact of the sizable cutbacks in the determination letter program that has been such an integral part of maintaining a qualified plan. ■