Employee Benefits Corner

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A Look at the New Rendition of EPCRS

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After five years of waiting, the IRS has issued its much-anticipated update to its Employee Plans Compliance Resolution System (EPCRS). Specifically, on December 31, 2012, the IRS issued Rev. Proc. 2013-12,[1] which replaces Rev. Proc. 2008-50,[2] effective as of April 1, 2013, or as soon as December 31, 2012, if the plan sponsor wants to adopt the provisions early.

This updated Revenue Procedure makes a number of important substantive changes to the correction program, and the plans (and types of failures) that are eligible for the program. It also streamlines the application process, and provides some needed relief to the existing user fees, which are described more fully below. It is important for all plan sponsors and advisors to review these provisions, as this guidance can save the tax-favored status of the plan, which is put in jeopardy on a regular basis for failure to follow the terms of the Plan or the ever-complex provisions of the Internal Revenue Code.

I. Types of Plans and Failures Covered

The correction program covers qualified plans (401(a), 401(k), 403(a), 403(b) plans), and SEP and SIMPLE IRAs. The big news here is that 403(b) plans are now generally covered to the same extent that 401(k) plans were covered in the past. Therefore, no longer will a 403(b) plan be subject to limited relief provisions.

Moreover, governmental 457(b) plans will continue to be accepted by the IRS on a provisional basis outside of EPCRS through standards similar to EPCRS, and the IRS expanded this provisional review to include certain tax-exempt 457(b) plans, particularly where the plan was erroneously established to benefit the entity's non–highly compensated employees and the plan was operated in a manner similar to a qualified plan. However, 457(b) plans that are unfunded plans established for top hat employees will generally not be covered.

EPCRS failures generally fall within four types of failures—Plan Document Failures, Operational Failures, Demographic Failures and Employer Eligibility Failures.

II. Pre-Approved Corrections

There are a number of additional pre-approved corrections addressed in EPCRS, largely geared to 403(b) plans, which are summarized below. Notably, the existing corrections largely remained unchanged (*e.g.,* loan corrections have not been expanded to self-correction), and EPCRS continues to provide no guidance on the correction of errors related to safe-harbor notices, and Roth 401(k) contributions. The IRS is still seeking comments on the proper treatment of these violations, and violations of automatic enrollment and automatic accelerator provisions.

Notably, for self-correction, the Plan must have established practices and procedures reasonably designed to promote and facilitate overall compliance with the Code. The IRS clarified that for self-correction, a plan that provides for elective deferrals and nonelective employer contributions (not matching contributions) is still eligible for self-correction if the plan routinely violates 415 limit, provided that the excess annual additions are regularly corrected by return of the elective deferrals within two and a half months after the end of the plan's limitation year (provided that the correction does not violate another Code requirement).

Let's now look at the specific changes to the pre-approved correction approaches for the various types of plans.

A. All Plans

For all plans, EPCRS for the first time includes the definition of "earnings," which is almost universally required for corrective contributions and distributions to be adjusted for earnings for the delay in the contribution or distribution. Importantly, the definition refers to an adjustment of a principal amount to reflect subsequent investment gains and losses. But EPCRS still retains the provision that for a corrective allocation to a DC plan, losses are not required to be taken into account.

In addition, EPCRS updates the missing participant provisions as the IRS letter forwarding service is no longer available, and also provides for limited transition relief (generally through May 30, 2013) to provide plan sponsors additional time to take additional steps to locate missing participants.

B. 403(b) Plans

For 403(b) plans, effective January 1, 2009, the corrective provisions largely track the expansive rules for qualified plans. For example, the term "excess amount" is expanded to track the 401(a) definition, and the broad term "overpayment" now applies to 403(b) plans, which means a 403(b) failure due to a payment to a participant or beneficiary that exceeds the amount payable under the terms of the plan or that exceeds a limitation provided in the Code or regulations. Accordingly, the same correction approach that applies to 401(k) plans applies to 403(b) excess amounts and overpayments. *See* Chart 2.

Moreover, the pre-approved correction methods set forth in Appendix A and B are deemed reasonable and appropriate correction methods for 403(b) plans as well. This approval includes corrections for the following errors: (1) ACP nondiscrimination testing failures, (2) 402(g) limit failure, (3) exclusion of eligible employees from participation, (4) minimum required distribution failures, (5) 415(c) limit failure, (6) orphan plans and contracts, (7) vesting failures, (8) overpayment failures, (9) 401(a)(17) compensation failures, and (10) correction by plan amendment (which is limited).

Lastly, there are a few special correction principles for 403(b) plans that are new under Rev. Proc. 2013-12. They are shown in Chart 1.

C. 401(k) Plans

For 401(k) plans, EPCRS brings the changes shown in Chart 2.

Chart 1.

