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IRS EXPANDS SELF-CORRECTION PROGRAM FOR FIXING RETIREMENT PLAN ERRORS

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Rev. Proc. 2019-19 significantly expands the Self-Correction Program (SCP) for retirement plans under the IRS Employee Plans Compliance Resolution System (EPCRS). Sponsors can now self-correct certain plan document and loan failures and retroactively amend plans to fix more operational failures. Practitioners had pushed for SCP's expansion, saying more opportunities to self-correct errors would increase compliance while reducing related costs and burdens for plan sponsors. Sponsors can immediately rely on the new SCP.

BACKGROUND ON SELF-CORRECTION PROGRAM

Plan sponsors can use the SCP to correct operational failures — that is, failures to follow a plan's terms — without facing any fee or sanction if certain conditions are satisfied. In all cases, the sponsor must have procedures in place to facilitate overall compliance. Additional conditions apply if correcting a significant operational failure.

Significant Operational Failures

To use SCP for a significant failure, the sponsor must have a "favorable letter" for its plan and substantially complete the correction by the last day of the second plan year after the plan year in which the failure occurred. This correction period is cut short, however, if the plan becomes subject to an IRS audit.

For sponsors of qualified plans, a favorable letter is a determination letter (for individually designed plans) or an advisory or opinion letter (for preapproved plans). A 403(b) plan is treated as having a favorable letter if the sponsor timely adopted a plan document to comply with the 403(b) plan rules or used EPCRS to correct the untimely adoption of a plan document. (The deadline to adopt written 403(b) plan documents is the later of Dec. 31, 2009, or the end of the plan year when the plan took effect.)

Insignificant Operational Failures

If an operational failure is insignificant, the sponsor doesn't need a favorable letter and can correct under SCP at any time, even if the plan is under audit.

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Failures Ineligible for SCP

If a failure is ineligible for SCP, the sponsor's only other proactive correction option is the Voluntary Correction Program (VCP), which requires IRS approval and payment of a fee. Errors discovered on audit can be corrected through the Audit Closing Agreement Program (Audit CAP), which includes a sanction that depends on the severity of the failure.

PLAN DOCUMENT FAILURES

One notable expansion of SCP is the ability to self-correct plan document failures (other than the initial failure to timely adopt a plan document). A plan document failure is a plan provision (or the absence of a provision) that causes a plan to violate the rules for qualified or 403(b) plans. Until now, sponsors had to use VCP to fix these failures.

Plan document failures are considered significant failures. So sponsors using SCP to fix plan documents must have a favorable letter from IRS and complete the correction by the end of the second plan year after the failure occurred. As noted earlier, this correction period is cut short if IRS audits the plan.

Interaction With Remedial Amendment Period

A plan document failure occurs if a plan isn't amended to correct a disqualifying provision by the end of the remedial amendment period for the provision. For example, a sponsor of an individually designed plan must adopt required amendments by the end of the second calendar year after they appear on IRS's Required Amendments List. If that deadline is missed, the sponsor can now use SCP to fix the error until the end of the second plan year after the end of the remedial amendment period. But sponsors should act quickly to fix any discovered errors since the opportunity to self-correct ends if the plan becomes subject to an IRS audit.

CORRECTING OPERATIONAL FAILURES BY PLAN AMENDMENT

Prior versions of SCP allowed sponsors to retroactively amend their plans to fix certain operational failures identified in Section 2.07 of Appendix B of the EPCRS revenue procedure. The new program adds another type of failure that may be corrected in this way. Under certain conditions, sponsors can also use SCP to correct other operational failures with retroactive amendments.

SCP now provides that the following errors may be corrected through retroactive plan amendment:

- Allocations under a defined contribution plan that were based on compensation exceeding the IRC Section 401(a)(17) compensation limit
- Early inclusion of employees who hadn't yet satisfied all of the plan's eligibility requirements
- Loans and hardship distributions under plans that don't provide for the distributions
- Loans exceeding the number permitted under plan terms (newly available for self-correction in the 2019 EPCRS)

Conditions for Self-Correcting Loans and Hardship Distributions

The corrections for both loan failures are subject to the following conditions (the first two conditions applied under earlier versions of EPCRS; the third condition is new):

- The amendment satisfies the qualification requirements in IRC Section 401(a).
- The plan would have satisfied those qualification requirements and the plan loan requirements under Section 72(p) if the amendment had been adopted and effective when plan loans were first made available.
- The loans must have been available to either all participants or only participants who weren't highly compensated employees.

The correction for hardship distributions is subject to similar conditions, excluding the third one.

