

Employee Benefits Corner

A Look at Two Areas of Historic Interest for Qualified Plans—Self-Correction and E-Delivery

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Over the years, the plan sponsors and recordkeepers have wanted the IRS to expand the availability of self-correction of Plan errors, and expand the rules and availability of electronic delivery and electronic signatures. (A similar expansion of the Department of Labor rules for electronic delivery/e-signature has also been requested.) With the changes to the determination letter program, the increased fees for small plans for filing under Voluntary Correction Program (VCP), and the legislative proposals on updating the IT functions at the IRS, now may be the perfect time for these changes.

Below we review the current IRS rules in this area, which can be expanded to facilitate additional plan compliance.

Employee Plans Compliance Resolution System

The current rendition of Employee Plans Compliance Resolution System (“EPCRS”) is set forth in Rev. Proc. 2016-51, which expressly provides that it is expected that the IRS and the Department of the Treasury will continue to update the EPCRS revenue procedure, in whole or in part, from time to time, including further improvements to EPCRS based on comments received. This guidance sets forth the rules for self-correction, which the key provisions are briefly summarized below:

- **Insignificant Operational Failures.** Based on a facts and circumstances test, an operational failure that is determined to be insignificant can be self-corrected (*i.e.*, no IRS approval required) at any time. An “operational failure” is a failure to follow the terms of the Plan, which includes Code Secs. 401(k) and 401(m) requirements. It does not include other qualification failures, such as plan document (*e.g.*, a provision in the plan document that, on its face, violates the requirements of Code Sec. 401(a)) or demographic (*e.g.*, nondiscrimination and coverage testing under Code Sec. 401(a)(4), 401(a)(26), or 410(b)) failures.
- **Significant Operational Failures.** Based on this same facts and circumstances test, if an operational failure is determined to be significant, then it can only be self-corrected within a two-year period (by the last day of the second plan year following the plan year for which the failure occurred). If not corrected

within this period, a VCP filing would be required (or audit cap if raised in an IRS audit).

- *Special Rules*
- *Loan Failures.* Currently, to avoid participant taxation as a result of a loan failure (e.g., failure to limit the loan amount to the Code Sec. 72(p) limit, failure to provide for level amortization, failure to provide for repayment within five years (other than a home loan), or failure to timely report a loan default) a VCP filing is required. Prior to Rev. Proc. 2018-4, there was a special VCP filing rate for loans, but that special rate was eliminated. The only self-correction currently permitted is to report the loan as a taxable distribution in the year of the default, which is not a favorable outcome for a participant.
- *Correction by Plan Amendments.* Currently, to correct an operational failure *via* plan amendment (other than in very narrow circumstances), a VCP filing with the IRS is required. Similarly, to correct a late interim amendment or a late discretionary amendment, a VCP filing with the IRS is required.

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- *Required Minimum Distributions.* Currently, to self-correct missed minimum required distributions, in addition to receiving the missed MRD payments (adjusted for earnings), a participant must file Forms 5329 to ask for abatement of the 50% excise tax under Code Sec. 4974. This participant filing for abatement can only be avoided if the plan sponsor/recordkeeper files a VCP submission and requests that the excise tax be abated through the VCP filing. Prior to Rev. Proc. 2018-4 there was a special fee for MRD filings, but that was eliminated with the streamlined filing fees.
- *Earnings Adjustment.* EPCRS provides guidance regarding appropriate calculations and assumptions for making earnings adjustments for defined contribution plans, which currently do not extend to simply using the DOL on-line calculator (except in limited situations). Similarly, EPCRS requires a calculation of interest on overpayments without providing safe harbor methods to satisfy these provisions.
- *Overpayments.* EPCRS provides guidelines for self-correction of plan overpayments, but these

guidelines typically require a make-whole payment to the plan in the event that the funds are not restored (as adjusted for the plan's earnings rate), without taking into account prior funding for a defined benefit plan, or the fact that the overpayment for a defined contribution plan may not be allocated to any other participants. And the rules do not otherwise permit the overpayment (even if the result of a timing issue alone) to be treated as an eligible rollover distribution, nor to be corrected by a retroactive plan amendment (as noted above).