	Rev. Proc. 2013-12
Special correction principles—such as for employer eligibility failure, failure to provide full vesting (including a failure to maintain a separate account), or an exchange made to a vendor which is not part of the plan (and for which there is no information sharing agreement)	A 403(b) failure can be corrected by treating a contract as a 403(c) annuity contract (or, if applicable, as an amount to which Code Sec. 61, 83 or 402(b) applies).
Failure to adopt a written 403(b) plan timely	VCP or Audit CAP correction is available, but it will not be a determination as to whether the form of the document satisfies the 403(b) requirements. A compliance statement will trigger the extended remedial amendment period set forth in Ann. 2009-89.
Universal availability failure	Same as 401(k) failure correction (for exclusion of otherwise eligible employees) or the missed deferral can equal the greater of three percent of compensation or the maximum deferral percentage that provides a matching contribution rate that is at least as favorable as 100 percent of the elective deferral made by the employee.
Information Sharing Failures—403(b) failure results from a contract issued in exchange not being part of a 403(b) plan due to the failure to have an information sharing agreement	Transfer the assets held under that contract to another vendor that is covered by the plan.
Favorable Letter	Pending further guidance, the employer needs to be an eligible employer and timely adopt a 403(b) document (generally on or before December 31, 2009) effective as of January 1, 2009 (or otherwise corrects the document issue, as noted above). Also, for self-correction, established practices and procedures are only required after December 31, 2009.

Chart 2.

	Rev. Proc. 2008-50	Rev. Proc. 2013-12
Correction of ADP, ACP or multiple use test	Corrective allocations should come only from employer nonelective contributions, including forfeitures if the plan permits their use to reduce employer contributions.	Any amounts used to fund QNECs must satisfy the definition of QNEC in Reg. §1.401(k)-6. This is consistent with informal IRS comments on this topic.
Missed Matching Contributions	QNEC is the appropriate correction.	Employer nonelective contribution is permissible (QNEC is only required for 401(k)(12) plans).
Overpayments	Employer takes reasonable steps to have the overpayment, *plus appropriate interest* from the date of the distribution to the date of repayment, returned to the plan. To the extent the amount returned is less than the overpayment adjusted for earnings at the plan's earning's rate, the employer or another person must contribute the difference (the "make-whole" contribution).	The "plus appropriate interest" language is replaced with "adjusted for Earnings at the plan's earnings rate." Importantly, for the first time the guidance includes an exception. The make-whole contribution does not apply when the failure arose solely because a payment was made from the plan to a participant or beneficiary in the absence of a distributable event (but was otherwise determined in accordance with the terms of the plan (*e.g.,* an impermissible in-service distribution). The provision also expressly provides that to the extent an overpayment was solely considered a premature distribution but was otherwise determined in accordance with the plan terms, any amount returned by the participant or beneficiary is allocated to his or her account.
Loans		Loan violations can be corrected through Audit Cap.
Failure to make automatic contribution under 401(k)(13)		The missed deferral is three percent of the employee's compensation for the first year, and for subsequent years the qualified percentage set forth in the plan. The corrective contribution is 50 percent of this amount (plus earnings), plus 100 percent of the match or nonelective contribution (plus earnings).

Chart 3.

	Rev. Proc. 2008-50	Rev. Proc. 2013-12
Corrective Distribution	A corrective distribution for an individual should be increased to take into account the delayed payment, consistent with the plan's actuarial adjustments.	A corrective distribution for an individual should be increased to take into account the delayed payment in accordance with the plan's provisions for actuarial equivalence (after considering the applicable requirements of Code Sec. 417(e)(3) and 415(b)) or any other applicable provision) that were in effect on the date that the distribution should have been made. A corrective distribution is not subject to the requirements of Code Sec. 417(e)(3) if it is made to make up for missed payments with respect to a benefit that is not subject to the requirements of Code Sec. 417(e)(3). This eliminates much of the flexibility that has historically been interpreted to apply to corrective distribution, and will likely result in increased adjustments for earnings.
Code Sec. 436 violation	Silent	A payment of benefits that violates the requirements of Code Sec. 436(b), (c), or (e) can be corrected by (1) a corrective contribution to the plan equal to the 436 exemption amount, plus interest up to the date of the contribution; or (2) following the EPCRS DB plan overpayment correction approach (which is also available for a Code Sec. 436(d) failure).
Impact of Code Sec. 436 for corrective distributions or a corrective amendment	Corrective distributions or amendments must not violate another Code provision.	The correction is not subject to Code Sec. 436 restrictions. However, if the plan is subject to Code Sec. 436 at the time of a correction distribution, a contribution must be made to the plan (1) equal to the corrective distribution for corrective lump sum (other prohibited payment) in violation of Code Sec. 436(d) (only half of the distribution if violates Code Sec. 436(d)(3)). For example, if to correct a failure to obtain spousal consent, the spouse elects a lump-sum payment, the plan sponsor must make a contribution to the plan. For a corrective amendment that is made when the plan is subject to Code Sec. 436(c), a contribution to the plan equal to the increase in the funding target of the plan attributable to the amendment is required. This special contribution is treated as separate from a minimum required contribution and is disregarded for determining prefunding balances.
Required minimum distributions	Distribute the required minimum distributions, plus an interest payment representing the loss of use of such amounts.	Distribute the required minimum distributions, plus an interest payment based on the plan's actuarial equivalence factors in effect on the date that the distribution should have been made. If this correction is made at the time the plan is subject to a restriction on single-sum payments pursuant to Code Sec. 436(d), the plan sponsor must also make a contribution to the plan (*see* above).

