

Employee Plans Compliance Resolution System (EPCRS)

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EPCRS Basics

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What's 'New' in the New EPCRS?

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Purpose of EPCRS

- Alternative to plan disqualification
- Permits plan sponsors to correct failures and continue to provide employees with tax-favored retirement benefits
 - Protects tax benefit for employees
 - Encourages timely correction by employers
- Limited availability for egregious errors, abusive transactions, diversion or misuse of plan assets

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EPCRS Components

- Self-Correction Program (SCP)
- Voluntary Correction Program (VCP)
- Audit Closing Agreement Program (Audit CAP)

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Voluntary Correction with Service Approval (VCP)

- Proposed corrections voluntarily submitted to IRS for review and approval
- Submission fees apply
- Special procedures available for anonymous and group submissions

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Self-Correction Program (SCP)

- Corrections made without payment of any fee or sanction to the IRS
- Available to correct insignificant operational failures
- Certain significant operational failures may also be corrected within 2 years

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Correction on Audit (Audit CAP)

- Failures identified during an IRS audit
- Sanctions linked to the nature, extent, and severity of the failure
- IRS will consider whether correction occurred before the audit

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Top Ten Failures in VCP

- Miss deadlines for amendments to the plan
- Not apply the plan's definition of compensation
- Improperly include or exclude employees
- Not satisfy plan loan provisions
- Allow impermissible in-service withdrawals
- Not satisfy minimum distribution rules
- Employer ineligibility
- Fail ADP/ACP nondiscrimination tests
- Not provide minimum top-heavy benefits to employees
- Not satisfy §415 limits

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Rev. Proc. 2006-27

- Fifth version of EPCRS
- Release Date: May 5, 2006
- Interim Effective Date: May 30, 2006
 - Elect 2006-27 or prior
 - Mandatory:
 - Acknowledgement letter procedure
 - Assembly instructions for submission package
 - Nonamender fee schedule
- Final Effective Date: September 1, 2006

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2006 EPCRS Changes

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Changes to EPCRS

- New Correction Methods
- Revised Correction Methods
- Nonamender Provisions
- Determination Letter Procedures
- Submission Procedures and Fees
- Excise Tax Relief
- Orphan Plans
- Abusive Tax Avoidance Transactions

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New Correction Methods

- Plan loans
 - Exceed statutory maximum amount
 - Exceed permitted repayment time
 - Payment default
 - No loan provisions in plan document
- Failure to obtain spousal consent

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Plan Loan Errors

Loans in excess of dollar limits

- Repay loan amount over the statutory maximum
- May reamortize balance remaining after correction
 - Limited to statutory repayment period
 - Maximum repayment period based on date of original loan
 - Payments must comply with level amortization requirements

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Plan Loan Errors

- Employee generally responsible for making corrective payments for loans under EPCRS
- For defaulted loans, employer may be required to contribute additional interest that accumulated due to the failure
- Corrections for amount, repayment period and default are available only if:
 - Failures are corrected through VCP
 - Corrected within maximum statutory repayment period

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Plan Loan Errors

Repayment schedule exceeds statutory maximum

- Differs from missed repayments
- Reamortize remaining balance
 - Limited to statutory repayment period
 - Maximum repayment period based on date of original loan
 - Payments must comply with level amortization requirements

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Plan Loan Errors

Defaulted loans

- Lump sum repayment, with interest
- Reamortize outstanding balance, including interest, over remaining schedule
- Combination lump sum and reamortization

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Spousal Consent

Additional correction option for distribution without required spousal consent

- Offer spouse choice between survivor annuity or actuarially equivalent lump sum payment
- Previously no lump sum alternative

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Plan Loan Errors

No loan provisions in plan document

- Retroactive plan amendment
 - Amendment and amended plan satisfy §§401(a) and 72(p)
- Available under Self-Correction Program, as well as VCP

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Revised Correction Methods

- Excluded Eligible Employees
- Small Overpayments/Excess Amounts

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Excluded Employees

- Exclusions of eligible employees
 - Pre-tax deferrals
 - After-tax contributions (not Roth)
 - Matching contributions
 - Safe harbor contributions
 - Safe harbor match formula
 - Safe harbor nonelective contribution
 - Exclusion for brief period