Electronic Delivery Rules

Following E-SIGN, the IRS issued its key set of guidance set forth in Reg. §1.401(a)-21, which is limited to IRS notices, election or similar communications provided to, or made by, a participant or beneficiary, and does not by its terms extend to other employer actions. These rules are summarized below.

In order to distribute a required notice electronically under the Treasury Regulations, either an "affirmative consent" method or an "effective ability to access" method must be satisfied, plus the following two requirements—the process should be designed to (1) provide information in a manner that is no less understandable to the recipient than a written paper copy, and (2) alert the recipient of the significance of the documents and provide any instructions needed to access the documents in a manner that is readily understandable.¹ If those are satisfied, the Affirmative Consent and Effective Ability to Access method requirements are as follows:

Affirmative Consent Method

The affirmative consent method of disclosure is satisfied if:

- The recipient has affirmatively consented to receive the notice electronically;
- The recipient consented electronically in a manner that demonstrates that the recipient can access the electronic medium that will be used to provide the notice (or in written form if consent is confirmed electronically in a manner that demonstrates ability to access);
- Prior to consenting, the recipient is provided notice of the right to receive a paper copy upon request, right to withdraw consent, scope of consent (e.g., one-time only or ongoing), procedures to update contact information, and any hardware/software requirements; and
- If there is a change in hardware/software requirements, the recipient may need to be notified of such change and reaffirm consent.²

Effective Ability to Access Method

The “effective availability to access” method is satisfied if:

- The recipient has “effective ability to access” the electronic medium being used to provide the notice; and
- At the time the notice is provided, the recipient is advised that he or she may request and receive the notice in writing at no charge (and, upon request, the notice is provided to the recipient at no charge).³

Obtaining Consents Electronically

There are additional rules for participant elections *via* electronic delivery set forth in Reg. §1.401(a)-21. The rules for participant elections require:

1. *Effective ability to access.* The electronic medium under an electronic system used to make a participant election must be a medium that the person who is eligible to make the election is effectively able to access. See the observation above on this.
2. *Authentication.* The electronic system used in making participant elections is reasonably designed to preclude any person other than the appropriate individual from making the election. Whether this condition is satisfied is based on facts and circumstances, including whether the participant election has the potential for a conflict of interest between the individuals involved in the election.
3. *Opportunity to review.* The electronic system used in making participant elections provides the person making the participant election with a reasonable opportunity to review, confirm, modify, or rescind the terms of the election before the election becomes effective.
4. *Confirmation of action.* The person making the participant election receives, within a reasonable time, a confirmation of the effect of the election under the terms of the plan or arrangement through either a written paper document or an electronic medium

under a system that satisfies the requirements for participant notices described above.

5. *Special rules for witnessed consents.* Witnessed consents may be quite difficult to perform electronically. In the case of participant elections, including spousal consents, that are required to be witnessed by a plan representative or a notary public (such as a spousal consent under Code Sec. 417):
 - (i) The signature of the individual making the participant election must be witnessed in the physical presence of a plan representative or a notary public; and
 - (ii) An electronic notarization acknowledging a signature (in accordance with Code Sec. 101(g) of E-SIGN and State law applicable to notary publics) may be given legal effect if the signature of the individual is witnessed in the physical presence of the notary public.

Over the years, as smartphones and the Internet became a part of our daily lives, plan sponsors and recordkeepers have been interested in revisiting these rules to facilitate increased electronic delivery, in an effort to protect the environment and save valuable costs. A coordinated effort with the DOL, PBGC, and the IRS would be the goal. And a recent legislative proposal is a step in the right direction, that has strong bipartisan support in the House H.R. 5445, the 21st Century IRS Act, which supports various information technology initiatives within the IRS.

Conclusion

Perhaps once tax reform guidance is issued, the IRS can focus on these important issues for plan sponsors, recordkeepers, and participants. Expanding self-correction and electronic delivery procedures would facilitate compliance, and thereby help plans maintain their tax-qualified status.

ENDNOTES

¹ See Reg. §1.401(a)-21(a)(1)(ii)(B), (a)(5).

² See Reg. §1.401(a)-21(b).

³ See Reg. §1.401(a)-21(c).

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