D. Defined Benefit Plans

For defined benefit plans, EPCRS brings the complications shown in Chart 3.

III. Application Process

The VCP process has been streamlined again. Now the IRS has merged the Appendix D submission and the Appendix F streamlined submissions for certain errors into a single new Appendix C, and the application is required to include new Form 8950 and Form 8951 (compliance fee).

However, the interplay with the determination letter process is still important, as a determination letter may be required (or permitted) with the submission. In this regard, the IRS attempted to clarify these rather complex rules, and explained that certain failures to timely adopt an amendment that was required as part of the determination letter can be submitted for a VCP filing without a determination letter request. Moreover, the guidance provides that any corrective amendment adopted through self-correction should be expressly identified as such when submitted as part of the next determination letter submission. And notably, a corrective amendment through VCP or Audit CAP alone will generally not result in the loss of reliance on the plan's opinion or advisory letter or pre-approved plan status, which is good news for plan sponsors.

Other minor changes include the following: (1) for anonymous submissions, requiring a plan rep-

Chart 4.

	Rev. Proc. 2008-50	Rev. Proc. 2013-12
General Fee	$750–$25,000 (depending on number of participants)	No change
Failure to adopt a written 403(b) plan document timely—file by December 31, 2013	N/A	50 percent off regular
Loan Failure (e.g., only failure, *etc.*)	50 percent off regular	50 percent off regular
RMD Failure (less than 50 participants, *etc.*)	$500	$500
Nonamenders	50 percent off regular VCP fee if filed within one year following the applicable remedial amendment period Late interim/optional law changes—$375	No change Adds good faith amendments—still $375
Failure to timely adopt required determination letter amendment (*e.g.,* after the 91 days)	Silent	$500, if adopted within three months following the deadline
Multiple failures	Silent	Sum of the reduced fees (if less than the regular VCP fee)
Group Submission	Initial fee $10,000 for 20 plans, $250 for each plan thereafter (maximum $50,000)	Same, but clarified that the compliance fee is based on the number of pre-approved base documents (and not adoption agreements) that are part of the submission.
SEP or SIMPLE IRA	$250 (minimum)	$250 (minimum)
Egregious or intentional failures	Up to 40 percent of the maximum payment amount	Up to 40 percent of the maximum payment amount
Terminating Orphan Plans	May be waived (at the discretion of the IRS)	May be waived (at the discretion of the IRS)

resentative to represent under penalties of perjury that they comply with the power of attorney provisions and will provide an executed Form 2848 when the plan sponsor is subsequently disclosed; (2) for group submissions for pre-approved plans, clarifying the application of the minimum plan limit and applicable fees (which applies per base plan document and not adoption agreements); (3) for all group submissions, clarifying that a certification for Form 5500 filing is only needed for the most recent plan year that the Form was required to have been filed; (4) for multiemployer and multiple employer plans, clarified that the compliance fee can be calculated separately for each employer (where not all employers are impacted) based on the participants attributable to that employer; (5) new mailing address for VCP submissions (first class mail and express mail); and (6) detailed instructions on the ordering of the submission.

IV. Fee Structure

Importantly, there were largely no increases in the VCP filing fees, and there are now special rules for determining the number of participants if no Form 5500 is filed. The VCP filing fees are set forth in Chart 4.

However, the fees imposed through Audit CAP, in the event that the determination letter process raises a late/missing IRS amendment, increased slightly, ranging from $2,500–$88,000, depending on the plan size and the amendment. However, there is a 60-percent discount off these fees for amendments that are adopted within the plan's remedial amendment period. Moreover, if the sole failure is to timely adopt an amendment upon which a favorable determination letter was issued, the Audit CAP fee is $1,000, provided that it is adopted within three months of the deadline.

ENDNOTES

[1] Rev. Proc. 2013-12, IRB 2013-4 (Dec. 31, 2012).

[2] Rev. Proc. 2008-50, IRB 2008-35, 464 (Aug. 14, 2008).