EPCRS Self-Correction
Ilene H. Ferenczy, CPC, Esq.
Robert M. Richter, APM, Esq.
Agenda

• Really Quick Self-Correction Overview
• Self-Correction: In General
• Rev. Proc. 2019-19 Changes
• Policies & Procedures
• Case Studies
• Documenting the Correction
• Parting Thoughts
REALLY QUICK
SELF-CORRECTION OVERVIEW

2019 EASTERN
Regional Conference
What Is EPCRS?

• Employee Plans Compliance Resolution System (EPCRS) is the procedure the IRS has established for dealing with (and properly fixing) plan qualification errors:
  – Found by the Plan Sponsor during plan operations
  – Found by the IRS during audits
• Found in NEW Rev. Proc. 2019-19
Four Types of Qualification Errors

• Plan Document Failure
  – Terms of plan not qualified
  – Failure to timely adopt interim amendment/restatement

• Demographic Failure
  – Failure to satisfy §410(b) or §401(a)(26)
Four Types of Qualification Errors (cont.)

• Employer Eligibility Failure
  – Not eligible to establish type of plan (e.g., governmental 401(k) or ineligible for 403(b))

• Operational Failure
  – Not following the terms of the plan (i.e., usually everything else you encounter)
EPCRS Structure

• Three correction procedures:
  – Self correction procedure (“SCP”)
  – Voluntary submissions to IRS (“VCP”)
  – Audit Closing Agreement Program (“CAP”)
Self-Correction:
In General
Self-Correction Procedure

• Do-It-Yourself Program
  – No IRS filings
  – No user fees
• If insignificant failure: correct anytime
• If significant failure: have until end of the 2\textsuperscript{nd} plan year following the year in which the failure occurred
Self-Correction Procedure

• If ADP/ACP testing failure:
  – Law gives you one year after year at issue to correct
  – Self-correction two-year period starts after that year
  – On a practical basis, have until 3\(^{rd}\) year following year of failure to self-correct
Insignificance: Balancing of Factors

- Have other failures occurred?
- % of plan assets and contributions involved
- Number of years affected
- Number of participants affected (as % of total in plan and as % of those who could have been affected)
- Was correction made within a reasonable time after discovery?
- Why did the failure happen?
Insignificance

• No single factor is determinative
• Factors should not be interpreted so as to exclude small businesses
• Anything requiring plan amendment has been deemed by IRS to be significant (so must be corrected within two-year window)
Changes

• In early 2018, IRS changed user fees for VCP:
  – Fees based on level of plan assets, rather than number of participants:
    • Assets of $500,000 or less: $1,500
    • $500,001-$10 million: $3,000
    • Over $10 million: $3,500
  – Eliminated “special fee” deals

- Practitioners (including ASPPA GAC) protested that, if VCP fees were going to be raised, IRS needed to:
  - Broaden the Self-Correction Program to allow more things to be self-corrected
  - Better explain the difference between “significant” and “insignificant” failures

• Broadened Self-Correction to include:
  – Some additional loan problems so that taxation and/or disqualification could be avoided
  • Loans without loan provision (already there)
  • Defaults due to nonpayment
  • Failure to get spousal consent
  • Failure to limit number of loans as plan required

• Plan Document Failures:
  – Always were four errors that could be corrected by amendment:
    • Loans made without loan provision in plan
    • Hardships without hardship provision in plan
    • IRC §401(a)(17) violations, if corrected by increasing contribution rate for everyone
    • Early inclusion of ineligible employees, if predominately NHCEs

• Plan Document Failures:
  – New procedure permits retroactive amendments to match actual plan operations if:
    • A benefit, right, or feature would increase as a result of the amendment;
    • The increase applies to all eligible employees; and
    • Providing the increase is consistent with the EPCRS correction principles

• Plan Document Failures:
  – Amendments to cure plan failures:
    • Failure to timely adopt interim amendment
    • Failure to timely adopt an amendment to an individually designed plan to comply with Required Amendments List
    • *May* include late restatements

• Plan Document Failures:
  – Amendments to cure plan failures:
    • IRS considers these *always* to be significant failures
    • *That means that they must be adopted within two-year self-correction period*
    • If too late, need to file in VCP to fully correct
Policies and Procedures
Practices and Procedures

• It has always been a requirement for self-correction that the plan have practices and procedures in place “reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements.”
Practices and Procedures

• EPCRS states that:
  – The plan document itself is not enough
  – The policies and procedures must have been in place and routinely followed

• Can be formal or informal
  – Failure must have occurred as an oversight or mistake in applying the rules
Policies and Procedures

• If these requirements have always been there, what’s the big thing?
  – The self-corrections permitted under the new procedures are more extensive in nature
  – It is possible (likely?) that the IRS will be more critical in reviewing self-corrections under audit
Policies and Procedures

• This is a huge opportunity for TPAs!
  – Help your clients establish internal policies with regard to the plan (improves compliance and sets up eligibility for self-correction)
  – Give your clients a “who to call” list so that they are primed to come to you when errors occur
Case Studies
Case #1

- ABC Plan made a participant loan to Mary
- The loan was for $60,000
- Mary’s vested accrued benefit was $200,000 at the time
- Can we self-correct?
Case #1