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Excluded Employees

Pre-tax contributions

- 50% of 'missed deferral amount'
- Missed deferral amount = ADP for group (HCE/NHCE) applied to individual compensation for period excluded
- Missed deferral amount subject to §402(g) limit

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Excluded Employees

- Replacement of 'lost opportunity'
 - Employer contribution required
 - Lost earnings required
 - New correction formula lessens windfall for participants
 - Not based on full ADP/ACP
 - Recognizes employee received full pay
- Not required to rerun nondiscrimination tests

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Excluded Employees

After-tax employee contributions

- 40% of 'missed after tax contribution'
- Missed after tax contributions = ACP for group (HCE/NHCE) applied to individual compensation for period excluded
- ACP can be calculated separately for after-tax contributions (exclude match)
- Missed after tax contributions subject to plan limits
- Not applicable to plans with Roth contributions

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Excluded Employees

Match

- Corrective contribution based on full missed deferral amount and/or missed after tax contribution
- Plan's matching formula used – not ACP %

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Excluded Employees

Safe harbor plan: Nonelective Contribution

- 50% of 'missed deferral amount'
- Missed deferral amount = 3% of compensation
- Full nonelective contribution

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Excluded Employees

Safe harbor plan: Match Formula

- 50% of missed deferral amount
- 'Missed deferral amount' = greater of 3% or % eligible for 100% match
- Match based on full missed deferral amount

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Excluded Employees

Exclusion for brief period

- If employee is permitted to make deferrals and/or after tax contributions for last nine months of plan year, no corrective deferral or after tax contribution required
- Employee must be able to make maximum contribution for plan year
- Match correction still required

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Small Overpayments/Excess Amounts

- Overpayments ≤ \$100
 - Not required to notify participant
- Excess Amount ≤ \$100
 - Not required to notify participant unless statutory limit exceeded

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Nonamender Provisions

- Nonamender VCP Fee: \$375
- Fee schedule added nonamenders found in determination letter process
- Increased sanction for nonamender failure discovered on EP examination

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Nonamender Provisions

- Streamlined submission procedures if only failure is failure to timely adopt:
 - EGTRRA good faith amendments
 - §401(a)(9) amendments
 - Rev. Proc. 2005-66 interim amendments
- Streamlined submission does not address operational failures – only document failures
- Compliance statement covers timeliness of amendment adoption, not qualification of amendment as drafted

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Nonamender Provisions

- Fee structure for nonamenders discovered during a determination letter application process not related to a VCP submission

| Number of Participants | EGTRRA / subsequent legislation | GUST / 401(a)(9) Regs | UCA / OBRA '93 | TRA '86 | T/D/R | ERISA |
|------------------------|---------------------------------|-----------------------|----------------|----------|----------|----------|
| 20 or less | \$2,500 | \$3,000 | \$3,500 | \$4,000 | \$4,500 | \$5,000 |
| 21-50 | \$5,000 | \$6,000 | \$7,000 | \$8,000 | \$9,000 | \$10,000 |
| 51-100 | \$7,500 | \$9,000 | \$10,500 | \$12,000 | \$13,500 | \$15,000 |
| 101-500 | \$12,500 | \$15,000 | \$17,500 | \$20,000 | \$22,500 | \$25,000 |
| 501-1,000 | \$17,500 | \$21,000 | \$24,500 | \$28,000 | \$31,500 | \$35,000 |
| 1,001-5,000 | \$25,000 | \$30,000 | \$35,000 | \$40,000 | \$45,000 | \$50,000 |
| 5,001-10,000 | \$32,500 | \$39,000 | \$45,500 | \$52,000 | \$58,500 | \$65,000 |
| Over 10,000 | \$40,000 | \$48,000 | \$56,000 | \$64,000 | \$72,000 | \$80,000 |

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Determination Letter Procedures

- Determination letter will be issued under VCP and Audit CAP for:
 - Nonamender filing (other than streamlined)
 - Terminating plan
- Nonamender determination letter will cover only laws with respect to which remedial amendment period expired
- Determination letter may be issued for amendment/ submission within last 12 months of remedial amendment cycle
- VCP Compliance Letter/Audit CAP Closing Letter serves as determination letter if none is issued

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Determination Letter Procedures

- IRS may require determination letter submission for any correction amendment under VCP or Audit CAP