Conditions for Self-Correcting Other Operational Failures

Under the new SCP, sponsors may now retroactively amend their plans to correct operational failures in addition to those listed in Section 2.07 of Appendix B if three conditions are satisfied:

- The plan amendment would increase a benefit, right or feature.
- The increased benefit, right, or feature is available to all eligible employees.
- Increasing the benefit, right or feature is permitted under the Code and satisfies EPCRS's general correction principles.

If these conditions aren't satisfied, the error may be eligible for correction under VCP or Audit CAP.

PLAN LOAN FAILURES

Plan sponsors may now use SCP to correct certain plan loan failures if the loan terms comply with the Code's requirements for plan loans, but the participant defaults or the loan is administered incorrectly. However, sponsors still cannot use SCP to correct plan loan terms that violate the Code's maximum permissible loan amount, maximum repayment period and requirement to repay loans over a level amortization period. To correct these statutory violations, sponsors must use VCP or Audit CAP.

Loan Defaults

Until now, sponsors could only correct loan defaults through VCP or Audit CAP. Both are still options under the new EPCRS, but sponsors can also use SCP. Under all three programs, the default can be corrected by a single-sum repayment (including interest on missed repayments), reamortization of the outstanding loan balance or a combination of the two.

Coordination with VFCP. Although EPCRS now permits correction of loan defaults under SCP and VCP, sponsors that want the protection of a no-action letter under the Department of Labor's (DOL's) Voluntary Fiduciary Correction Program (VFCP) will still need to use VCP to correct the error. DOL has advised IRS

that it will not issue a no-action letter for a loan default unless the VFCP application includes proof of payment of the loan and an IRS VCP compliance statement approving the correction.

A no-action letter means that DOL will not initiate legal action against the sponsor for the default or impose penalties on the amounts repaid to the plan. A sponsor might want this protection if the default is caused by the administrator's failure to withhold repayments from an employee's paycheck — for example, when a change in administrators occurs after a merger or acquisition.

Failure To Obtain Spousal Consent

Sponsors can now use SCP to correct failures to obtain spousal consent for a plan loan when the plan requires such consent. (For example, if distribution of a participant's benefit requires spousal consent under the QJSA rules, spousal consent is also required for a plan loan.) The sponsor must notify the participant and the spouse and give the spouse an opportunity to consent. If the spouse doesn't consent, the sponsor must correct the error using either VCP or Audit CAP.

More Loans Than Plan Allows

As discussed above, SCP now lets sponsors retroactively amend their plans (if certain conditions are met) to correct failures from granting more plan loans than permitted under the plan terms.

Reporting Deemed Distributions

Prior versions of EPCRS generally required sponsors to report deemed distributions resulting from loan failures on Form 1099-R. However, depending on the type of loan failure, sponsors could request the following relief:

- No reporting of deemed distributions caused by loan defaults and violations of the Code's maximum permissible loan amount, maximum repayment period and requirement to repay loans over a level amortization period

- Reporting of deemed distributions caused by other loan failures in the year of the correction (instead of the year of the failure)

Under the new EPCRS, sponsors no longer have to request this relief.

FURTHER PROGRAM CHANGES BY IRS, CONGRESS POSSIBLE

The Treasury Department and IRS are considering additional EPRCS updates on how sponsors recoup overpayments, including the correction of overpayments under SCP. Other changes could come through legislative action by Congress. A bill modeled on last year's Retirement Security and Savings Act (S 3781) — introduced in December by Sens. Rob Portman (R-OH) and Benjamin Cardin (D-MD) — is expected to get reintroduced this year. Provisions in that bill would expand SCP by:

- Allowing sponsors to self-correct "any inadvertent failure" to comply with the rules for qualified and 403(b) plans, unless IRS or Treasury identifies the error before the sponsor implements self-correction

- Requiring DOL to treat any plan loan failure corrected under SCP as satisfying VFCP requirements
- Allowing sponsors to self-correct missed required minimum distributions within 180 days of the date the distribution was due

Current House Ways and Means Committee Chairman Richard Neal, D-MA, proposed similar changes (HR 4524) in the last Congress and is likely to revive those proposals, so improvements to SCP and EPCRS could advance this year.

RELATED RESOURCES

Non-Mercer Resources

- Rev. Proc. 2019-19 (IRS, April 19, 2019)
- S 3781, Retirement Security and Savings Act (Congress, Dec. 19, 2018)
- HR 4524, Retirement Plan Simplification and Enhancement Act (Congress, Dec. 1, 2017)

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- IRS Updates VCP Kit for Late Adopters of Preapproved DC Plans (Feb. 1, 2019)
- IRS Issues 2019 Procedures for Retirement Plan Determination Letters, Rulings, Other Guidance (Jan. 21, 2019)

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