• Answer: Cannot use SCP
• Loan failures still must be corrected under VCP (i.e., cannot be self-corrected) if they relate to:
  – Excessive amounts
  – Excessive loan periods (i.e., > five years or reasonable time for home loan)
  – Failure to fully amortize
Case #2

- ABC Plan made a participant loan to Sam
- The loan was for $50,000 (and Sam’s vested interest was sufficient to support that loan)
- Sam made three payments and then forgot to do more
- Can ABC self-correct to help Sam avoid taxation in year of default?
Case #2

• Answer: Yes

• The correction:
  – Sam must either make a payment equal to the principal and interest to bring him up to date; or
  – The loan may be reamortized over the remaining period of the loan (or up to five-year maximum)
Case #3

• Same facts as Case #2 except that the reason why Sam’s loan went into default is that there was a glitch in ABC’s payroll program, and it ceased to take the payments out of Sam’s paycheck

• Still self-correctable?
Case #3

• Answer: Yes
• In this case, the employer should pay the increased interest due to the fact that payments stopped
• Sam is still responsible for making up the late principal payments, either in a lump sum or by reamortizing the loan
Case #4

- ABC Plan made a loan to Marguerite for $50,000
- Marguerite had sufficient vested interest to cover the loan
- ABC forgot to put the loan into its payroll system, so no loan payment was ever made by Marguerite
- The loan was taken nine years ago
- Nothing was ever done in regard to issuing a Form 1099R to Marguerite
Case #4

- Still correctable under SCP
- But, there is no way to avoid having Marguerite taxed on the loan
- Does she need to go back and amend her tax return from nine years ago (and pay penalties and interest, etc.?)
- No, the plan can self-correct by issuing a Form 1099R for the current year
Case Study #5

- DEF Plan made a loan to Frank for $50,000
- Frank had sufficient vested interest to cover the loan
- Unfortunately, the DEF Plan does not permit loans
Case Study #5

- Plan is subject to disqualification
- Lucky for DEF, EPCRS permits this to be self-corrected through a retroactive amendment
- DEF amends its plan to permit loans, effective as of the date that Frank took the loan
- BUT, what if Frank is an HCE?
Case Study #6

- GHI Plan decided to add Roth deferrals to its 401(k) plan, effective 1/1/2018
- GHI didn’t tell its document provider
- Five participants elected Roth deferrals in 2018
- Problem is discovered in mid-2019
Case Study #6

• Adding Roth deferrals requires a discretionary amendment
• Discretionary amendments must be signed by the end of the plan year in which they are effective
• The amendment is late; the plan is subject to disqualification for failing to follow its terms
Case Study #6

• This is now self-correctable
• GHI adopts an amendment to its plan, effective 1/1/2018 to add Roth deferrals
Case Study #7

• Same facts as Case Study #6, except:
  – GHI did not communicate the ability to make Roth deferrals to any of the employees
  – The only person to elect Roth deferrals – and the only person who really had an opportunity to elect Roth deferrals – was GHI’s 100% owner
Case Study #8

- Congress passes the Garbage Retirement Act of 2020 (GRA20)
- All plans must be amended to conform to the provisions of the GRA20 by 12/31/2022
- JKL Corp. fails to amend its plan by the due date
- The failure is discovered during 2023
Case Study #8

- Congress passes the Garbage Retirement Act of 2020 (GRA20)
- The IRS issues Rev. Proc. 2020-99, which provides a model amendment. The Rev. Proc. requires all plans to amend their distribution provisions to conform to the new requirements of the GRA20 by 12/31/2022
- JKL Corp. fails to amend its plan by the due date
- The failure is discovered during 2023
Case Study #8

- The GRA20 amendment is an interim amendment
- Failure to adopt subjects the plan to disqualification
- JKL may self-correct this error by adopting the model amendment, retroactive to when it was supposed to be effective
- Because this is a plan document failure, the correction must happen within the self-correction period (i.e., by 12/31/2024, assuming the JKL plan is a calendar year plan)
Documenting the Correction
Self-Correction Memoranda

- Although not specifically required by Rev. Proc. 2019-19, it is wise to properly document any found failures and the corrections made to fix them.
- This will clearly demonstrate that these issues were discovered and fixed before the IRS came knocking.
Self-Correction Memoranda

• **Recommended contents:**
  – Description of the failure, including the important dates (i.e., when the failure happened, when it was discovered, and when it was corrected)
  – The type of failure (operational, plan document, employer eligibility, demographic) – note, the latter two are not eligible for self-correction
Self-Correction Memoranda

• Recommended contents:
  – Explanation of how the error occurred
  • Description of policies and procedures in place to avoid
  • Description of how this happened anyway
Self-Correction Memoranda

• Recommended contents:
  – Eligibility for self-correction:
    • If based on timing (i.e., within self-correction period, describe)
    • If based on insignificance, balance the factors
  – Description of correction (with calculations, if necessary), including timing
Self-Correction Memoranda

• Recommended contents:
  – Explanation of new practices, procedures designed to avoid the problem in the future
Parting Thoughts
Questions?