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Determination Letter Procedures

- Remedial amendment under Self-Correction
 - Must be submitted for determination letter by end of applicable remedial amendment cycle
 - SCP must be identified in cover letter for determination submission
 - Not required to submit 'off-cycle' if remedial amendment is on approved list

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Submission Procedures and Fees

- New procedures for acknowledgement of receipt of submission
- New submission assembly procedure
- Submission procedures for anonymous and group submissions clarified

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Submission Procedures and Fees

- Acknowledgement letter
 - Form letter included with submission
 - Facilitates faster notification of receipt of a VCP submission
- Submission Assembly
 - Appendix D – sample formats/statements
 - Order of assembly
 - In addition to Appendix C checklist

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Submission Procedures and Fees

- Group Submissions
 - Employer Eligibility failure may be corrected
 - Multiple plans/multiple submissions & fees, even if identical error
 - Eligible Organization includes Volume Submitter practitioner
 - Affected employers may be identified at any time
 - Can include eligible plan sponsor in Group Submission if notified of exam after submission is filed
- Anonymous Submissions must be uniquely labeled

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Submission Procedures and Fees

- Streamlined submission procedure for nonamenders
 - Sole failure is failing to make timely interim amendments for EGTRRA, §409(a), Rev. Proc. 2005-66 interim amendments
 - Appendix F -- abbreviated narrative and documentation requirements

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Submission Procedures and Fees

- Reduced compliance fee for small plans (≤ 50 participants) with minimum distribution failure only (\$500)
- Reduced compliance fee for failure to timely adopt certain plan amendments (\$375)
- Reduced compliance fee for SEPs and SIMPLE IRAs (\$250)

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Excise Tax Relief

- Under VCP and Audit CAP, IRS will waive §4974 excise tax -- failure to satisfy minimum required distribution
- Expanded list of excise taxes that IRS may waive:
 - §4972 – nondeductible contributions
 - §4979 – ADP/ACP corrective distributions

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Orphan Plans

- ‘Eligible Parties’ may make EPCRS submission:
 - Court-appointed representative with authority to terminate the plan and dispose of plan assets
 - Person or entity accepting responsibility under DOL investigation for terminating the plan and distributing assets
 - Surviving spouse, as sole beneficiary for sole owner of plan sponsor AND sole plan participant if ERISA never applied to plan

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Orphan Plans

- To be an ‘orphan plan,’ the plan sponsor must:
 - No longer exist
 - Be missing, unable to be located
 - Be unable to maintain the plan
 - Have abandoned the plan pursuant to DOL regulations
- An orphan plan that is terminating may be corrected under VCP and Audit CAP

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Orphan Plans

- Special provisions for orphan plans
 - Full correction may not be required for terminating orphan plan, at the IRS’s discretion
 - VCP fee may be waived, if waiver request is included in the submission

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Abusive Tax Avoidance Transactions

- Controlled availability of EPCRS in cases where the plan *or plan sponsor* is a party to an abusive tax avoidance transaction (ATAT)
 - Notice sent to EP Tax Shelter Coordinator
 - If ATAT is suspected, IRS may
 - Conclude EPCRS is unavailable, or
 - Allow correction if error is unrelated to any purported ATAT
- EPCRS compliance statement is not precedent for IRS ATAT investigation

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Top Ten Corrections Standardized/Streamlined?

- ✓ Miss deadlines for amendments to the plan
- ✗ Not apply the plan's definition of compensation
- ✗/✓ Improperly **include** or exclude employees
- ✓ Not satisfy plan loan provisions
- ✗ Allow impermissible in-service withdrawals
- ✓ Not satisfy minimum distribution rules
- ✗ Employer ineligibility
- ✓ Fail ADP/ACP nondiscrimination tests
- ✓ Not provide minimum top-heavy benefits to employees
- ✓ Not satisfy § 415 limits

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Other Changes

- Changing Definitions
 - Favorable Letter
 - Egregious Failure
 - Under Examination
- §403(b) Plan Provisions
- §457(b) Eligible Governmental Plans
- SEP correction: reasonable interest rate

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And EPCRS VI?

- Comments requested regarding:
 - Catch-up Contributions
 - Roth Contributions
 - §415 Violations
 - Orphan Plans (DOL Fiduciary Safe Harbor)

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