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Employee Benefits Corner

IRS Expands Its Correction Program (EPCRS) for Qualified Plans

By Elizabeth Thomas Dold and David N. Levine

A plan sponsor of a qualified plan must operate its plan in accordance with the Internal Revenue Code and the Plan terms. Failure to do so raises concerns regarding the loss of the tax favored status of the Plan. The Internal Revenue Service (IRS) has a voluntary correction program—the Employee Plans Compliance Resolution System (EPCRS)—that provides procedures to correct these plan qualification failures. And recently the IRS expanded EPCRS, in Rev. Proc. 2019-19, in large measure to facilitate additional self-correction (*i.e.*, correction without IRS approval) for certain types of failures, including for the first time in the history of the program, certain plan loan violations which are common errors that plan sponsors routinely face.

Set forth below, in F&Q format, is a summary of the changes to the program, which are effective as of April 19, 2019, which are welcomed relief for plan sponsors (particularly for small plan sponsors as the VCP filing fees start at \$1500, which is avoided through self-correction).

1. What Changes Were Made for the Correction of Plan Loans?

Previously, EPCRS only permitted self-correction of a loan violation through Form 1099-R reporting of the outstanding loan balance as a taxable distribution to the participant. Otherwise, the IRS required a “voluntary correction program” (VCP) submission be filed with the IRS. Now, the following loan violations are eligible for self-correction, provided that the error was “insignificant,” or was corrected by the end of the second year following the year of the error.

A. Missed Payments—Defaulted Loans

If a participant fails to repay a plan loan in accordance with plan terms (*e.g.*, late, incorrect, or missed payments), and the maximum loan term has not been reached, the plan sponsor (or third party administrator) can generally correct the loan, without triggering taxation to the participant, by (1) a single-sum repayment of the missed payments (and accrued interest), (2) reamortization of the outstanding loan balance, including accrued interest, over the remaining period of the loan so that the unpaid principal and accrued interest is repaid by the end

of original term of the loan or by the end of the maximum loan period under Code Sec. 72(p)(2)(B), measured from the original date of the loan, or (3) a combination of the two. The IRS website notes that the employer should make a corrective contribution to the participant's account if the plan's rate of return exceeded the plan loan interest rate (which presumably is interpreting the EPCRS text that provides that the employer should pay a portion of the correction payment on behalf of the participant equal to the interest that accumulates as a result of such failure, generally determined at a rate equal to the greater of the plan loan interest rate or the rate of return under the plan).

And recently the IRS expanded EPCRS, in Rev. Proc. 2019-19, in large measure to facilitate additional self-correction (i.e., correction without IRS approval) for certain types of failures, including for the first time in the history of the program, certain plan loan violations which are common errors that plan sponsors routinely face.

B. Report as Taxable in the Year of Correction (Not Year of Default)

A defaulted participant loan that should have been reported in a prior year can now be corrected by reporting the outstanding loan balance as a taxable "deemed" distribution on Form 1099-R in the year of correction. No longer does a plan sponsor need to file a VCP to support this reporting position. Note that if income tax withholding applies (*see* Reg. §1.72(p)-1 (Q&A 15)), it must be paid by the plan sponsor.

C. Failure to Obtain Spousal Consent

If the plan terms require that a participant and spouse consent to the loan (which is only required in a defined benefit or money purchase pension plan), the plan sponsor can obtain the spousal consent now after the fact (and only if not received would a VCP filing be needed). Note that it is the spouse who was married to the participant at the time of the loan that must consent to the loan (even if they are no longer married).

D. Number of Loans Exceed the Plan Limit

A retroactive plan amendment is permitted to increase the number of loans available under the plan to correct an operational failure of where participant loans exceeded the limit. The amendment must comply with the Code and the number of loans must have been available to all participants, or only to one or more participants who were nonhighly compensated employees.

Note that not all loan failures may be self-corrected, in particular if the loan violates the dollar limit, maximum loan period, or level amortization requirements under Code Sec. 72(p)(2)(A), (B) or (C), VCP is still the proper correction vehicle.

2. What Changes Were Made for the Correction of Late Amendments?

For the first time, a plan document failure—a failure to adopt a required or interim amendment to reflect law changes—other than the initial failure to adopt a qualified plan or the failure to timely adopt a written 403(b) plan document, can be corrected by a retroactive plan amendment through self-correction.

The only requirements are that (1) the plan has a favorable IRS determination, advisory, or opinion letter, and (2) the correction is made within the required time period for correcting significant failures through self-correction, which is by the end of the second plan year following the amendment deadline.

Importantly, this correction does not extend to discretionary plan amendments (*e.g.*, optional design changes). Moreover, corrective amendments to resolve demographic failures that were not timely adopted are not eligible for this self-correction and must be resolved under VCP or Audit CAP.

3. What Changes Were Made for Correction of Operational Failure to Be Corrected by a Retroactive Plan Amendment?

Self-correction is now available to correct operational failures through a retroactive plan amendment to conform plan terms to plan operations. This retroactive plan amendment option is available if: (1) the amendment would result in an increase of a benefit, right, or feature; (2) such increase is available to all eligible employees; and (3) providing the increase is permitted under the Code and otherwise satisfies the general correction principles

of EPCRS. Notably, this is not available if the failure did not provide for a uniform increase in benefits, rights or features to all employees eligible to participate in the plan.

For example, if the plan document says that participants get a 2% match but the employer gave a 3% match to all participants in the plan, the plan sponsor would be able to adopt a retroactive amendment to provide for the 3% match, provided that the error was insignificant (based on the facts and circumstances) or the amendment was adopted by the end of the second plan year following the year of the failure.

Of course, this provision is not available if the amendment would discriminate in favor of highly compensated employees.

4. What Changes Were Made to Facilitate Electronic VCP Filings?

EPCRS was modified last year to require VCP filings (Forms 8950 and 8951) to be made electronically

through Pay.gov. However, the new process has had some challenges, particularly for authorized plan representatives (Form 2848) who were making the filings on behalf of the plan sponsor. The program has been updated to facilitate Form 2848 filers and better accommodate these filings.

5. What Changes Are Anticipated Next?

EPCRS includes a cross-reference to the “Correcting Plan Errors” webpage on the IRS website for pending additional examples of insignificant violations, which are failures that can be self-corrected regardless of the period of the failure (www.irs.gov/retirement-plans/correcting-plan-errors).

Moreover, the IRS indicated that correction methods for plan overpayments are next on their list of additional guidance in the next version of the program.

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