

# Employee Relations LAW JOURNAL

## Welcome Revisions to the Employee Plans Compliance Resolution System

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The Internal Revenue Service (IRS) released Revenue Procedure 2019-19 (the Revenue Procedure) and a separate IRS Release (the Release) updating the Employee Plans Compliance Resolution System (EPCRS). The Revenue Procedure provides significant changes to the self-correction program under EPCRS (SCP) and expands the circumstances under which plan failures may be corrected under the SCP.

### OVERVIEW

EPCRS provides a comprehensive system of correction programs for retirement plans which have failed to meet the various requirements of the Internal Revenue Code (the Code). Generally, defined benefit pension plans, 401(k) plans, profit-sharing plans, 403(b) plans, simplified employee pension plans, and SIMPLE IRAs can be corrected under EPCRS. If applicable failures are corrected, the retirement plan or IRA will not become disqualified under the provisions of the Code and retirement benefits can continue to be provided to employees on a tax-favored basis. EPCRS is made up of the following components:

- The SCP, which allows a plan sponsor that has established compliance practices and procedures to correct certain operational failures at any time without paying any fee;
- The voluntary correction program (“VCP”), which allows a plan sponsor to correct certain operational failures, at any

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time before an audit, by paying a user fee and getting the IRS' approval that the failure was properly corrected; and

- The audit closing agreement program, which allows a plan sponsor to correct a plan failure discovered during an IRS audit and pay a sanction.

## **MODIFICATIONS TO SCP**

Effective April 19, 2019, the Revenue Procedure made it easier to correct the following plan failures without having to file a VCP submission with the IRS by expanding SCP to:

- Cover certain plan document failures, including failure to timely amend a retirement plan;
- Provide additional opportunities for correcting certain operational failures by plan amendment; and
- Cover certain plan loan failures.

## **PLAN DOCUMENT FAILURES**

Under the Revenue Procedure, SCP now permits a plan sponsor to self-correct plan document failures by retroactively adopting certain required amendments. If a required provision is not included in the plan document or the document fails to comply with the Code's requirements, a retirement plan can be disqualified, unless the plan sponsor timely amends the retirement plan to correct the compliance failure. In general, a retirement plan is required to adopt the required amendments before they become effective or during the remedial amendment period. Previously, failure to timely amend a plan document for changes in the Code's requirements could only be corrected by filing a VCP application and paying a user fee (unless the correction was made during an IRS audit). The new procedure will now permit self-correction by retroactively adopting the required amendment if:

- The plan has a favorable determination letter or, for a pre-approved plan, a favorable opinion or advisory letter for the most recently expired six-year remedial amendment cycle; and
- The corrective amendment is adopted no later than the close of the second plan year following the plan year in which the amendment should have been adopted.

This new addition to SCP will allow plan sponsors the flexibility of amending the plan without filing a time consuming VCP application and paying a burdensome fee.

## **OPERATIONAL FAILURES**

Operational failures occur when a retirement plan is not operated in accordance with its terms. Operational failures are divided into insignificant operational failures and significant operational failures. The Revenue Procedure continues to list specific factors to be considered in determining whether a retirement plan's operational failure is insignificant. It is important to note that no one factor is considered determinative.

Insignificant operational failures can be corrected under SCP at any time, and significant operational failures can be corrected under SCP within two years of the failure.

The Revenue Procedure includes new rules for correcting operational failures by plan amendment under SCP. An operational failure may be corrected by plan amendment if the following conditions are satisfied:

- The plan amendment would result in an increase of a benefit, right, or feature;
- The increase in the benefit, right, or feature is available to eligible employees; and
- Providing the increase in the benefit, right, or feature is permitted under the Code and satisfies the correction principles set forth in the Revenue Procedure which include that the correction method should be reasonable and appropriate for the failure and should be consistently applied.

For example, this new addition to the SCP will allow certain plan sponsors to correct one of the most common plan failures – the failure to follow the plan terms relating to the definition of compensation. Thus, if in operation a plan uses a definition of compensation that is more favorable to the employee than the definition of compensation specified in the plan documents, the plan sponsor may correct the operational failure by adopting a plan amendment which reflects the compensation definition used in the operation of the plan.

This change to the SCP appears to be very broad and practitioners are waiting on more guidance to the limits of this correction procedure.

## **PLAN LOAN FAILURES**

The Revenue Procedure permits the following plan loan failures to be corrected under SCP:

- Errors relating to the failure to repay a plan loan according to the plan's terms (a defaulted loan) without reporting a deemed distribution;
- A failure to obtain spousal consent for a plan loan as required by the plan's terms; and
- A failure where the number of plan loans to a participant exceeds the number of loans permitted by the plan's terms.

Again, the Revenue Procedure provides a welcome relief to plan sponsors. Loan failures are a common plan failure and before the Revenue Procedure, the only way to correct a defaulted loan without tax consequences to the participant was by filing under the VCP and paying a user fee. The new correction procedure allows a plan sponsor to correct the loan default by allowing a single sum repayment, re-amortization of the outstanding loan balance, or a combination of the two, without having to report the failure as a deemed taxable distribution to the participant.

The Department of Labor's Voluntary Fiduciary Correction Program (VCFP) allows certain defaulted loans made to parties in interest under the Employee Retirement Income Security Act of 1974 to be corrected under the IRS' VCP. If a VCP filing is made the Department of Labor will issue a no-action letter stating that it will not take any action under the VCFP with regard to a potential fiduciary breach in conjunction with the defaulted loan. It should be noted, however, that the Department of Labor will not issue for the no-action letter under the VCFP unless a VCP filing is made. Thus, plan sponsors should carefully determine whether the loan default should be corrected under SCP or VCP.

## **MISCELLANEOUS UPDATES**

The Revenue Procedure supersedes and replaces the prior Revenue Procedure concerning VCP. Beginning with April 1, 2019, all VCP submissions must be made electronically. Any paper (hardcopy) VCP submissions postmarked after March 31, 2019, will be returned to the applicant.

## **CONCLUSION**

The Revenue Procedure will allow plan sponsors the flexibility to use SCP without having to pay a fee and will reduce the administrative burdens associated with filing an application under the VCP program.

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